



back *to* basics



2002 ANNUAL REPORT

company profile

SANDERSON FARMS 2002 ANNUAL REPORT



Sanderson Farms, Inc. is engaged in the production, processing, marketing and distribution of fresh and frozen chicken and other prepared food items. The Company sells its chicken products primarily under the Sanderson Farms® brand name to retailers, distributors and casual dining operators in the southeastern, southwestern and western United States. Through its foods division, the Company also sells, under the Sanderson Farms® name, processed and prepared frozen entrees and other specialty food products to distributors, food service establishments and retailers.

The common shares of Sanderson Farms, Inc. are traded on the Nasdaq National Market under the symbol SAFM.

financial highlights

SANDERSON FARMS 2002 ANNUAL REPORT

	OCTOBER 31	
	2002	2001
	<i>(In thousands, except per share data)</i>	
THE FISCAL YEAR		
Net sales	\$ 743,665	\$ 706,002
Net income	\$ 28,840	\$ 27,784
Basic earnings per share	\$ 2.18	\$ 2.04
Diluted earnings per share	\$ 2.15	\$ 2.04
Dividends per share	\$.40	\$.20
Weighted average shares outstanding:		
Basic	13,200	13,596
Diluted	13,429	13,640
AT FISCAL YEAR-END		
Working capital	\$ 68,452	\$ 76,969
Total assets	\$ 280,510	\$ 288,971
Long-term debt, less current maturities	\$ 49,969	\$ 77,212
Stockholders' equity	\$ 155,891	\$ 144,339

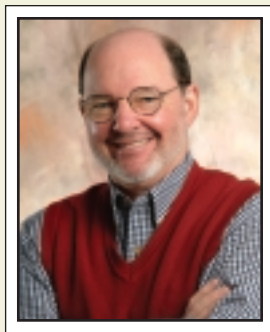
letter *to* shareholders

SANDERSON FARMS 2002 ANNUAL REPORT

Sanderson Farms demonstrated strong execution in fiscal 2002, marking another year of growth and progress in spite of a volatile economy and difficult market conditions for our industry. The extraordinary events of the past year have clearly demonstrated that strong companies with basic, sound business models are able to remain stable even through challenging times. Following a decade of rapid growth at Sanderson Farms, our return to the basics of our operations has resulted in lower costs, more efficient operations, impressive sales execution and a return to the top of our industry in terms of both operations and profitability.

We are pleased to report record annual sales of \$743.7 million, a 5.3% increase compared with net sales of \$706.0 million for fiscal 2001. This growth reflects a 10.9% increase in poultry pounds sold compared with the prior year. We reported net income of \$28.8 million, or \$2.15 per diluted share, for fiscal 2002, compared with net income of \$27.8 million, or \$2.04 per diluted share, for fiscal 2001. During the year, the Company recognized a total of \$3.1 million, net of income taxes, or \$0.23 per diluted share, for Sanderson Farms' share in the settlement of class action lawsuits against vitamin suppliers and a methionine supplier for overcharges. Excluding these special items, net income was \$25.7 million, or \$1.92 per diluted share, for fiscal 2002.

During fiscal 2002, we experienced an increasingly difficult market beginning in the second quarter, and, as a result, our average sales price for poultry products dropped 6.3% for the year. While prices for whole chickens and boneless breast meat were up slightly, this modest gain was offset by a precipitous drop in market prices for leg quarters and wings. Bulk leg quarter prices fell 23.9% for the year, primarily due to the impact of the Russian embargo of United States poultry meat and the resulting increase of product in the domestic market. Wing prices were also down 33.1% for the year. In addition to the decline in market prices, our overall cost structure was affected by increases in the cash market prices for corn and soybean meal, our primary feed ingredients. However, despite lower market prices and higher grain costs, our operating income for fiscal 2002 was \$50.0 million,



JOE F. SANDERSON, JR.

a modest decline from \$51.1 million in the prior year. We believe these results reflect the consistent execution of our operating strategy and our ability to adapt to changing market conditions.

Our export business in fiscal 2002 was significantly affected by the ban on United States poultry products imposed on March 10, 2002, by Russia. The interruption in access to the world's largest poultry importer adversely affected our entire industry, placing excess supply in the domestic market. It is difficult to determine what the Russian embargo, and the subsequent negative impact on market prices for leg quarters, cost the Company during the year. However, its impact on Sanderson Farms and our industry was dramatic. While shipments to Russia resumed on a limited basis during the last quarter of our fiscal year, it will be hard to determine exactly when volumes will return to historical levels until the new protocol governing future shipments is more clearly defined. We do expect, however, that shipments to Russia will continue to slowly move toward normalization during fiscal 2003.

