CALAVO GROWERS INC
Form 10-Q
September 10, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended July 31, 2007

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number: 000-33385

CALAVO GROWERS, INC.
(Exact name of registrant as specified in its charter)

California	**33-0945304**
(State of incorporation)	(I.R.S. Employer Identification No.)

1141-A Cummings Road
Santa Paula, California 93060
(Address of principal executive offices) (Zip code)
(805) 525-1245
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).Yes o No þ

Registrant s number of shares of common stock outstanding as of July 31, 2007 was 14,299,833

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CAUTIONARY STATEMENT

This Quarterly Report on Form 10-Q contains statements relating to our future results (including certain projections and business trends) that are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbor created by those sections. Forward-looking statements frequently are identifiable by the use of words such as believe, anticipate, expect, intend, will, and other similar expressions. Our actual results may d materially from those projected as a result of certain risks and uncertainties. These risks and uncertainties include, but are not limited to: increased competition, conducting substantial amounts of business internationally, pricing pressures on agricultural products, adverse weather and growing conditions confronting avocado growers, new governmental regulations, as well as other risks and uncertainties, including but not limited to those set forth in Part I., Item 1A, *Risk Factors*, in our Annual Report on Form 10-K for the fiscal year ended October 31, 2006, and those detailed from time to time in our other filings with the Securities and Exchange Commission. These forward-looking statements are made only as of the date hereof, and we undertake no obligation to update or revise the forward-looking statements, whether as a result of new information, future events, or otherwise.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

CALAVO GROWERS, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS (UNAUDITED)
(All amounts in thousands, except per share amounts)

	July 31, 2007	October 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 1,243	$ 50
Accounts receivable, net of allowances of $2,306 (2007) and $1,833 (2006)	33,300	24,202
Inventories, net	13,314	10,569
Prepaid expenses and other current assets	6,923	4,934
Advances to suppliers	1,775	1,406
Income tax receivable	582	2,268
Deferred income taxes	2,348	2,348
Total current assets	59,485	45,777
Property, plant, and equipment, net	20,997	19,908
Investment in Limoneira	53,586	33,879
Investment in Maui Fresh, LLC	338	229
Goodwill	3,591	3,591
Other long-term assets	6,659	4,110
	$ 144,656	$ 107,494
Liabilities and shareholders equity		
Current liabilities:		
Payable to growers	$ 12,718	$ 6,334
Trade accounts payable	3,083	4,046
Accrued expenses	12,420	13,689
Short-term borrowings	10,330	3,804
Dividend payable		4,573
Current portion of long-term obligations	1,308	1,308
Total current liabilities	39,859	33,754
Long-term liabilities:		
Long-term obligations, less current portion	13,106	10,406
Deferred income taxes	11,857	4,391
Total long-term liabilities	24,963	14,797
Commitments and contingencies		
Shareholders equity:		
Common stock, $0.001 par value; 100,000 shares authorized; 14,299 (2007) and 14,293 (2006) issued and outstanding	14	14
Additional paid-in capital	37,190	37,109
Notes receivable from shareholders		(2,430)

Accumulated other comprehensive income	18,533	6,293
Retained earnings	24,097	17,957
Total shareholders equity	79,834	58,943
	$ 144,656	$ 107,494

The accompanying notes are an integral part of these consolidated condensed financial statements.

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CALAVO GROWERS, INC.
CONSOLIDATED CONDENSED STATEMENTS OF INCOME (UNAUDITED)
(All amounts in thousands, except per share amounts)

	Three months ended July 31,		Nine months ended July 31,	
	2007	**2006**	**2007**	**2006**
Net sales	$ 91,307	$ 78,900	$ 217,689	$ 196,880
Cost of sales	82,680	68,827	192,998	174,936
Gross margin	8,627	10,073	24,691	21,944
Selling, general and administrative	4,803	5,141	14,151	14,448
Operating income	3,824	4,932	10,540	7,496
Interest expense	(315)	(284)	(996)	(805)
Other income, net	68	148	456	604
Income before provision for income taxes	3,577	4,796	10,000	7,295
Provision for income taxes	1,355	1,870	3,860	2,845
Net income	$ 2,222	$ 2,926	$ 6,140	$ 4,450
Net income per share:				
Basic	$ 0.16	$ 0.20	$ 0.43	$ 0.31
Diluted	$ 0.15	$ 0.20	$ 0.43	$ 0.31
Number of shares used in per share computation:				
Basic	14,300	14,292	14,295	14,308
Diluted	14,452	14,351	14,399	14,365

The accompanying notes are an integral part of these consolidated condensed financial statements.

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CALAVO GROWERS, INC.
CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)
(All amounts in thousands)

	Three months ended July 31,		Nine months ended July 31,	
	2007	**2006**	**2007**	**2006**
Net income	$ 2,222	$ 2,926	$ 6,140	$ 4,450
Other comprehensive income (loss), before tax:				
Unrealized holding gains (losses) arising during period	(3,457)	(5,531)	19,706	(9,680)
Income tax (expense) benefit related to items of other comprehensive income (loss)	1,331	2,194	(7,466)	3,839
Other comprehensive income (loss), net of tax	(2,126)	(3,337)	12,240	(5,841)
Comprehensive income (loss)	$ 96	$ (411)	$ 18,380	$ (1,391)

The accompanying notes are an integral part of these consolidated condensed financial statements.

CALAVO GROWERS, INC.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine months ended July 31, 2007	2006
Cash Flows from Operating Activities:		
Net income	$ 6,140	$ 4,450
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,812	1,786
Income from Maui Fresh LLC	(109)	
Stock based compensation	14	549
Provision for losses on accounts receivable	332	44
Effect on cash of changes in operating assets and liabilities:		
Accounts receivable	(9,430)	(11,540)
Inventories, net	(2,745)	(647)
Prepaid expenses and other current assets	(1,249)	766
Advances to suppliers	(369)	980
Income taxes receivable	1,689	953
Other long-term assets	89	(1,342)
Payable to growers	6,384	10,787
Trade accounts payable and accrued expenses	(2,236)	349
Income taxes payable		823
Net cash provided by operating activities	322	7,958
Cash Flows from Investing Activities:		
Loan to Agricola Belher	(3,700)	
Acquisitions of and deposits on property, plant, and equipment	(2,576)	(2,693)
Net cash used in investing activities	(6,276)	(2,693)
Cash Flows from Financing Activities:		
Payment of dividend to shareholders	(4,573)	(4,564)
Proceeds from borrowings, net	9,226	329
Exercise of stock options	64	250
Retirement of common stock		(1,200)
Collection on notes receivable from shareholders	2,430	206
Payments on long-term obligations		(1,312)
Net cash provided by (used in) financing activities	7,147	(6,291)
Net increase (decrease) in cash and cash equivalents	1,193	(1,026)
Cash and cash equivalents, beginning of period	50	1,133
Cash and cash equivalents, end of period	$ 1,243	$ 107
Noncash Investing and Financing Activities:		
Tax benefit related to stock option exercise	$ 3	$ 60
Construction in progress included in trade accounts payable	$ 4	$ 526

Unrealized holding gains (losses)	$ 19,707	$ (9,680)

The accompanying notes are an integral part of these consolidated condensed financial statements.

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CALAVO GROWERS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

1. Description of the business

Business

Calavo Growers, Inc. (Calavo, the Company, we, us or our) procures and markets avocados and other perishable commodities and prepares and distributes processed avocado products. Our expertise in marketing and distributing avocados, processed avocados, and other perishable foods allows us to deliver a wide array of fresh and processed food products to food distributors, produce wholesalers, supermarkets, and restaurants on a worldwide basis. We procure avocados principally from California, Mexico, and Chile. Through our operating facilities in southern California, Texas, New Jersey, Arizona, and Mexico, we sort, pack, and/or ripen avocados for distribution both domestically and internationally. Additionally, we also distribute other perishable foods, such as tomatoes and Hawaiian grown papayas, and prepare processed avocado products. We report our operations in two different business segments: (1) fresh products and (2) processed products.

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of adjustments of a normal recurring nature necessary to present fairly the Company s financial position, results of operations and cash flows. The results of operations for interim periods are not necessarily indicative of the results that may be expected for a full year. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended October 31, 2006.

Recent Accounting Standards

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which permits entities to choose to measure at fair value eligible financial instruments and certain other items that are not currently required to be measured at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We will adopt SFAS No. 159 no later than the first quarter of fiscal 2009. We are currently assessing the impact the adoption of SFAS No. 159 will have on our financial position and results of operations.

In September 2006, the FASB issued SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. SFAS No. 158 requires company plan sponsors to display the net over- or under-funded position of a defined benefit postretirement plan as an asset or liability, with any unrecognized prior service costs, transition obligations or actuarial gains/losses reported as a component of other comprehensive income in shareholders equity. SFAS No. 158 is effective for fiscal years ending after December 15, 2006. We will adopt SFAS No. 158 as of the end of fiscal 2007. We are currently assessing the impact the adoption of SFAS No. 158 will have on our financial position and results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 establishes a framework for measuring fair value in generally accepted accounting principles, clarifies the definition of fair value and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. However, the application of SFAS No. 157 may change current practice for some entities. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We will adopt SFAS No. 157 in the first quarter of fiscal 2009. We are currently assessing the impact that the adoption of SFAS No. 157 will have on our financial position and results of operations.

