

Almond crunch: California drought withers world supply

How California's drought is shrinking one of the nation's most valuable crops

By [Jim Jelter](#), MarketWatch

SAN FRANCISCO (MarketWatch) — While most of the nation was digging out this winter, California's great calamity has been relentless sunshine. For farmers in the Central Valley, hundreds of thousands of acres will go unplanted this year. For almond growers, this unprecedented drought threatens to slam the brakes on one of the state's fastest-growing crops and biggest moneymakers.

It will be felt by consumers around the world. Maybe not this year, but certainly in 2015, when the water-starved 2014-15 crop goes to market.

Here's what's at stake: Almonds, according to the California Department of Food and Agriculture, are the state's second most valuable crop, with sales hitting \$4.35 billion in 2012. Only grapes sold more: \$4.45 billion.

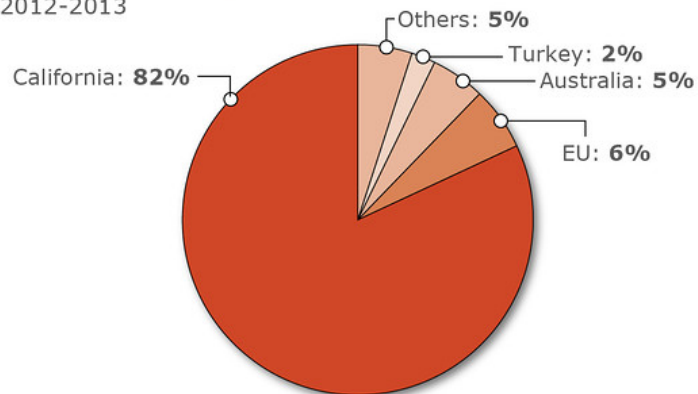
California supplies practically all of the U.S.'s and well over half of the rest of the world's almonds. Last year was an especially good year. The Almond Board of California said 82% of the global crop came from its 3,500 growers. Shipments overseas topped 1 billion pounds for a fourth straight year. The top five export markets? China, Spain, India, Germany and the United Arab Emirates.

California's almond production has more than doubled from 912 million pounds in 2006 to 1.88 billion last year. And demand continues to surge.

What's driving it? Shelled nuts and almond paste are certainly in the mix. The USDA reports that the average American ate 1.3 pounds of almonds in 2008. By 2012 that had jumped 36% to 1.8 pounds. Walnuts run a distant second at about half a pound per capita per annum.

World almond production

2012-2013



Source: Almond Board of California

At the same time, demand is booming from overseas, especially in China, India, South Korea and Russia, which have been targeted by Almond Board marketers as key emerging markets.

There's also a relatively new product lighting up the almond market: plant milk.

Plant milk refers primarily to soy and almond milk, which were initially found only at health-food stores catering to the lactose intolerant. It's since gone mainstream, however, with baristas nationwide now well-versed in making almond-milk lattes.

So how is this year's crop shaping up? It's a good news–troublesome news story. The spring bloom has been good, so that's not a problem. The drought is.

Most almond orchards are also in counties suffering what meteorologists call “extreme” drought conditions. December and January, the peak of California's rain season, were the driest on record. Subsequent storms have helped, but, looking ahead to the dry summer months, Gov. Jerry Brown has already declared a drought emergency. The California State Water Project, which supplies drinking water to two-thirds of Californians, has taken the unprecedented decision to allocate no water for agriculture this year. Zero. That means growers will be forced to rely on ground water on their property or water they can buy from other irrigation districts.

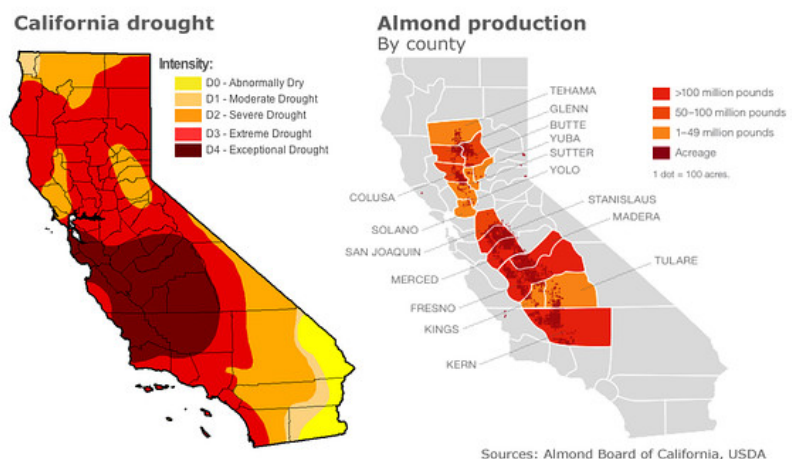
It won't amount to much, however, and it will be pricey.

“We're in uncharted territory as far as [water] allocations are concerned,” Richard Waycott, CEO of the Almond Board of California, told MarketWatch. “But one thing is clear: There will be an impact. That includes letting trees go.

Growers are talking about sacrificing trees, many of them with another five to seven years [of commercial production] in them. All the years I've been at the board, I've never heard this before.”

Asked about market impact, Waycott said: “There's been phenomenal growth in demand for a number of years. Prices are at or near all-time highs, and that's prior to the drought. Supply and demand [are] going to rule the day. We're hoping prices remain stable, but it's a free market.”

To cope with bad harvests, Waycott said some of California's 106 almond-crop “handlers” (the companies that buy, sort, package and ship the nuts) have reserves they can draw on. But there's no institutional or coordinated strategic reserve for the industry.



And unlike for corn, wheat, coffee or sugar, there's no almond futures market where buyers and sellers can hedge against shortages.

The almond play

So how does an investor play the almond market? One option is to buy stock in almond companies.

There's no such thing as a pure play, however. The closest to that is Diamond Foods Inc. [DMND](#) +9.28% , a major name in both the almond and walnut businesses.

San Francisco-based Diamond Foods has been in the nut business for over 100 years and claims a 23.8% market share. But it's struggled to secure adequate walnut supplies and has set aside several million dollars to cover a recent SEC investigation.

After the closing bell, it reported [a fiscal second-quarter loss](#) of \$15 million, narrowing the previous quarter's loss largely on the strength of its Kettle potato chips and Pop-Secret popcorn snacks segment. Adjusted to exclude one-time items, the company earned 9 cents a share, beating Wall Street estimates by a penny.

Diamond Foods predicted it will wrap up 2014 with a higher year-over-year adjusted profit, despite what it calls "continued headwinds" from rising commodity costs in its almond and walnuts business.

Diamond Foods' share price rose 1.9% after hours, adding to an 18% advance so far this year, which suggests investors believe it's putting its recent struggles behind it and is strong enough to weather the drought.

Meanwhile, there's White Wave Foods Co. [WWAV](#) -0.17% , perhaps best known for its Horizon organic cow's milk and the Silk soy- and almond-milk brands.

Denver-based White Wave claims soy milk now represents less than 35% of plant-milk industry sales while almond milk has surged to more than 55%. The trend is also seen in grocery stores, which show almond milk among their fastest-growing items of the past two years.

What skimpier almond supplies mean for White Wave and how much of the higher cost it can pass down to consumers remains to be seen. But Wall Street so far isn't worried. White Wave's share price is up 28% since Jan. 1, built on continued financial strength after several smart acquisitions. Its performance earned it an upgrade Monday from J.P. Morgan Chase & Co., which raised its price target on the company's stock to \$33 a share from \$29.