We are pleased with Sanderson Farms' strong sales and operating execution in light of the uncertainties in the market and inconsistent prices for poultry products. Our ability to focus on the key areas for success in our business – delivering a favorable product mix and outstanding customer service, efficiently managing our operations, and reducing our production costs – allowed us to deliver another year of strong earnings for our shareholders in fiscal 2002. More importantly, we believe we have defined a clear strategy to fully leverage our assets and maximize our opportunities going forward.

letter to shareholders

SANDERSON FARMS 2002 ANNUAL REPORT

Our strong marketing execution has allowed us consistently to deliver a favorable product mix in our target markets. One of Sanderson Farms' strengths is our ability to adapt to ongoing changes in the dining preferences of consumers. We have continued to focus on the production and marketing of value-added products that meet the demands of our customers. With over 200 food items in our processed and prepared foods product line, we are able to serve a wide array of food service accounts, club stores and national distributors. Our improved retail sales reflect the strength of the Sanderson Farms brand name as we continued to grow our volume in fresh chicken chill pack sales. Commitment to quality and dedication to customer service are synonymous with the Sanderson Farms name, and we strive to ensure that we meet and exceed our customers' expectations. We place a high value on our reputation in the market and believe our focus on excellence in all aspects of our business is a distinct competitive advantage for the Company.

Our operations continued to run at near full capacity throughout fiscal 2002, allowing us to process over 264 million chickens, or 1.3 billion dressed pounds, and positioning the Company as the seventh largest processor of dressed chickens in the United States. Our operating achievements reflect the benefits of our strategic market shift over the past two years to increase the average live weight of chickens and focus our production and processing on higher-margin products. Another phase of this strategic shift was completed during the first quarter of fiscal 2002 when we converted our Hazlehurst, Mississippi, processing facility from a small bird plant to a big bird plant. As a result of the volume increases and additional plant efficiency improvements, we reduced our overall plant costs, improved our live grow-out operations, and reduced our overall cost per pound by 5.8%. We further leveraged the success of our operating strategy with the conversion of our Hammond, Louisiana, processing facility to a larger live weight plant during the first fiscal quarter of 2003. We have also identified additional opportunities for improvement in our plants, in the field, and in sales, and look forward to further progress in our operating performance in 2003.

As reflected in our fiscal 2002 results, Sanderson Farms has proven its ability to operate at the top of our industry even in challenging times. When we speak of the Company's progress over the past year, we must also recognize the extraordinary efforts that many people – our employees, our customers and our growers – contribute to our ongoing success. The dedication and commitment of everyone involved with Sanderson Farms provide us with a solid foundation and, more importantly, give us the ability to look confidently into the future.

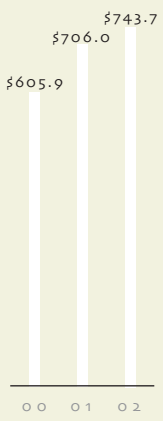
As we remain focused on the basics of our business – our products, our customers and our operations – we are confident that Sanderson Farms will continue to set a high standard for success in our industry. Above all, we are committed to delivering greater value to our shareholders. On behalf of everyone at Sanderson Farms, thank you for the support your investment provides.

Sincerely,



Joe F. Sanderson, Jr.

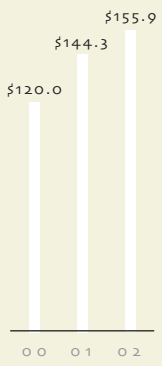
Chairman, President and Chief Executive Officer



NET SALES
(in millions)



POUNDS PROCESSED
(in millions)



STOCKHOLDERS' EQUITY
(in millions)





back *to* basics

SANDERSON FARMS 2002 ANNUAL REPORT

OVER THE PAST YEAR, our world has changed dramatically. The unspeakable tragedies of war and terrorism, a faltering economy, and unprecedented corporate upheavals have touched all of our lives, and will undoubtedly have a far-reaching impact in the future. Yet throughout this remarkable year, a new sense of unity and purpose has emerged to reshape our nation, and in many ways,

has renewed our spirit. People have stopped to consider what is really important, and basic traditional values of friendship, home and family have taken on a new and more meaningful familiarity. For Sanderson Farms, traditional values have always defined our approach to everything we do, and have allowed us to develop trusted relationships with our employees, our growers, our

back *to* basics

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customers, our communities, and our shareholders. We have selected the theme of “*back to basics*” for this year’s annual report because we believe it reflects the values that are as important to Sanderson Farms today as they were when the Company was founded over a half century ago. By sticking to the basics of our business, and doing what we do best even in challenging times, Sanderson Farms has continued to be recognized

as a respected leader in our industry.