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CALAVO GROWERS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 108 on Quantifying Misstatements. SAB No. 108 requires companies to use both a balance sheet and an income statement approach when quantifying and evaluating the materiality of a misstatement, and contains guidance on correcting errors under the dual approach. SAB No. 108 also provides transition guidance for correcting errors existing in prior years. SAB No. 108 is effective for annual financial statements covering the first fiscal year ending after November 15, 2006, with earlier application encouraged. We do not believe that the adoption of SAB 108 will have a significant impact on our financial position or results of operations.

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). This interpretation clarifies the application of SFAS No. 109, *Accounting for Income Taxes*, by defining a criterion that an individual tax position must meet for any part of the benefit of that position to be recognized in an enterprise s financial statements and also provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006, but earlier adoption is permitted. We will adopt FIN 48 on November 1, 2007. We are currently assessing the impact the adoption of FIN 48 will have on our financial position and results of operations.

Stock Based Compensation

We adopted SFAS No. 123(R), *Share-Based Payment*, on November 1, 2005. SFAS No. 123(R) requires us to account for awards of equity instruments issued to our employees under the fair value method of accounting and recognize such amounts in our statements of operations. We are required to measure compensation cost for all stock-based awards at fair value on the date of grant and recognize compensation expense in our consolidated statements of operations over the service period that the awards are expected to vest. In our consolidated statements of operations, we record: (i) compensation cost for options granted, modified, repurchased or cancelled on or after November 1, 2005 under the provisions of SFAS No. 123(R) and (ii) compensation cost for the unvested portion of options granted prior to November 1, 2005 over their remaining vesting periods using the amounts previously measured under SFAS No. 123 for pro forma disclosure purposes.

The value of each option award is estimated using the Black-Scholes-Merton or lattice-based option valuation models, which primarily consider the following assumptions: (1) expected volatility, (2) expected dividends, (3) expected term and (4) risk-free rate. Such models also consider the intrinsic value in the estimation of fair value of the option award. Forfeitures are estimated when recognizing compensation expense, and the estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of compensation expense to be recognized in future periods.

In December 2006, our Board of Directors approved the issuance of options to acquire a total of 20,000 shares of our common stock to two members of our Board of Directors. Each grant to acquire 10,000 shares vests in increments of 2,000 per annum over a five-year period and have an exercise price of $10.46 per share. Vested options have a term of five years from the vesting date. The market price of our common stock at the grant date was $10.46. The estimated fair market value of such option grant was approximately $40,000, based on the following assumptions:

Expected dividend yield	3.10%
Expected stock price volatility	22.19%
Risk free interest rate	3.25%
Expected life (in years)	5.5

The expected stock price volatility rate was based on the historical volatility of our common stock. The risk free interest rate was based on the U.S. Treasury yield curve in effect at the time of grant for periods approximating the expected life of the option. The expected life represents the average period of time that options granted are expected to be outstanding, as calculated using the simplified method described in the Securities and Exchange Commission s Staff Accounting Bulletin No. 107.

CALAVO GROWERS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

2. Information regarding our operations in different segments

We report our operations in two business segments: (1) fresh products and (2) processed products. These two business segments are presented based on how information is used by our president to measure performance and allocate resources. The fresh products segment includes all operations that involve the distribution of avocados grown both inside and outside of California, as well as the distribution of other non-processed, perishable food products. The processed products segment represents all operations related to the purchase, manufacturing, and distribution of processed avocado products. Additionally, selling, general and administrative expenses, as well as other non-operating income/expense items, are evaluated by our president in the aggregate. We do not allocate assets, or specifically identify them to, our operating segments. Prior period amounts have been reclassified to conform to the current period presentation.

	Fresh Products	Processed products	Inter-segment eliminations	Total
	(All amounts are presented in thousands)			
Nine months ended July 31, 2007				
Net sales	$ 197,342	$ 35,930	$ (15,583)	$ 217,689
Cost of sales	180,899	27,682	(15,583)	192,998
Gross margin	$ 16,443	$ 8,248		$ 24,691

	Fresh Products	Processed products	Inter-segment eliminations	Total
Nine months ended July 31, 2006				
Net sales	$ 177,035	$ 31,766	$ (11,921)	$ 196,880
Cost of sales	162,720	24,137	(11,921)	174,936
Gross margin	$ 14,315	$ 7,629		$ 21,944

	Fresh Products	Processed products	Inter-segment eliminations	Total
Three months ended July 31, 2007				
Net sales	$ 82,645	$ 14,021	$ (5,359)	$ 91,307
Cost of sales	76,142	11,897	(5,359)	82,680
Gross margin	$ 6,503	$ 2,124		$ 8,627

	Fresh Products	Processed products	Inter-segment eliminations	Total
Three months ended July 31, 2006				
Net sales	$ 70,071	$ 11,870	$ (3,041)	$ 78,900
Cost of sales	62,833	9,035	(3,041)	68,827
Gross margin	$ 7,238	$ 2,835		$ 10,073

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CALAVO GROWERS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

The following table sets forth sales by product category, by segment (in thousands):

	Nine months ended July 31, 2007			Nine months ended July 31, 2006		
	Fresh products	Processed products	Total	Fresh products	Processed products	Total
Third-party sales:						
California avocados	$ 62,530	$	$ 62,530	$ 96,429	$	$ 96,429
Imported avocados	89,111		89,111	39,900		39,900
Papayas	3,726		3,726	3,705		3,705
Diversified products	12,438		12,438	7,189		7,189
Processed food service		27,913	27,913		24,923	24,923
Processed retail and club		7,945	7,945		7,840	7,840
Total fruit and product sales to third-parties	167,805	35,858	203,663	147,223	32,763	179,986
Freight and other charges	19,761	497	20,258	22,451	464	22,915
Total third-party sales	187,566	36,355	223,921	169,674	33,227	202,901
Less sales incentives	(19)	(6,213)	(6,232)	(49)	(5,972)	(6,021)
Total net sales to third-parties	187,547	30,142	217,689	169,625	27,255	196,880
Intercompany sales	9,795	5,788	15,583	7,410	4,511	11,921
Net sales before eliminations	$ 197,342	$ 35,930	233,272	$ 177,035	$ 31,766	208,801
Intercompany sales eliminations			(15,583)			(11,921)
Consolidated net sales			$ 217,689			$ 196,880

	Three months ended July 31, 2007			Three months ended July 31, 2006		
	Fresh products	Processed products	Total	Fresh products	Processed products	Total
Third-party sales:						
California avocados	$ 40,665	$	$ 40,665	$ 51,722	$	$ 51,722
Imported avocados	28,290		28,290	4,918		4,918
Papayas	1,266		1,266	1,114		1,114
Diversified products	1,735		1,735	2,215		2,215
Processed food service		10,894	10,894		9,224	9,224
Processed retail and club		2,834	2,834		3,163	3,163
Total fruit and product sales to third-parties	71,956	13,728	85,684	59,969	12,387	72,356
Freight and other charges	7,513	189	7,702	8,693	178	8,871

Total third-party sales	79,469	13,917	93,386	68,662	12,565	81,227
Less sales incentives	(2)	(2,077)	(2,079)	(10)	(2,317)	(2,327)
Total net sales to third-parties	79,467	11,840	91,307	68,652	10,248	78,900
Intercompany sales	3,178	2,181	5,359	1,419	1,622	3,041
Net sales before eliminations	$ 82,645	$ 14,021	96,666	$ 70,071	$ 11,870	81,941
Intercompany sales eliminations			(5,359)			(3,041)
Consolidated net sales			$ 91,307			$ 78,900

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CALAVO GROWERS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

3. Inventories

Inventories consist of the following (in thousands):

	July 31, 2007	October 31, 2006
Fresh fruit	$ 8,112	$ 4,961
Packing supplies and ingredients	2,784	2,380
Finished processed foods	2,418	3,228
	$ 13,314	$ 10,569

During the three and nine month periods ended July 31, 2007 and 2006, we were not required to, and did not, record any provisions to reduce our inventories to the lower of cost or market.

4. Related party transactions

We sell papayas obtained from an entity owned by our Chairman of the Board of Directors, Chief Executive Officer and President. Sales of papayas procured from the related entity amounted to approximately $3,726,000, and $3,705,000 for the nine months ended July 31, 2007 and 2006, resulting in gross margins of approximately $354,000 and $311,000. Sales of papayas procured from the related entity amounted to approximately $1,266,000, and $1,114,000 for the three months ended July 31, 2007 and 2006, resulting in gross margins of approximately $136,000 and $108,000. Included in accrued liabilities are approximately $269,000 and $79,000 at July 31, 2007 and October 31, 2006 due to this entity.