TODAY SANDERSON FARMS ranks seventh among poultry producers in the country in terms of size, processing over five million chickens per week, and is positioned at the top of our industry in terms of operating efficiency and profitability. We take great pride in our strong tradition of providing quality products





back *to* basics

SANDERSON FARMS 2002 ANNUAL REPORT

and being responsive to the needs of our customers. Sanderson Farms has always been at the forefront of anticipating and meeting the changing demands of the marketplace. Over the past year, national consumer trends reveal that people are enjoying a simpler lifestyle and staying closer to home and family. Much of our success is due to our ability to connect with our customers, and, as a result, they know they can always

rely on Sanderson Farms to provide quality food products. Whether it is fresh chicken for a summer cookout or a holiday dinner, or prepared food items for busy working families, now, more than ever, our products meet the basic need for people to gather together over a nourishing meal. More importantly, we strive to constantly revise and offer a product line that reflects the changing taste preferences of our customers, and provides

back *to* basics

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the assurance of always serving their families fresh, high-quality products.



SANDERSON FARMS was built on a strong foundation of the basic traditional values of hard work, honesty, integrity and respect for the dignity of all individuals. Through the strength and character of our people, a firm commitment to quality, and unmatched dedication to customer

service, we have continued to deliver value to both our customers and our shareholders.

Furthermore, we are confident that the basic values that have defined our success in the past will continue to serve Sanderson Farms well into the future.



Sanderson
Farms®



*All natural chicken
No artificial ingredients
Specially prepared*

DRUM



STICKS



KEEP REFRIGERATED

message *from the* chief financial officer

SANDERSON FARMS 2002 ANNUAL REPORT

Sanderson Farms' solid financial performance in fiscal 2002 reflects our strategic focus on achieving higher productivity from our operations and a conservative approach to financial management. In spite of a difficult economy and challenging market conditions for the poultry industry, the Company delivered improvement in revenues and earnings, and maintained a balance sheet that is among the strongest in the poultry industry. We have always set a high priority on aggressively managing our working capital and other key components of our balance sheet, and are very pleased to report that Sanderson Farms' financial position and liquidity improved considerably over the fiscal year. More importantly, we have the financial flexibility to continue to pursue our growth strategy, as well as the ability to capitalize on new market opportunities as they present themselves.

At fiscal year-end, Sanderson-Farms' balance sheet reflects stockholders' equity of \$155.9 million, compared with \$144.3 million at the end of fiscal 2001, and net working capital of \$68.5 million, compared with \$77.0 million at the end of fiscal 2001. Our improved cash flow from operations reflects our ability to increase productivity and fully leverage our assets. More importantly, with the build-up in our cash position, we reduced our long-term debt by more than \$27.0 million over the last year. As of October 31, 2002, our total debt was \$53.2 million and our debt to total capitalization ratio was 25.5%. Due to our strong cash position at the end of the fiscal year, our net debt to total capitalization ratio stood at 21.9%, compared with 28.0% the prior year. Our interest expense for the year dropped significantly to \$3.7 million, compared with \$6.8 million in the prior fiscal year. On July 31, 2002, we amended our revolving credit facility to, among other things, increase the available credit from \$90 million to \$100 million, and extend the maturity date by one year. Substantially all of the Company's debt is unsecured, carries favorable interest rates and includes financial covenants allowing significant capacity for future investments.

Capital expenditures for fiscal 2002 totaled \$19.7 million, compared with \$14.6 million in fiscal 2001. The increase was primarily related to the conversion of our Hazlehurst, Mississippi, facility to a larger live weight plant during the first and second fiscal quarters, as well as general plant improvements for the Company's existing processing facilities. We expect that our capital expenditures for fiscal 2003 will be approximately \$20 million, and will again be funded by internally generated working capital and cash flows from operations. This amount includes budgeted items for a similar conversion to our Hammond, Louisiana, processing facility during the first fiscal quarter of 2003.

During fiscal 2002 we repurchased a total of 736,079 shares of our common stock in open market transactions and negotiated purchases pursuant to the stock buyback plan approved by our Board of Directors, and we doubled our annual dividend from \$.20 to \$.40 per share. In October, our Board of Directors approved a plan to extend the stock repurchase program for up to 1,000,000 additional shares of common stock at a purchase price not to exceed \$25.0 million over the next two years. The Company has repurchased 1,581,579 shares since the stock repurchase program was first instituted in January 1999. We believe that a stock repurchase program is a meaningful way to enhance shareholder value and represents an attractive use of capital for the Company. Both our substantial debt reduction and stock repurchase program in fiscal 2002 reflect our conservative approach to financial management and the consistent execution of our business strategy. Having a strong financial position provides not only a secure foundation, but serves to reinforce our confidence in Sanderson Farms' future.

As we enter fiscal 2003, we intend to continue to pursue a strategic direction that will meet our primary objective as a public company – to deliver greater value to our shareholders. We appreciate your unwavering support and the confidence in Sanderson Farms that your investment represents.

Sincerely,

A handwritten signature in black ink that reads "Mike Cockrell". The signature is fluid and cursive, with the first name "Mike" and last name "Cockrell" clearly distinguishable.

D. Michael Cockrell
Treasurer and Chief Financial Officer



MIKE COCKRELL

selected financial data

SANDERSON FARMS 2002 ANNUAL REPORT

	YEAR ENDED OCTOBER 31				
	2002	2001	2000	1999	1998
	<i>(In thousands, except per share data)</i>				
Net sales	\$743,665	\$706,002	\$605,911	\$559,031	\$521,394
Operating income (loss)	49,977	51,094	(588)	23,008	31,822
Net income (loss)	28,840	27,784	(5,571)	10,546	15,256
Basic earnings (loss) per share	2.18	2.04	(.41)	.75	1.06
Diluted earnings (loss) per share	2.15	2.04	(.41)	.75	1.06
Working capital	68,452	76,969	71,334	67,272	59,665
Total assets	280,510	288,971	281,856	283,510	265,671
Long-term debt, less current maturities	49,969	77,212	107,491	104,651	95,695
Stockholders' equity	155,891	144,339	120,015	130,844	129,482
Cash dividends declared per share	\$.40	\$.20	\$.20	\$.20	\$.20

quarterly financial data

	FISCAL YEAR 2002			
	FIRST QUARTER	SECOND QUARTER	THIRD QUARTER	FOURTH QUARTER
	<i>(In thousands, except per share data)</i>			
	<i>(Unaudited)</i>			
Net sales	\$164,527	\$175,413	\$202,694	\$201,031
Operating income	9,497	13,382	15,910	11,188
Net income	5,295	7,708	9,285	6,552
Basic earnings per share	\$.39	\$.59	\$.71	\$.50
Diluted earnings per share	\$.39	\$.58	\$.70	\$.49

	FISCAL YEAR 2001			
	FIRST QUARTER	SECOND QUARTER	THIRD QUARTER	FOURTH QUARTER
	<i>(In thousands, except per share data)</i>			
	<i>(Unaudited)</i>			
Net sales	\$152,081	\$163,583	\$183,692	\$206,646
Operating income	2,339	10,068	16,668	22,019
Net income	384	5,018	9,559	12,823
Basic and diluted earnings per share	\$.03	\$.37	\$.70	\$.94

management's discussion and analysis

SANDERSON FARMS 2002 ANNUAL REPORT

CAUTIONARY STATEMENT REGARDING RISKS AND UNCERTAINTIES THAT MAY AFFECT FUTURE PERFORMANCE

This Annual Report contains certain forward-looking statements about the business, financial condition and prospects of the Company. The actual performance of the Company could differ materially from that indicated by the forward-looking statements because of various risks and uncertainties, including, without limitation, changes in the market price for the Company's finished products and for feed grains, both of which may fluctuate substantially and exhibit cyclical characteristics typically associated with commodity markets, as described below; changes in competition and economic conditions; various inventory risks due to changes in market conditions; changes in governmental rules and regulations applicable to the Company and the poultry industry; and other risks described below. These risks and uncertainties cannot be controlled by the Company. When used in this Annual Report, the words "believes," "estimates," "plans," "expects," "should," "outlook," "anticipates," and similar expressions as they relate to the Company or its management are intended to identify forward-looking statements. For a more complete cautionary statement concerning the risks and uncertainties of forward-looking statements, please see "General" under Item 2 of the Company's Form 10-Q for the quarter ended July 31, 2002.

GENERAL

The Company's poultry operations are integrated through its control of all functions relative to the production of its chicken products, including hatching egg production, hatching, feed manufacturing, raising chickens to marketable age ("grow-out"), processing and marketing. Consistent with the poultry industry, the Company's profitability is substantially impacted by the market price for its finished products and feed grains, both of which may fluctuate substantially and exhibit cyclical characteristics typically associated with commodity markets. Other costs, excluding feed grains, related to the profitability of the Company's poultry operations, including hatching egg production, hatching, growing, and processing cost, are responsive to efficient cost containment programs and management practices. Over the past three fiscal years, these other production costs have averaged approximately 65.6% of the Company's total production costs.

The Company believes that value-added products are subject to less price volatility and generate a higher, more consistent profit margin than whole chickens ice packed and shipped in bulk form. To reduce its exposure to market cyclicality that has historically characterized commodity chicken market prices, the Company has increasingly concentrated on the production and marketing of value-added product lines with emphasis on product quality, customer service, and brand recognition. The Company adds value to its poultry products by performing one or more processing steps beyond the stage where the whole chicken is first saleable as a finished product, such as cutting, deep chilling, packaging and labeling the product. The Company believes that one of its major strengths is its ability to change its product mix to meet customer demands.

management's discussion and analysis

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The Company's processed and prepared foods product line includes approximately 200 institutional and consumer packaged food items that it sells nationally, primarily to distributors, food service establishments and retailers. A majority of the prepared food items are made to the specifications of food service users.