Certain members of our Board of Directors market avocados through Calavo pursuant to marketing agreements substantially similar to the marketing agreements that we enter into with other growers. During the three months ended July 31, 2007 and 2006, the aggregate amount of avocados procured from entities owned or controlled by members of our Board of Directors was $4.1 million and $6.2 million. During the nine months ended July 31, 2007 and 2006, the aggregate amount of avocados procured from entities owned or controlled by members of our Board of Directors was $6.5 million and $12.4 million.

At July 31, 2007, prepaid expenses and other current assets include a receivable from Maui Fresh, LLC totaling $0.5 million.

5. Other assets

At July 31, 2007, other assets in the accompanying consolidated condensed financial statements included the following intangible assets: customer-related intangibles of $590,000 (accumulated amortization of $415,000) and brand name intangibles of $275,000. The customer-related intangibles are being amortized over five years. The intangible asset related to the brand name currently has an indefinite remaining useful life and, as a result, is not currently subject to amortization. We anticipate recording amortization expense of approximately $29,000 for the remainder of fiscal 2007 and approximately $118,000 per annum for fiscal 2008, with the remaining amortization expense of approximately $28,000 recorded in fiscal 2009.

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CALAVO GROWERS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

6. Stock-Based Compensation

In November 2001, our Board of Directors approved two stock-based compensation plans.

The Directors Stock Option Plan

Participation in the directors stock option plan is limited to members of our Board of Directors. The plan makes available to the Board of Directors, or a plan administrator, the right to grant options to purchase up to 3,000,000 shares of common stock. In connection with the adoption of the plan, the Board of Directors approved an award of fully vested options to purchase 1,240,000 shares of common stock at an exercise price of $5.00 per share. We terminated this plan during the third quarter of fiscal 2007. Outstanding options have not been impacted by such termination.

In December 2003, our Board of Directors approved the issuance of options to acquire a total of 50,000 shares of our common stock to two members of our Board of Directors. Each option to acquire 25,000 shares vests in substantially equal installments over a three-year period, has an exercise price of $7.00 per share, and has a term of five years from the grant date. The market price of our common stock at the grant date was $10.01. In December 2005, the related stock option agreements were modified to shorten the option terms, as defined. Such modifications were contemplated primarily as a result of Section 409A of the tax code. During the nine months ended July 31, 2007 and 2006, we recognized approximately $8,000 and $38,000 of compensation expense with respect to these stock option awards. No compensation expense was recorded in our second or third fiscal quarters of 2007 related to these stock options.

A summary of stock option activity follows (in thousands, except for per share amounts):

	Number of Shares	Weighted-Average Exercise Price	Aggregate Intrinsic Value
Outstanding at October 31, 2006 and July 31, 2007	49	$ 7.00	$ 356
Exercisable at July 31, 2007	49	$ 7.00	$ 356

The weighted average remaining life of such outstanding options is 1.39 years. The total fair value of shares vested during the nine months ended July 31, 2007 was approximately $238,000.

The Employee Stock Purchase Plan

The employee stock purchase plan was approved by our Board of Directors and shareholders. Participation in the employee stock purchase plan is limited to employees. The plan provides the Board of Directors, or a plan administrator, the right to make available up to 2,000,000 shares of common stock at a price not less than fair market value.

The 2005 Stock Incentive Plan

The 2005 Stock Incentive Plan of Calavo Growers, Inc. (the 2005 Plan) was approved by our Board of Directors and shareholders. The 2005 Plan authorizes the granting of the following types of awards to persons who are employees, officers, consultants, advisors, or directors of Calavo Growers, Inc. or any of its affiliates:

- Incentive stock options that are intended to satisfy the requirements of Section 422 of the Internal Revenue Code of 1986, as amended, and the regulations thereunder;

- Non-qualified stock options that are not intended to be incentive stock options; and

- Shares of common stock that are subject to specified restrictions.

CALAVO GROWERS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

Subject to the adjustment provisions of the 2005 Plan that are applicable in the event of a stock dividend, stock split, reverse stock split or similar transaction, up to 2,500,000 shares of common stock may be issued under the 2005 Plan and no person shall be granted awards under the 2005 Plan during any 12-month period that cover more then 500,000 shares of common stock.

A summary of stock option activity follows (in thousands, except for share amounts):

	Number of Shares	Weighted-Average Exercise Price	Aggregate Intrinsic Value
Outstanding at October 31, 2006	391	$ 9.10	
Granted	20	$ 10.46	
Exercised	(7)	$ 9.10	
Outstanding at July 31, 2007	404	$ 9.17	$ 2,089
Exercisable at July 31, 2007	384	$ 9.10	$ 1,985

The weighted average remaining life of such outstanding options is 3.28 years and the estimated fair market value per share granted during the nine-months ended July 31, 2007 was approximately $2.06 per share. At July 31, 2007, the total unrecognized compensation cost related to such unvested stock options awards was approximately $36,000, which is expected to be recognized over the remaining period of approximately five years.

7. Other events

Dividend payment

In January 2007, we paid a $0.32 per share dividend in the aggregate amount of $4.6 million to shareholders of record on December 15, 2006. In January 2006, we paid a $0.32 per share dividend in the aggregate amount of $4.6 million to shareholders of record on December 15, 2005.

Contingencies

Hacienda Suit We are currently under examination by the Mexican tax authorities (Hacienda) for the tax year ended December 31, 2000. During the first quarter of fiscal 2005, we received an assessment totaling approximately $2.0 million from Hacienda related to the amount of income at our Mexican subsidiary. Subsequent to that initial assessment, the Hacienda offered a settlement of approximately $400,000, which we declined. Based primarily on discussions with legal counsel and the evaluation of our claim, we maintain our belief that the Hacienda s position has no merit and that we will prevail. Accordingly, no amounts have been provided in the financial statements as of July 31, 2007. We pledged our processed products building located in Uruapan, Michoacan, Mexico as collateral to the Hacienda in regards to this assessment. We are currently working on removing such lien.

Processed Products suit During the first quarter of fiscal 2007, the Company was named defendant in a complaint filed with the Superior Court of the State of California for the County of Los Angeles, seeking monetary damages of not less than $2.5 million stemming from packing services performed on behalf of the complainant. The initial complaint stated various allegations, including breach of contract, negligence, etc. Subsequent to that initial complaint, the court has dismissed certain allegations. We believe the charges in this case are without merit and intend to vigorously defend the litigation. Accordingly, no amounts have been provided in the financial statements as of July 31, 2007.

We are also involved in litigation arising in the ordinary course of our business that we do not believe will have a material adverse impact on our financial statements.

CALAVO GROWERS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

Term Revolving Credit Agreement

In January 2007, we converted one of our short-term, non-collateralized, revolving credit facilities into a term revolving credit agreement due February 2010. In February 2007 and June 2007, we further amended the term and also amended the total credit available pursuant to this borrowing agreement. The term is through February 2012, and the total available credit is $20 million. Under the terms of this agreement, we are advanced funds for both working capital and long-term productive asset purchases. Borrowings incur interest at 6.3% at July 31, 2007. Under this credit facility, we had $10.0 million outstanding as of July 31, 2007. The credit facility contains various financial covenants, the most significant relating to working capital, tangible net worth (as defined), and Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) (as defined). We were in compliance with all such covenants at July 31, 2007.

Agreements with Tomato Grower

In June 2007, we entered into a distribution agreement with Agricola Belher (Belher) of Mexico, a well-established quality producer of fresh vegetables, primarily tomatoes, for export to the U.S. market. Pursuant to such distribution agreement, Belher agreed, at their sole cost and expense, to harvest, pack, export, ship, and deliver tomatoes exclusively to one of our operating facilities described in footnote 1 or to our Los Angeles, California market location. In exchange, we agreed to sell and distribute such tomatoes, advance $2 million to Belher for operating purposes, provide additional advances as shipments are made during the season (subject to limitations, as defined), and return the proceeds from such tomato sales to Belher, net of our commission and aforementioned advances. The agreement also allows for us to advance additional amounts to Belher at our sole discretion. All advances that remain outstanding as of May 2008 are immediately due and payable. As of July 31, 2007, we have advanced $1 million to Belher (included in advances to suppliers) pursuant to this agreement and have advanced an additional $500,000 in August 2007. We anticipate advancing the remaining $500,000 in September 2007. Pursuant to EITF 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*, we will record gross revenues related to this agreement, as we believe we are acting more like the principal in these sales transactions.

Concurrently, we also entered into an infrastructure agreement in June 2007 with Belher in order to significantly increase production yields and fruit quality. Pursuant to this agreement, we are to advance up to $5 million to be used solely for the acquisition, construction, and installation of improvements to and on certain land owned by Belher, as well as packing line equipment. Advances incur interest at 9.4% at July 31, 2007. We advanced $3.7 million as of July 31, 2007 ($0.7 million included in prepaid expenses and other current assets and $3.0 million included in other long-term assets) and also advanced an additional $1.1 million in August 2007. We anticipate advancing the remaining $0.2 million during our fourth fiscal quarter of 2007. The agreement allows for additional $1.0 million advances to take place during the last five months of each of our fiscal years 2008 through 2010, but they are subject to certain conditions and are to be made at our sole discretion. Belher is to annually repay these advances in no less than 20% increments of the original principal amount of each advance made on or before each of July 2008 through July 2010. Interest is to be paid monthly or annually, as defined. All unpaid amounts advanced during our fiscal 2007 are due in July 2012. Belher may prepay, without penalty, all or any portion of the advances at any time.

In order to secure their obligations pursuant to both agreements discussed above, Belher granted us a first-priority security interest in certain assets, including cash, inventory and fixed assets, as defined.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This information should be read in conjunction with the unaudited consolidated condensed financial statements and the notes thereto included in this Quarterly Report, and the audited consolidated financial statements and notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations contained in the Annual Report on Form 10-K for the year ended October 31, 2006 of Calavo Growers, Inc. (we, Calavo, or the Company). Certain prior year amounts have been reclassified to conform with the current period presentation.

Recent Developments

Dividend payment

In January 2007, we paid a $0.32 per share dividend in the aggregate amount of $4.6 million to shareholders of record on December 15, 2006. In January 2006, we paid a $0.32 per share dividend in the aggregate amount of $4.6 million to shareholders of record on December 15, 2005.

Contingencies

Hacienda Suit We are currently under examination by the Mexican tax authorities (Hacienda) for the tax year ended December 31, 2000. During the first quarter of fiscal 2005, we received an assessment totaling approximately $2.0 million from Hacienda related to the amount of income at our Mexican subsidiary. Subsequent to that initial assessment, the Hacienda offered a settlement of approximately $400,000, which we declined. Based primarily on discussions with legal counsel and the evaluation of our claim, we maintain our belief that the Hacienda s position has no merit and that we will prevail. Accordingly, no amounts have been provided in the financial statements as of July 31, 2007. We pledged our processed products building located in Uruapan, Michoacan, Mexico as collateral to the Hacienda in regards to this assessment. We are currently working on removing such lien.

Processed Products suit During the first quarter of fiscal 2007, the Company was named defendant in a complaint filed with the Superior Court of the State of California for the County of Los Angeles, seeking monetary damages of not less than $2.5 million stemming from packing services performed on behalf of the complainant. The initial complaint stated various allegations, including breach of contract, negligence, etc. Subsequent to that initial complaint, the court has dismissed certain allegations. We believe the charges in this case are without merit and intend to vigorously defend the litigation. Accordingly, no amounts have been provided in the financial statements as of July 31, 2007.

We are also involved in litigation arising in the ordinary course of our business that we do not believe will have a material adverse impact on our financial statements.

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In January 2007, we converted one of our short-term, non-collateralized, revolving credit facilities into a term revolving credit agreement due February 2010. In February 2007 and June 2007, we further amended the term and also amended the total credit available pursuant to this borrowing agreement. The term is through February 2012, and the total available credit is $20 million. Under the terms of this agreement, we are advanced funds for both working capital and long-term productive asset purchases. Borrowings incur interest at 6.3% at July 31, 2007. Under this credit facility, we had $10.0 million outstanding as of July 31, 2007. The credit facility contains various financial covenants, the most significant relating to working capital, tangible net worth (as defined), and Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) (as defined). We were in compliance with all such covenants at July 31, 2007.

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Concurrently, we also entered into an infrastructure agreement in June 2007 with Belher in order to significantly increase production yields and fruit quality. Pursuant to this agreement, we are to advance up to $5 million to be used solely for the acquisition, construction, and installation of improvements to and on certain land owned by Belher, as well as packing line equipment. Advances incur interest at 9.4% at July 31, 2007. We advanced $3.7 million as of July 31, 2007 ($0.7 million included in prepaid expenses and other current assets and $3.0 million included in other long-term assets) and also advanced an additional $1.1 million in August 2007. We anticipate advancing the remaining $0.2 million during our fourth fiscal quarter of 2007. The agreement allows for additional $1.0 million advances to take place during the last five months of each of our fiscal years 2008 through 2010, but they are subject to certain conditions and are to be made at our sole discretion. Belher is to annually repay these advances in no less than 20% increments of the original principal amount of each advance made on or before each of July 2008 through July 2010. Interest is to be paid monthly or annually, as defined. All unpaid amounts advanced during our fiscal 2007 are due in July 2012. Belher may prepay, without penalty, all or any portion of the advances at any time.

In order to secure their obligations pursuant to both agreements discussed above, Belher granted us a first-priority security interest in certain assets, including cash, inventory and fixed assets, as defined.

Net Sales

The following table summarizes our net sales by business segment for each of the three and nine month periods ended July 31, 2007 and 2006:

	Three months ended July 31,			Nine months ended July 31,		
(in thousands)	**2007**	**Change**	**2006**	**2007**	**Change**	**2006**
Net sales to third-parties:						
Fresh products	$ 79,467	15.8%	$ 68,652	$ 187,547	10.6%	$ 169,625
Processed products	11,840	15.5%	10,248	30,142	10.6%	27,255
Total net sales	$ 91,307	15.7%	$ 78,900	$ 217,689	10.6%	$ 196,880
As a percentage of net sales:						
Fresh products	87.0%		87.0%	86.2%		86.2%
Processed products	13.0%		13.0%	13.8%		13.8%
	100.0%		100.0%	100.0%		100.0%

Net sales for the third quarter of fiscal 2007, compared to fiscal 2006, increased by $12.4 million, or 15.7%; whereas net sales for the nine months ended July 31, 2007, compared to fiscal 2006, increased by $20.8 million, or

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10.6%. The increase in fresh product sales during the third quarter of fiscal 2007 was primarily related to increased sales in Mexico sourced avocados, partially offset by a decrease in sales from California sourced avocados. The increase in fresh product sales during the nine months ended July 31, 2007 was primarily driven by increased sales related to Chilean and Mexico sourced avocados, partially offset by decreased sales related to avocados sourced from California. While the procurement of fresh avocados related to our fresh products segment is seasonal, sales of our processed products business is generally not subject to a seasonal effect. For the related three and nine-month periods, the increase in net sales delivered by our processed products business was due primarily to an increase in total pounds of product sold.

Net sales to third parties by segment exclude value-added services billed by our Uruapan packinghouse and our Uruapan processing plant to the parent company. All intercompany sales are eliminated in our consolidated results of operations.

Fresh products

Net sales delivered by the business increased by approximately $10.8 million, or 15.8%, for the third quarter of fiscal 2007, when compared to the same period for fiscal 2006. This increase was primarily related to an increase in sales of Mexico grown avocados in the U.S. marketplace. The volume of Mexican fruit sold increased by approximately 19.7 million pounds, or 339.6%, when compared to the same prior year period. This increase was primarily in the U.S. marketplace and was substantially related to an increased emphasis in the Mexican avocado crop certified for export to the U.S., which principally stemmed from the expected, and ultimately realized, smaller California avocado crop. Additionally, the average per carton selling price of Mexican avocados increased approximately 32.1% when compared to the same prior year period. We attribute some of this increase to the smaller California avocado crop in the marketplace during our third fiscal quarter, as well as the premium pricing related to our ProRipeVIP™ avocado ripening program.

The increased sales discussed above was partially offset by a decrease in sales related to avocados sourced from California. California avocados sales reflect a 53.7% decrease in pounds of avocados sold, when compared to the same prior year period. The decrease in pounds is consistent with the expected decrease in the overall harvest of the California avocado crop for the 2006/2007 season. Our market share of shipped California avocados decreased to 29.5% in the third quarter of fiscal 2007, when compared to a 34.4% market share for the same prior year period. The average selling price, on a per carton basis, of California avocados sold, however, increased approximately 71.0% when compared to the same prior year period. We attribute some of this increase to the aforementioned smaller California avocado crop for the 2006/2007 season.

Net sales delivered by the business increased by approximately $17.9 million, or 10.6%, for the nine months ended July 31, 2007, when compared to the same period for fiscal 2006. This increase was primarily related to an increase in sales of Mexico and Chile grown avocados, as well as tomatoes, in the U.S. marketplace. The volume of Mexican fruit sold increased by approximately 47.5 million pounds, or 106.6%, when compared to the same prior year period. This increase was primarily in the U.S. marketplace and was substantially related to an increased emphasis in the Mexican avocado crop certified for export to the U.S., which principally stemmed from the expected, and ultimately realized, smaller California avocado crop. The volume of Chilean fruit sold increased by approximately 6.3 million pounds, or 92.0%, when compared to the same prior year period. This increase is primarily related to the size of the Chilean avocado crop, as well as the timing of the delivery to the United States. Additionally, the average per carton selling price of Mexican avocados increased approximately 18.9% when compared to the same prior year period. The average per carton selling price of Chilean avocados, however, decreased approximately 22.2% when compared to the same prior year period. We attribute some of these price fluctuations to the size and/or timing of delivery of the Chilean and California avocado crop in the marketplace during the nine month period ending July 31, 2007. The volume of non-brokered tomatoes increased by approximately 30.0 million pounds when compared to the same prior year period. This increase, which accounted for the majority of the fluctuation, was primarily related to a new supplier relationship.