Poultry prices per pound, as measured by the Georgia dock price, fluctuated during the three fiscal years ended October 31, 2002, as follows:

	FIRST QUARTER	SECOND QUARTER	THIRD QUARTER	FOURTH QUARTER
Fiscal 2002				
High	\$.6500*	\$.6300	\$.6425	\$.6425
Low	\$.6275	\$.6250*	\$.6250*	\$.6275
Fiscal 2001				
High	\$.6150*	\$.6200	\$.6250	\$.6650*
Low	\$.6150*	\$.6175	\$.6450	\$.6500
Fiscal 2000				
High	\$.5850	\$.5800	\$.5975	\$.6200*
Low	\$.5800	\$.5725*	\$.5725	\$.6000

*Year High/Low

Fiscal 2001 as compared to fiscal 2000 brought significant increases in the average sales price of whole birds, wings and leg quarters with only modest decreases in market prices for boneless breast meat. In addition, the average cost of feed grains, while higher than the fiscal 2000 average, remained at relatively favorable levels during fiscal 2001. The overall favorable market conditions during fiscal 2001 were enhanced by the ongoing improvements to the Company's operations and marketing changes implemented over the past several years. During fiscal 2002, the Company continued to see improvements in the Company's sales program and operating performance. These improvements, however, were offset by overall lower prices for poultry products and higher grain prices during fiscal 2002 as compared to fiscal 2001.

RESULTS OF OPERATIONS

Fiscal 2002 Compared to Fiscal 2001

For the fiscal year ended October 31, 2002, net sales were \$743.7 million, a 5.3% increase compared with net sales of \$ 706.0 million for the prior year. Net sales of poultry products increased \$24.2 million or 3.8%. This increase in the net sales of poultry products resulted from an increase in the pounds of poultry products sold of 10.9%, which was partially offset by a decrease in the average sales price of poultry products of 6.3%. The increase in the pounds of poultry products sold during fiscal 2002 as compared to fiscal 2001 resulted from

management's discussion and analysis

SANDERSON FARMS 2002 ANNUAL REPORT

an increase in the average live weight of chickens produced of 8.2%. Overall market prices for poultry products were significantly lower during fiscal 2002 as compared to fiscal 2001 as leg quarters, wings and breast tenders were 23.9%, 33.1% and 19.1% lower, respectively. The softness in leg quarter prices resulted from the Russian embargo of United States poultry meat on March 10, 2002. Shipments to Russia resumed during the fourth quarter of fiscal 2002. However, these shipments resumed only on a limited basis, and it may be some time before volumes return to previous levels. As a result, leg quarter prices will remain under pressure in the near term. Net sales of prepared food products increased \$13.0 million, or 16.9%, during fiscal 2002 as compared to fiscal 2001. The increase reflects an increase in the pounds of prepared food products sold of 12.0% and an increase in the average sales price of prepared food products sold of 4.4%.

Cost of sales during fiscal 2002 increased \$36.5 million, or 5.8%, as compared to fiscal 2001, which is net of \$5.0 million in awards received from lawsuits against vitamin and methionine vendors. The Company is a party to lawsuits against various vitamin and methionine suppliers arising out of alleged price fixing activities by the defendants. During fiscal 2002 and through December 26, 2002, the Company recognized \$5.0 million as partial settlement of these lawsuits with various defendants. Settlement discussions are ongoing with the remaining defendants, and, based on prior settlement discussions and the results thereof and developments that have occurred subsequent to October 31, 2002, management believes it is likely that material settlement payments will be made to the Company by certain defendants during fiscal 2003.

Cost of sales of poultry products during fiscal 2002 increased \$24.1 million, or 4.3%. The increase in cost of sales of poultry products reflects a decrease in the average cost of sales per pound of poultry products of 5.9% as the Company benefited from improved operating performance, lower energy costs and the awards mentioned above. Cash market prices for corn and soy meal during fiscal 2002 as compared to fiscal 2001 increased 9.0%, and decreased 0.9%, respectively. However, during the fourth quarter of fiscal 2002 as compared to the fourth quarter of fiscal 2001 the cash market prices for corn and soy meal increased 25.4% and 4.9%, respectively. The Company expects corn and soy meal prices to be higher during fiscal 2003 than during fiscal 2002. Cost of sales of prepared food products during fiscal 2002 as compared to fiscal 2001 increased \$12.4 million, or 19.0%, due to an increase in pounds of prepared food products sold of 12.0%, an increase in the cost of raw materials and a change in the mix of products sold.

Selling, general and administration expenses for fiscal 2002 increased \$2.3 million compared to fiscal 2001. This increase was primarily due to expenses associated with the Company's employee incentive plan, an increase in allowance for doubtful accounts and increased contributions to the Company's Employee Stock Ownership Plan.