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The increased sales discussed above were partially offset by a decrease in sales related to avocados sourced from California. California avocado sales reflect a 56.7% decrease in pounds of avocados sold, when compared to the same prior year period. The decrease in pounds is consistent with the expected decrease in the overall harvest of the California avocado crop for the 2006/2007 season. Our market share of shipped California avocados decreased to 31.6% for the nine month period ending July 31, 2007, when compared to a 34.4% market share for the same prior year period. The average per carton selling price of California avocados, however, increased approximately 49.2% when compared to the same prior year period. We attribute some of this increase to the aforementioned smaller California avocado crop for the 2006/2007 season.

We anticipate that California avocado sales will experience a seasonal decrease during our fourth fiscal quarter of 2007, as compared to the third fiscal quarter of 2007. Based on the expected smaller California avocado crop for fiscal 2007, which was further impacted by adverse weather conditions that primarily struck California crops during our first quarter, we do not expect sales from California sourced avocados to meet or exceed sales from California sourced avocados generated in the prior year. We intend to leverage our position as the largest packer of Mexico grown avocados for export markets to improve our overall sales.

We anticipate that net sales related to non-California sourced avocados will experience a seasonal increase in the fourth fiscal quarter of 2007, as compared to the third fiscal quarter of 2007.

Processed products

For the quarter ended July 31, 2007, when compared to the same period for fiscal 2006, sales to third-party customers increased by approximately $1.6 million, or 15.5%. This increase is primarily related to a 13.0% increase in total pounds sold, primarily related to an increase in our frozen-foodservice products to new customers. Our average net selling prices remained fairly consistent for the quarter ended July 31, 2007, when compared to the same prior year period.

For the first nine months of fiscal 2007, when compared to the same period for fiscal 2006, sales to third-party customers increased by approximately $2.9 million, or 10.6%. This increase is primarily related to an 8.5% increase in total pounds sold, as our ultra high-pressure products have experienced widespread acceptance in both the retail and foodservice sectors, as well as an increase in our frozen-foodservice products sold to new customers. Our average net selling prices remained fairly consistent during the first nine months ended July 31, 2007, when compared to the same prior year period.

Our ultra high-pressure products continue to experience solid demand. During the nine months ended July 31, 2007, gross sales of high-pressure product totaled approximately $11.4 million, as compared to $10.3 million for the same prior year period. We believe that these fresh guacamole products are successfully addressing a growing market segment.

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Gross Margins

The following table summarizes our gross margins and gross profit percentages by business segment for each of the three and nine-month periods ended July 31, 2007 and 2006:

	Three months ended July 31,			Nine months ended July 31,		
(in thousands)	**2007**	**Change**	**2006**	**2007**	**Change**	**2006**
Gross margins:						
Fresh products	$ 6,503	(10.2)%	$ 7,238	$ 16,443	14.9%	$ 14,315
Processed products	2,124	(25.1)%	2,835	8,248	8.1%	7,629
Total gross margins	$ 8,627	(14.4)%	$ 10,073	$ 24,691	12.5%	$ 21,944
Gross profit percentages:						
Fresh products	8.2%		10.5%	8.8%		8.4%
Processed products	17.9%		27.7%	27.4%		28.0%
Consolidated	9.4%		12.8%	11.3%		11.1%

Our cost of goods sold consists predominantly of fruit costs, packing materials, freight and handling, labor and overhead (including depreciation) associated with preparing food products and other direct expenses pertaining to products sold. Gross margin dollars decreased by approximately $1.4 million and, as a percent of sales, decreased 3.4% for the third quarter of fiscal 2007; whereas gross margin dollars for the nine months ended July 31, 2007, compared to fiscal 2006, increased by $2.7 million, or, as a percent of sales, increased 0.2%. The decrease in consolidated gross margin percent during the third quarter of fiscal 2007, as compared to the same prior period, was primarily related to a decrease in gross margin percent from both our fresh products and processed products segments. The increase in consolidated gross margin percents for the nine-month period ended July 31, 2007, as compared to the same prior period, was primarily related to an increase in gross margin percent from our fresh products segment, partially offset by a decrease in our gross margin percent from our processed products segments.

For the third quarter of fiscal 2007, as compared to the same prior year period, gross margin percent related to our fresh products segment decreased approximately 21.9%. Such decrease was primarily driven by a significant decrease in pounds of California sourced fruit and the lower gross margins resulting therefrom. For the third quarter of fiscal 2007, the volume of California fruit decreased 53.7%, when compared to the same prior year period. This had the effect of increasing our per pound production costs, which, as a result, negatively impacted gross margins. The resulting lower gross margins described above were partially offset, however, by an increase in Mexican fruit sold, a decrease in Mexican fruit costs, and/or higher sales prices. The increased volume and decreased fruit costs had the effect of decreasing our per pound production costs, which, as a result, positively impacted gross margins.

For the nine months ended July 31, 2007, as compared to the same prior year period, gross margin percent related to our fresh products segment increased approximately 4.8%. Such increases were primarily driven by a significant increase in pounds of Mexican and Chilean fruit sold, a decrease in Mexican fruit costs, and/or higher sales prices. For the first nine months of fiscal 2007, we experienced a 106.6% increase in fruit sold related to Mexico sourced fruit. Additionally, for the first nine months of fiscal 2007, we experienced a 92.0% increase in fruit sold related to Chile sourced fruit. This had the effect of decreasing our per pound production costs, which, as a result, positively impacted gross margins. Additionally, the significant increase in tomato volume positively impacted gross margins as well. The resulting higher gross margins described above were partially offset, however, by decreases in California sourced fruit and the lower gross margins resulting therefrom. For the first nine months of fiscal 2007, the volume of California fruit decreased 56.7%, when compared to the same prior year period.

The processed products gross profit percentages for the third quarter of fiscal 2007, as compared to the same prior period, decreased 35.4% primarily as a result of significantly higher fruit costs, as well as increased packaging costs, which had the effect of increasing our per pound costs. We anticipate that the gross profit percentage for our processed product segment will continue to experience significant fluctuations during the next fiscal quarter primarily due to the uncertainty of the cost of fruit that will be used in the production process.

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Selling, General and Administrative

(in thousands)	Three months ended July 31, 2007	Change	2006	Nine months ended July 31, 2007	Change	2006
Selling, general and administrative	$4,803	(6.6%)	$5,141	$14,151	(2.1)%	$14,448
Percentage of net sales	5.3%		6.5%	6.5%		7.3%

Selling, general and administrative expenses include costs of marketing and advertising, sales expenses and other general and administrative costs. Selling, general and administrative expenses decreased $0.3 million, or 6.6%, for the three months ended July 31, 2007, when compared to the same period for fiscal 2006. This decrease was primarily related to lower corporate costs, including, but not limited to, a decrease in stock based compensation (totaling approximately $0.3 million) and a decrease in certain employee compensation costs (totaling approximately $0.2 million). Such decreases were partially offset, however, by higher bad debt expense for the quarter (totaling approximately $0.1 million).

Interest Expense

(in thousands)	Three months ended July 31, 2007	Change	2006	Nine months ended July 31, 2007	Change	2006
Interest expense	$(315)	10.9%	$(284)	$(996)	23.7%	$(805)
Percentage of net sales	(2.2%)		(2.4)%	(0.5%)		(0.4%)

Interest expense is primarily generated from our short-term borrowings as well as our term loan agreement with Farm Credit West, PCA. For the three and nine months ended July 31, 2007, the increase in interest expense is primarily related to an increase in the average borrowing balance from our short-term credit facilities.

Provision for Income Taxes

(in thousands)	Three months ended July 31, 2007	Change	2006	Nine months ended July 31, 2007	Change	2006
Provision for income taxes	$1,355	(27.5)%	$1,870	$3,860	35.7%	$2,845
Percentage of income before provision for income taxes	37.9%		39.0%	38.6%		39.0%

For the first nine months of fiscal 2007, our provision for income taxes was $3.9 million, as compared to $2.8 million recorded for the comparable prior year period. We expect our effective tax rate to approximate 38.6% during fiscal 2007.

Liquidity and Capital Resources

Cash provided by operating activities was $0.3 million for the nine months ended July 31, 2007, compared to $8.0 million for the similar period in fiscal 2006. Operating cash flows for the nine months ended July 31, 2007 reflect our net income of $6.1 million, net non-cash items (depreciation and amortization, stock compensation expense, income from Maui Fresh, LLC, and provision for losses on accounts receivable) of $2.0 million and a net decrease in the components of our working capital of approximately $7.8 million.

These working capital decreases include an increase in accounts receivable of $9.4 million, an increase in inventory of $2.8 million, an decrease in trade accounts payable and accrued expenses of $2.2 million, an increase in prepaid expenses and other current assets of $1.2 million, and an increase in advances to suppliers of $0.4 million. These decreases were partially offset by an increase in payable to growers of $6.4 million,, an increase in income tax receivable of $1.7 million, and a increase in other assets of $0.1 million.