The Company's operating income during fiscal 2002 as compared to fiscal 2001 was approximately the same despite the challenging market environment the poultry industry

management's discussion and analysis

SANDERSON FARMS 2002 ANNUAL REPORT

experienced during fiscal 2002. The Company's operating income for fiscal 2002 was approximately \$50.0 million as compared to operating income during fiscal 2001 of \$51.1 million. The fiscal 2002 operating income reflects improved plant efficiency and live grow-out performance and the \$5.0 million in awards from the lawsuits against vitamin and methionine suppliers. Excluding these awards, the Company's operating income for fiscal 2002 was \$45.0 million.

As in fiscal 2001, the Company continued to decrease its outstanding debt during fiscal 2002. The Company decreased its debt during fiscal 2002 by \$27.2 million, which, along with lower interest rates, resulted in significantly lower interest expense. Interest expense for fiscal 2002 was \$3.7 million as compared to \$6.8 million for fiscal 2001, a decrease of \$3.1 million, or 45.6%. The Company expects interest expense to be lower during the first quarter of fiscal 2003 as compared to the first quarter of fiscal 2002.

The Company's effective tax rates for fiscal 2002 and fiscal 2001 were 38.0% and 37.9%, respectively.

Fiscal 2001 Compared to Fiscal 2000

The Company's net sales during fiscal 2001 were \$706.0 million, an increase of \$100.1 million, or 16.5%, over fiscal 2000 net sales of \$605.9 million. This increase in the Company's net sales resulted from an increase in pounds of poultry products sold of 9.6% and an increase in the average sales price of poultry products of 8.9%. The increase in the pounds of poultry products sold resulted from an increase in the number of chickens processed primarily from the expansion of the Brazos, Texas processing plant during the second half of fiscal 2000 and an increase in the average live weight of chickens processed. During fiscal 2001 the Company benefited from improved market prices for wings and leg quarters of 66.8% and 27.9%, respectively. In addition, a simple average of the Georgia Dock prices for whole birds for fiscal 2001 increased 7.3% as compared to fiscal 2000. These improvements were partially offset by lower average market prices for boneless breast meat. Net sales of prepared food products decreased \$1.6 million, or 2.0%, which is the net result of a decrease in the pounds of prepared food products sold of 4.5% partially offset by an increase in the average sale price of prepared food products of 2.6%.

During fiscal 2001 as compared to fiscal 2000, cost of sales increased \$46.6 million, or 8.0%. Cost of sales of poultry products increased \$47.5 million, or 9.2%, during fiscal 2001 as compared to fiscal 2000. The increase in the Company's cost of sales resulted from the increase in the pounds of poultry products sold of 9.6%, and to a lesser extent, increases in the average cost of feed grains. Corn and soybean meal cash market prices for fiscal 2001 as compared to fiscal 2000 increased 3.0% and 2.2%, respectively. Cost of sales of prepared food products during the fiscal year ended October 31, 2001 as compared to the fiscal year ended October 31, 2000, decreased approximately \$900,000, or 1.4%, as the Company eliminated less profitable prepared food sales.

management's discussion and analysis

SANDERSON FARMS 2002 ANNUAL REPORT

Selling, general and administrative expenses for fiscal 2001 increased \$1.9 million, or 7.0%, as compared to fiscal 2000. This increase resulted from contributions during fiscal 2001 to the Company's Employee Stock Ownership Plan and increased contributions to the Company's 401(k) Plan. The Company did not make contributions to the Employee Stock Ownership Plan in fiscal 2000 because of operating losses. Also, the increase reflects a charge during fiscal 2001 for the employee incentive program. These increases were partially offset by a planned reduction in the Company's advertising expenditures during fiscal 2001 as compared to fiscal 2000, and a nonrecurring bad debt expense of \$1.2 million during the second quarter of fiscal 2000 resulting from the bankruptcy filing by AmeriServe Food Distribution, Inc. on February 1, 2000.

The Company's operating income for fiscal 2001 was \$51.1 million as compared to an operating loss for fiscal 2000 of \$600,000, an improvement of \$52.5 million. The improvement in the Company's operating income reflects a continued strong performance by its prepared foods division, a significant increase in market prices for leg quarters and wings, and marketing changes the Company implemented over the past several years as well as ongoing improvements to the Company's operations.

During fiscal 2001 the Company was able to reduce its outstanding debt by approximately \$31.2 million. As a result, interest expense for fiscal 2001 was \$6.8 million as compared to \$8.2 million for fiscal 2000, a decrease of \$1.4 million most of which decrease came in the fourth fiscal quarter. During the fourth quarter of fiscal 2001 as compared to the fourth quarter of fiscal 2000 the Company's interest expense decreased \$1.0 million.

The Company's effective tax rates for fiscal 2001 and fiscal 2000 were 37.9% and 37.2%, respectively.