The increase in our accounts receivable balance, as of July 31, 2007, when compared to October 31, 2006, primarily reflects higher sales recorded in the month of July 2007, as compared to October 2006. The increase in inventory, as well as the corresponding increase in payable to growers, is primarily related to an increase in California fruit delivered in the month of July 2007, as compared to October 2006. The decrease in trade accounts payable and accrued expenses primarily reflects a decrease in un-vouched liabilities as of July 2007, as compared to October 2006.

Cash used in investing activities was $6.3 million for the nine months ended July 31, 2007 and related to the loan made to Agricola Belher, as well as the purchase of property, plant and equipment items.

Cash provided by financing activities was $7.1 million for the nine months ended July 31, 2007, which related principally to $9.2 million of borrowings from our lines of credit, as well as $2.4 million from the collection of our notes receivable from shareholders. Such proceeds were partially offset, however, by the payment of a $4.6 million dividend.

Our principal sources of liquidity are our existing cash reserves, cash generated from operations and amounts available for borrowing under our existing credit facilities. Cash and cash equivalents as of July 31, 2007 and October 31, 2006 totaled $1.2 million and $0.1 million. Our working capital at July 31, 2007 was $19.6 million, compared to $12.0 million at October 31, 2006. The overall working capital increase primarily reflects increases in our accounts receivable, inventory, prepaid expenses and other current assets and advances to suppliers balances, partially offset by an increase in our payable to growers.

We believe that cash flows from operations, available credit facilities, and long-term credit facilities will be sufficient to satisfy our future capital expenditures, grower recruitment efforts, working capital and other financing requirements. We will continue to evaluate grower recruitment opportunities and exclusivity arrangements with food service companies to fuel growth in each of our business segments. We have one short-term and one long-term, non-collateralized, revolving credit facilities. These credit facilities expire in February 2012 and April 2008 and are with separate banks. Under the terms of these agreements, we are advanced funds for both working capital and long-term productive asset purchases. Total credit available under the combined borrowing agreements was $30 million, with a weighted-average interest rate of 6.3% and 6.2% at July 31, 2007 and October 31, 2006. Under these credit facilities, we had $14.3 million and $3.8 million outstanding as of July 31, 2007 and October 31, 2006. The credit facilities contain various financial covenants with which we were in compliance at July 31, 2007. The most significant financial covenants relate to working capital, tangible net worth (as defined), and Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) (as defined) requirements. We have no significant commitments for capital expenditures as of July 31, 2007.

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Impact of Recently Issued Accounting Pronouncements

See footnote 1 to the consolidated condensed financial statements that are included in this Quarterly Report on Form 10-Q.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our financial instruments include cash and cash equivalents, accounts receivable, loan to Agricola Belher, payable to growers, accounts payable, current and long-term borrowings pursuant to our credit facilities with financial institutions, and long-term, fixed-rate obligations. All of our financial instruments are entered into during the normal course of operations and have not been acquired for trading purposes. The table below summarizes interest rate sensitive financial instruments and presents principal cash flows in U.S. dollars, which is our reporting currency, and weighted-average interest rates by expected maturity dates, as of July 31, 2007.

	Expected maturity date July 31,							
(All amounts in thousands)	2007	2008	2009	2010	2011	Thereafter	Total	Fair Value
Assets								
Cash and cash equivalents (1)	$ 1,243	$	$	$	$	$	$ 1,243	$ 1,243
Accounts receivable (1)	33,300						33,300	33,300
Loan to Agricola Belher (4)		740	740	740	740	740	3,700	3,700
Liabilities								
Payable to growers (1)	$12,718	$	$	$	$	$	$12,718	$12,718
Accounts payable (1)	3,083						3,083	3,083
Current borrowings pursuant to credit facilities (1)	10,330						10,330	10,330
Long-term borrowings pursuant to credit facilities (2)				4,000		ated in these forward-looking statements as a result of many factors, including, but not limited to, those set forth elsewhere in this report. See Cautionary Note Regarding Forward-Looking Statements.		

The discussion and analysis of the financial condition and results of operations are based upon the unaudited consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP). The preparation of financial statements in conformity with US GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of any contingent liabilities at the financial statement date and reported amounts of revenue and expenses during the reporting period. We base these estimates on historical experience and other assumptions that we believe to be reasonable under the circumstances. Actual results may differ materially from those estimates.

Introduction

This Management s Discussion and Analysis (MD&A) for Rare Element Resources Ltd. has been prepared based on information known to management as of the date of this report. This MD&A is intended to help the reader understand the unaudited consolidated financial statements of Rare Element.

We are focused on exploring and developing mineral projects which contain or have the potential to contain rare-earth elements with or without gold. We plan to explore advanced-stage exploration projects ourselves, and to acquire and option out earlier stage exploration projects, while keeping a retained interest. Our main focus is advancing the Bear Lodge rare earth element (REE) Project (the Bear Lodge Project) located near Sundance, Wyoming, USA.

On July 1, 2011, we became a domestic issuer in the United States and transitioned from reporting according to Canadian regulations with US secondary filings, to reporting according to US regulations with Canadian secondary filings. While this will have no impact on the value of Rare Element, shareholders will have to adapt to filings in the US regulation formats. We have adopted US GAAP, as required under SEC rules. This MD&A should be read in conjunction with the consolidated financial statements for the three and nine months ended March 31, 2012 and supporting notes.

Our reporting under US GAAP is similar to Canadian GAAP, except that exploration expenditures are expensed as incurred until a property has declared proven and probable mineral reserves.

We are responsible for the preparation and integrity of the consolidated financial statements, including the maintenance of appropriate information systems, procedures and internal controls. We also ensure that information used internally or disclosed externally, including the consolidated financial statements and MD&A, is complete and reliable.

The board s audit committee meets with our management regularly to review the consolidated financial statements, including the MD&A, and to discuss other financial, operating and internal-control matters.

All currency amounts are expressed in thousands of US dollars, unless otherwise noted.

Outlook

We have sufficient cash on hand to conduct our current exploration and development plans through 2013. We plan to continue to advance the Bear Lodge Project in Wyoming, USA, during 2012 and into 2013 including the following:

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Additional resource definition drilling to expand and upgrade the resources at the Bull Hill, Whitetail Ridge, and Bull Hill NW deposits.

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Exploration drilling at the Bull Hill West, Carbon REE, Taylor REE, and other prospective REE targets identified during the 2010 and 2011 exploration programs.

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Geological mapping, geochemical sampling, and geophysical surveys over selected areas in order to better delineate current target areas and identify new targets for economic REE mineralization.

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Collection of additional bulk sample mineralized material for continued pilot plant testing from a second large diameter core drilling program in select, well-mineralized areas, along with additional sampling of mineralized surface exposures in road cuts, trenches, and drill sites.

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A condemnation drilling program to ensure that the proposed low-grade stockpile and waste facility will not cover ground that is prospective for REE and/or gold mineralization.

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Environmental baseline and geotechnical studies for use in the environmental impact study (EIS) and prefeasibility study.

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Continued metallurgical testing of the oxide, the oxide-carbonate and the low-grade stockwork mineralized material for optimization of mineral concentration and chemical concentration processes.

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Initial metallurgical testing of Heavy Rare Earth Elements (HREEs) enriched oxide material at the Whitetail Ridge, Carbon REE and East Taylor REE deposits.

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Perform market testing from product produced by the pilot plant.

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Completion of a Definitive Feasibility Study, which is anticipated mid-year 2013.

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Start of the formal National Environmental Policy Act EIS process in 2012.

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Start of the formal Land Quality Division of the Wyoming Department of Environmental Quality permitting process in the second quarter of 2013.

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Continue to add key personnel during 2012 to develop the corporate infrastructure to support the current project development and future planned production operation.

Property Update

On April 12, 2012, we announced revised results of a PFS for the Bear Lodge Project. This revision supersedes the previous announcement made March 1, 2012. After consultation with Roche Engineering, Inc. (Roche), the independent engineering company that completed the PFS on behalf of Rare Element, several changes were made to optimize the Bear Lodge Project, including revised and improved estimates of both capital and operating costs. The revised and improved estimates are now based on an optimally-sized hydrometallurgical (hydromet) plant, and the recalibrated upside production sensitivity case is now based on 150% of the production rate of the Base Case. Sensitivity analyses are also presented utilizing a lower long-term price assumption. The PFS was principally authored by Roche Engineering Inc. (Roche). Roche undertook the process engineering and mine and mill capital and operating cost estimation in the PFS. Mr. Eric F. Laroche, P.Eng., Vice President of Operations, USA, of Roche is an independent qualified person as defined by Canadian National Instrument 43-101 *Standards of Disclosure for Mineral Projects* ("NI 43-101"), prepared or supervised the preparation of material on behalf of Roche. Mr. Michael P. Richardson, P.E., of John T. Boyd and Company of Denver, Colorado, an independent qualified person as defined by NI 43-101, prepared the mine plan for the PFS. Jaye T. Pickarts, P.E. is COO of Rare Element, a qualified person as defined by NI 43-101 prepared the metallurgy and process development and Mr. Alan C. Noble, P.E., of Ore Reserves Engineering ("ORE") of Lakewood, Colorado, an independent qualified person as defined by NI 43-101, prepared the mineral resource estimate. The technical report summarizing the results of the PFS is entitled "Rare Element Resources Inc. Bear Lodge Project Canadian NI 43-101 Technical Report on the Mineral Reserves and Development of the Bull Hill Mine," is dated April 13, 2012; and is available on SEDAR at www.sedar.com. The qualified persons listed above have reviewed the below technical disclosures.