LIQUIDITY AND CAPITAL RESOURCES

The Company's working capital at October 31, 2002, was \$68.4 million and its current ratio was 2.2 to 1. This compares to working capital of \$77.0 million and a current ratio of 2.6 to 1 as of October 31, 2001. During fiscal 2002 the Company spent approximately \$19.7 million on planned capital projects and \$14.6 million to repurchase 736,079 shares of its common stock under its existing stock repurchase plan.

The Company's capital budget for fiscal 2003 is approximately \$19.4 million. The fiscal 2003 capital budget includes cost of renovations and changes and additions to existing processing facilities to allow better product flows and product mix. The Company expects that working capital and cash flows from operations will be sufficient in fiscal 2003 to fund the anticipated capital expenditures. However, if needed, the Company has available \$80.0 million under its revolving credit agreement as of October 31, 2002.

management's discussion and analysis

SANDERSON FARMS 2002 ANNUAL REPORT

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in accordance with accounting standards generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Management suggests that the Company's Summary of Significant Accounting Policies, as described in Note 1 of the Notes to the Consolidated Financial Statements, be read in conjunction with this Management's Discussion and Analysis of Financial Condition and Results of Operations. The Company believes the critical accounting policies and estimates that most impact the Company's Consolidated Financial Statements are described below.

ALLOWANCE FOR DOUBTFUL ACCOUNTS

In the normal course of business, the Company extends credit to its customers on a short-term basis. Although credit risks associated with its customers are considered minimal, the Company routinely reviews its accounts receivable balances and makes provisions for probable doubtful accounts. In circumstances where management is aware of a specific customer's inability to meet its financial obligations to the Company, a specific reserve is recorded to reduce the receivable to the amount expected to be collected.

INVENTORIES

Processed food and poultry inventories and inventories of feed, eggs, medication and packaging supplies are stated at the lower of cost (first-in, first-out method) or market. If market prices for poultry or feed grains move substantially lower, the Company would record adjustments to write down the carrying values of processed poultry and feed inventories to fair market value.

Live poultry inventories of broilers are stated at the lower of cost or market and breeders at cost less accumulated amortization. The cost associated with broiler inventories, consisting principally of chicks, feed, medicine and grower payments, are accumulated during the growing period. The cost associated with breeder inventories, consisting principally of breeder chicks, feed, medicine and grower payments are accumulated during the growing period. Capitalized breeder costs are then amortized over nine months using the straight-line method. Mortality of broilers and breeders is charged to cost of sales as incurred. High mortality from disease or extreme temperatures would result in abnormal charges to cost of sales to write-down live poultry inventories.

management's discussion and analysis

SANDERSON FARMS 2002 ANNUAL REPORT

LONG-LIVED ASSETS

Depreciable long-lived assets are primarily composed of buildings and machinery and equipment. Depreciation is provided by the straight-line method over the estimated useful lives, which are 19 to 39 years for buildings and 3 to 7 years for machinery and equipment. An increase or decrease in the estimated useful lives would result in changes to depreciation expense.

The Company continually reevaluates the carrying value of its long-lived assets, for events or changes in circumstances, which indicate that the carrying value may not be recoverable. As part of this reevaluation, the Company estimates the future cash flows expected to result from the use of the asset and its eventual disposal. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, an impairment loss is recognized to reduce the carrying value of the long-lived asset to the estimated fair value of the asset.

ACCRUED SELF INSURANCE

Insurance expense for workers' compensation benefits and employee-related health care benefits are estimated using historical experience and actuarial estimates. Stop-loss coverage is maintained with third-party insurers to limit the Company's total exposure. Management regularly reviews the assumptions used to recognize periodic expenses. However, actual expenses could differ significantly from these estimates.

INCOME TAXES

The Company determines its effective tax rate by estimating its permanent differences resulting from differing treatment of items for financial and income tax purposes. The Company is periodically audited by taxing authorities. Any audit adjustments affecting permanent differences could have an impact on the Company's effective tax rate.

management's discussion and analysis

SANDERSON FARMS 2002 ANNUAL REPORT

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Market Risk

The Company is a purchaser of certain commodities, primarily corn and soybean meal. As a result, the Company's earnings are affected by changes in the price and availability of such feed ingredients. As market conditions dictate, the Company from time to time will lock in future feed ingredient prices using forward purchase agreements with suppliers. The Company does not use such instruments for trading purposes and is not a party to any leverage derivatives.

The Company's interest expense is sensitive to changes in the general level of U.S. interest rates. The Company maintains certain of its debt as fixed rate in nature to mitigate the impact of fluctuations in interest rates. The fair value of the Company's fixed-rate debt approximates the carrying amount at October 31, 2002. Management believes the potential effects of near-term changes in interest rates on the Company's fixed-rate debt are not material.