Mineral Reserves and Resources

The Bull Hill Mine is planned as a conventional truck and shovel open-pit operation that will extract near-surface proven and probable mineral reserves consisting of a diluted 6.3 million tons averaging 3.6% total rare-earth oxide (TREO or REO), plus 1.6 million tons of lower-grade stockwork material averaging 1.1% TREO. The mineral reserve is derived from a measured and indicated (M&I) mineral resource of 6.8 million tons averaging 3.75% TREO. Located within the pit is another 4.5 million tons of high-grade oxide inferred mineral resource that will be the subject of further drilling in 2012 with a goal to upgrade the resource category. An additional 12 million tons of near-surface high-grade inferred resources occurs outside the pit area, plus there is considerable exploration potential in the district for more of the HREE-enriched oxidized types of resources.

Since the Company reports its Mineral Reserves to both NI 43-101 and SEC Industry Guide 7 standards, it is possible for its mineral reserve figures to vary between the two. Where such a variance occurs it will arise from the differing requirements for reporting mineral reserves. For example, NI 43-101 has a minimum requirement that mineral reserves be

supported by a pre-feasibility study, whereas SEC Industry Guide 7 requires support from a detailed feasibility study that demonstrates that economic extraction is justified. For the mineral reserves at March 31, 2012, there is no difference between the mineral reserves as disclosed under NI 43-101 and those disclosed under SEC Industry Guide 7, and therefore no reconciliation is provided. These estimates are discussed in more detail below.

Cut-Off Grade	Oxides >1.5%		Oxide Stockwork >1.0%%		Total	
Reserve Classification	Short tons (in millions)	Average Grade (% TREO)	Short tons (in millions)	Average Grade (% TREO)	Short tons (in millions)	Average Grade (% TREO)
Proven	1.9	3.81	0.5	1.13	2.4	3.26
Probable	4.4	3.54	1.1	1.10	5.5	3.06
Proven & Probable	6.3	3.62	1.6	1.11	7.9	3.12

Cautionary Note to US Investors concerning estimates of Measured and Indicated Mineral Resources

This section uses the terms "Measured Mineral Resources" and "Indicated Mineral Resources." The Company advises US investors that while these terms are recognized and required by Canadian regulations, the US Securities and Exchange Commission does not recognize them. US investors are cautioned not to assume that any part or all of the mineral deposits in these categories will ever be converted into mineral reserves.

The Measured and Indicated Mineral Resources reported below are exclusive of the Proven and Probable Mineral Reserves as shown above and have been estimated in compliance with definitions set out in Canada's National Instrument 43-101.

Cut-Off Grade	Oxides >1.5%		Oxide Stockwork >1%		Total	
Resource Classification	Short tons (in millions)	Average Grade (% TREO)	Short tons (in millions)	Average Grade (% TREO)	Short tons (in millions)	Average Grade (% TREO)
Measured	-	-	0.2	1.20	0.2	0.95
Indicated	0.3	2.84	0.4	1.14	0.7	1.92
Measured & Indicated	0.3	2.84	0.6	1.16	0.9	1.71

Cautionary Note to US Investors concerning estimates of Inferred Mineral Resources

This section uses the term "Inferred Mineral Resources." We advise US investors that while this term is recognized and required by NI 43-101, the US Securities and Exchange Commission does not recognize it. "Inferred Mineral Resources" have a great amount of uncertainty as to their existence, and great uncertainty as to their economic and legal feasibility. It cannot be assumed that all or any part of Inferred Mineral Resources will ever be upgraded to a higher category. In accordance with Canadian rules, estimates of Inferred Mineral Resources cannot form the basis of feasibility or other economic studies. US investors are cautioned not to assume that any part or all of the Inferred Mineral Resource exists, or is economically or legally mineable.

Cut-Off Grade	Oxides >1.5%		Transitional and Sulfides >1.5%		Total	
Resource Classification	Short tons (in millions)	Average Grade (% TREO)	Short tons (in millions)	Average Grade (% TREO)	Short tons (in millions)	Average Grade (% TREO)
Inferred	16.5	2.76	7.7	2.74	24.2	2.74

Description of Metal Markets

REEs are used in hybrid-electric-vehicles (HEV) and all-electric vehicles, many of which contain REE-bearing nickel-metal-hydride (Ni-MH) batteries and REE super magnets within electrical motors and generators; REE are also used in computers, cellular telephones, TV screens, wind turbines, fuel cells, magnetic refrigeration technologies, compact fluorescent lights, petroleum-refining catalysts and numerous other modern specialty technologies.

The markets for REE have become more significant in recent years as more of these new technologies are developed. Currently REE markets are dominated by production from China, which produced over 95 percent of the world s REEs in recent years. For the past eight years and most recently in the summer of 2010, China has reduced its exports of REE by 40 percent and increased related export taxes, which has significantly increased producer sales prices since that time.

The prices of REEs are quoted in different forms, including rare-earth carbonate concentrates that contain approximately 42 percent to 45 percent TREOs, which can be marketed and sold in such form. REEs more commonly can be separated into individual oxides and sold or are sold in small sub-groups of similar elements.

According to www.metal-pages.com (Metal Pages), the prices of REEs increased approximately 2000 to 3000 percent, depending on the element, from July 2010 to August 2011, and then prices began decreasing through the end of 2011. For example, according to Metal Pages, the prices of REE carbonate concentrates increased from $4,500 per metric tonne ($4.50/kg) in early July 2010 to approximately $38,000 per tonne ($38/kg) in October through December 2010. REE carbonate concentrate prices remained steady at $38 per kilogram throughout 2011. REO prices of individual oxides increased considerably during the first two quarters of 2011 but declined in the third and fourth quarters.

Since REEs are used for many new technologies, it is estimated that the demand for REE will increase at a rate of seven to 10 percent per year for the next 5 to 10 years and possibly longer. Rare-earth magnet demand using Nd, Pr, Dy and Tb is expected to increase annually at a rate of 10 to 15 percent.

Risks and Uncertainties

Our operations are subject to certain risks and uncertainties that may impact our financial results. For a full list of such risks and uncertainties, please see Item 1A. Risk Factors and Uncertainties in our Annual Report on Form 10-K filed with the SEC on September 28, 2011.

Our failure to successfully address these risks and uncertainties would have a material adverse effect on our business, financial condition and/or results of operations. Consequently, the trading price of our common shares may decline and investors may lose all or part of their investment in Rare Element. We cannot assure you that we will successfully address these risks and uncertainties or other unknown risks and uncertainties that may affect our business.

Results of Operations

Results of operations

Our consolidated net loss for the three-month period ended March 31, 2012 was $5,317 or $0.12 per share as compared with a net loss of $1,633 or $0.04 per share for the same period in 2011, which is an increase of $3,684. Our consolidated net loss for the nine-month period ended March 31, 2012 was $26,379 or $0.60 per share as compared with a net consolidated loss of $9,509 or $0.25 per share for the same period in 2011, which is an increase of $16,870. For both the three and nine-month periods, the increases in net loss are primarily due to an increase in exploration expense of $1,495 and $5,694, respectively, an increase in stock-based compensation expense of $158 and $5,444, respectively, as well as a decrease in the gain on foreign currency translation of $881 and $5,244, respectively.

Exploration expense

Exploration expense for the three and nine-month periods ended March 31, 2012 was $2,599 and $12,392, respectively, as compared with $1,104 and $6,698 for the same periods in 2011, respectively. The increases for both the three and nine-month periods are due to additional exploration work, including the pre-feasibility study, at the Bear Lodge Project.

Gain/(loss) on currency translation

A gain on currency translation of $1,452 was recognized for the three-month period ended March 31, 2012, as compared with $2,333 for the same period in 2011. A loss on currency translation of $1,234 was recognized for the nine-month period ended March 31, 2012 as compared with a foreign exchange gain of $4,010 for the same period in 2011. The decrease in the foreign exchange gain of $881 for the three-month period and the increase in the foreign exchange loss of $5,244 for the nine-month period were due to the majority of our cash balances being in Canadian dollars during a period when the US dollar (our reporting currency) has appreciated against the Canadian dollar. In the future, we intend to hold between six months and twelve months of US-based spending in US dollars as a natural hedge against currency fluctuations.

Interest income

Interest income was $151 and $689 for the three and nine-month periods ended March 31, 2012, respectively, as compared to $261 and $333 for the same periods in 2011. The decrease of $110 for the three-month period is due primarily to a decrease in cash balances from the prior three-month period. The increase of $356 from the respective nine-month period is due to an increase in interest earned on the funds that we held in financial institutions as a result of increased average cash balances over the nine-month period.

Stock-based compensation

Non-cash stock-based compensation was $2,827 and $8,868 for the three and nine-month periods ended March 31, 2012, respectively, as compared to $2,669 and $3,424 for the same periods in 2011. The increases of $158 and $5,444 from the respective prior periods was the result of an increase in stock options granted during the latter part of the fiscal year ended June 30, 2011, and the subsequent amortization expense associated with the awards as they vest over time.

Liquidity and Capital Resources

Liquidity and capital resources for the three and nine months ended March 31, 2012

Our working capital as at March 31, 2012 was $55,031 (June 30, 2011 - $71,953). As at March 31, 2012, cash totaled $35,978, representing a decrease of $36,334 from June 30, 2011. This decrease is mostly the result of our purchase of short-term investments of $20,054 during the period ended March 31, 2012.

During the nine-month period ended March 31, 2012, 159,000 options were exercised for gross proceeds of $215. We spent $352 on the purchase of equipment. We also spent $16,253 on our operating activities, of which $1,200 relates to the foreign exchange loss as a result of the majority of our cash and cash equivalents being held in Canadian dollars.

We estimate that the current cash position and future cash flows from warrant and option exercises and potential equity or debt financing will be sufficient for us to carry out our anticipated exploration and operating plans through 2013.

We are of the opinion that sufficient financing will be obtained from external financing and further share issuances to meet our obligations. Although we have been successful in raising such capital in the past, there can be no assurance that we will be able to do so in the future. At March 31, 2012, we had working capital of $55,031, which we expect will be sufficient to fund operations for a period greater than twelve months.

Asset Retirement Obligations

An asset retirement obligation of $101 was recognized in the quarter ended March 31, 2012 for our current obligations to reclaim areas used for exploring the Bear Lodge Property. As we disturb more property, we will record an increase in our asset retirement obligations. We evaluated our current reclamation obligation at March 31, 2012 and concluded that the outstanding amount reserved approximated the value of our current obligation.

Potential Environmental Contingency

Our mining and exploration activities are subject to various federal, provincial and state laws and regulations governing the protection of the environment. These laws and regulations are continually changing and generally becoming more restrictive. We conduct our operations so as to protect public health and the environment and believe our operations are in compliance with all applicable laws and regulations. We have made, and expect to make in the future, expenditures to comply with such laws and regulations. The ultimate amount of reclamation and other future site restoration costs to be incurred is uncertain.

Transactions with Related Parties

During the three and nine months ended March 31, 2012:

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$46 and $96, respectively, was charged for consulting fees by the Chairman of the Board of Directors of Rare Element. As at March 31, 2012, there were no outstanding amounts owed to the Chairman.

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During the quarter ended March 31, 2012, Mark Brown resigned from the Board of Directors. At that time he ceased to be a related party and the company which he controlled also ceased to be a related party. As such, there were no related party charges associated with Mark Brown or his company during the three months ended March 31, 2012. During the nine months ended March 31, 2012, $162 was charged by Mark Brown s private company for accounting, management fees and rent.

Related party transactions were in the normal course of operations and are measured at fair value. The amounts owed bear no interest and are unsecured with no repayment terms.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

Contractual Obligations

There were no material changes to the contractual obligations disclosed in Item 7 of Part II in our Form 10-K for the fiscal year ended June 30, 2011.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCUSSION ABOUT MARKET RISK

Market risk. Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: interest rate risk, foreign currency risk, and other price risk.

Interest rate risk. Our cash and cash equivalents consist of cash held in bank accounts and guaranteed investment certificates that earn interest at variable interest rates. Due to the short-term nature of these financial instruments, fluctuations in market rates do not have a significant impact on estimated fair values as of March 31, 2012. Future cash flows from interest income on cash and cash equivalents will be affected by interest rate fluctuations. We manage interest rate risk by maintaining an investment policy that focuses primarily on preservation of capital and liquidity.

Foreign currency risk. We are exposed to foreign currency risk as monetary financial instruments are primarily denominated in Canadian Dollars. We have not entered into any foreign currency contracts to mitigate this risk. We attempt to mitigate this risk by holding six to twelve months of US-based spending in US dollars as a natural hedge against currency fluctuations. At March 31, 2012, a 1% fluctuation in the Canadian dollar to U.S. dollar exchange rate would have impacted our consolidated net loss by $283.

Other price risk. Other price risk is the risk that the fair or future cash flows of a financial instrument will fluctuate because of changes in market prices, other than those arising from interest rate risk or foreign exchange risk. We are not exposed to significant other price risk.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, an evaluation was carried out under the supervision of and with the participation of our management, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of the design and operations of our disclosure controls and procedures (as defined in Rule 13(a)-15(e) and Rule 15(d)-15(e) under the Exchange Act). Based on that evaluation, the CEO and the CFO have concluded that as of the end of the period covered by this quarterly report, our disclosure controls and procedures were effective in ensuring that: (i) information required to be disclosed by us in reports that we file or submit to the SEC under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in applicable rules and forms and (ii) material information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow for accurate and timely decisions regarding required disclosure.

Changes in Internal Controls

There has been no change in our internal control over financial reporting during the quarter ended March 31, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are not aware of any material pending or threatened litigation or of any proceedings known to be contemplated by governmental authorities which are, or would be, likely to have a material adverse effect upon us or our operations, taken as a whole. There are no material proceedings pursuant to which any of our directors, officers or affiliates or any owner of record or beneficial owner of more than 5% of our securities or any associate of any such director, officer or security holder is a party adverse to us or has a material interest adverse to us.

ITEM 1A. RISK FACTORS

Except for the below, there were no material changes to the risk factors disclosed in Item 1A of Part I in our Form 10-K for the fiscal year ended June 30, 2011.

Potential development of the Bear Lodge Project depends on numerous factors, including obtaining a positive definitive feasibility study.

Although we recently announced the results of the positive PFS with respect to the Bear Lodge Project, including updated mineral reserve and mineral resource estimates, our ability to develop the project and bring it into commercial production is subject to numerous risks and uncertainties. We intend to engage independent consultants to prepare a definitive feasibility study on the Bear Lodge Project, but there can be no assurance that the results of the definitive feasibility study will be positive or that such study will be completed when expected. Even if the results of the definitive feasibility study are positive, substantial expenditures are required to develop the Bear Lodge Project and to construct the associated processing facilities and infrastructure. These costs and expenditures may be significantly greater than those estimated in the PFS or definitive feasibility study. We may be unable to raise the financing required to complete these development activities and commence mining operations at the Bear Lodge Projects on terms acceptable to us, which could result in significant delays or the indefinite postponement of the project.

There may be delays in commencement of construction on the Bear Lodge Project.

Once the definitive feasibility study is obtained, delays in commencement of construction could result from delays in receiving the required governmental permits or approvals or from factors such as availability and performance of engineering and construction contractors, suppliers and consultants and the unavailability of required equipment. There can be no assurance as to whether or when construction at the Bear Lodge Project will commence or that the necessary personnel, equipment or supplies will be available to us if and when construction is commenced. If we are unable to acquire permits to mine the property, then we will have no reserves under SEC Industry Guide 7 and NI 43-101, which could result in an impairment and write down of the carrying value of the project.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

We consider health, safety and environmental stewardship to be a core value for Rare Element.

Pursuant to Section 1503(a) of the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act (The Dodd-Frank Act), issuers that are operators, or that have a subsidiary that is an operator, of a coal or other mine in the United States are required to disclose in their periodic reports filed with the SEC information regarding specified health and safety violations, orders and citations, related assessments and legal actions, and mining-related fatalities under the regulation of the Federal Mine Safety and Health Administration (MSHA) under the Federal Mine Safety and Health Act of 1977 (the Mine Act). During the quarter ended March 31, 2012 the Bear Lodge Project was not yet in production and as such, was not subject to regulation by the MSHA under the Mine Act.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit Number	Description of Exhibits
23.1	Consent of Michael P. Richardson, P.E
23.2	Consent of Ore Reserves Engineering
31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14 and Rule 15d-14(a), promulgated under the Securities and Exchange Act of 1934, as amended
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14 and Rule 15d-14(a), promulgated under the Securities and Exchange Act of 1934, as amended
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act
32.2	Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act
101.INS(1)	XBRL Instance Document
101.SCH(1)	XBRL Taxonomy Extension Schema Document
101.CAL(1)	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF(1)	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB(1)	XBRL Taxonomy Extension Label Linkbase Document
101.PRE(1)	XBRL Taxonomy Extension Presentation Linkbase Document

(1) Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Act of 1934 and otherwise are not subject to liability.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

RARE ELEMENT RESOURCES LTD.

By:

/s/ Randall J. Scott
Randall J. Scott
President, Chief Executive Officer and Director
(Principal Executive Officer)

Date: May 10, 2012

RARE ELEMENT RESOURCES LTD.

By:

/s/ David P. Suleski
David P. Suleski
Chief Financial Officer
(Principal Financial Officer
and Principal Accounting Officer)

Date: May 10, 2012

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