The Company is a party to no other market risk sensitive instruments requiring disclosure.

consolidated balance sheets

SANDERSON FARMS 2002 ANNUAL REPORT

	OCTOBER 31	
	2002	2001
	(In thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 9,542	\$ 24,175
Accounts receivable, less allowance of \$663,000 in 2002 and \$303,000 in 2001	41,073	40,187
Inventories	57,964	52,350
Refundable income taxes	2,764	0
Prepaid expenses	12,121	9,452
Total current assets	123,464	126,164
Property, plant and equipment:		
Land and buildings	134,076	130,366
Machinery and equipment	255,590	248,621
	389,666	378,987
Accumulated depreciation	(233,183)	(216,801)
	156,483	162,186
Other assets	563	621
Total assets	\$ 280,510	\$ 288,971
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 25,258	\$ 20,309
Accrued expenses	26,511	25,708
Current maturities of long-term debt	3,243	3,178
Total current liabilities	55,012	49,195
Long-term debt, less current maturities	49,969	77,212
Claims payable	2,600	2,400
Deferred income taxes	17,038	15,825
Stockholders' equity:		
Preferred Stock:		
Series A Junior Participating Preferred Stock, \$100 par value: authorized shares-500,000; none issued; par value to be determined by the Board of Directors: authorized shares-4,500,000; none issued		
Common Stock, \$1 par value: authorized shares-100,000,000; issued and outstanding shares-13,051,026 in 2002 and 13,564,955 in 2001	13,051	13,565
Paid-in capital	0	2,945
Retained earnings	142,840	127,829
Total stockholders' equity	155,891	144,339
Total liabilities and stockholders' equity	\$ 280,510	\$ 288,971

See accompanying notes.

consolidated statements of income

SANDERSON FARMS 2002 ANNUAL REPORT

	YEAR ENDED OCTOBER 31		
	2002	2001	2000
	<i>(In thousands)</i>		
Net sales	\$ 743,665	\$ 706,002	\$ 605,911
Cost and expenses:			
Cost of sales	663,161	626,693	580,136
Selling, general and administrative	30,527	28,215	26,363
	693,688	654,908	606,499
Operating income (loss)	49,977	51,094	(588)
Other income (expense):			
Interest income	185	377	213
Interest expense	(3,681)	(6,753)	(8,195)
Other	(1)	54	69
	(3,497)	(6,322)	(7,913)
Income (loss) before income taxes and cumulative effect of accounting change	46,480	44,772	(8,501)
Income tax expense (benefit)	17,640	16,988	(3,164)
Income (loss) before cumulative effect of accounting change	28,840	27,784	(5,337)
Cumulative effect of accounting change (net of income taxes of \$140,000)	0	0	(234)
Net income (loss)	\$ 28,840	\$ 27,784	\$ (5,571)
Basic net income (loss) per share:			
Income (loss) before cumulative effect of accounting change	\$ 2.18	\$ 2.04	\$ (.39)
Cumulative effect of accounting change	0	0	(.02)
Net income (loss) per share	\$ 2.18	\$ 2.04	\$ (.41)
Diluted net income (loss) per share:			
Income (loss) before cumulative effect of accounting change	\$ 2.15	\$ 2.04	\$ (.39)
Cumulative effect of accounting change	0	0	(.02)
Net income (loss) per share	\$ 2.15	\$ 2.04	\$ (.41)
Weighted average shares outstanding:			
Basic	13,200	13,596	13,726
Diluted	13,429	13,640	13,726

See accompanying notes.

consolidated statements of stockholders' equity

SANDERSON FARMS 2002 ANNUAL REPORT

	COMMON STOCK SHARES	COMMON STOCK AMOUNT	PAID-IN CAPITAL	RETAINED EARNINGS	TOTAL STOCKHOLDERS' EQUITY
<i>(In thousands, except shares and per shares amount)</i>					
Balance at November 1, 1999	13,932,455	\$13,932	\$5,835	\$111,077	\$130,844
Net loss for year				(5,571)	(5,571)
Cash dividends (\$.20 per share)				(2,740)	(2,740)
Purchase and retirement of common stock	(299,500)	(299)	(2,219)		(2,518)
Balance at October 31, 2000	13,632,955	13,633	3,616	102,766	120,015
Net income for year				27,784	27,784
Cash dividends (\$.20 per share)				(2,721)	(2,721)
Purchase and retirement of common stock	(68,000)	(68)	(671)		(739)
Balance at October 31, 2001	13,564,955	13,565	2,945	127,829	144,339
Net income for year				28,840	28,840
Cash dividends (\$.40 per share)				(5,245)	(5,245)
Purchase and retirement of common stock	(736,079)	(736)	(5,320)	(8,584)	(14,640)
Issuance of common stock	222,150	222	2,375		2,597
Balance at October 31, 2002	13,051,026	\$13,051	\$0	\$142,840	\$155,891

See accompanying notes.

consolidated statements of cash flows

SANDERSON FARMS 2002 ANNUAL REPORT

	YEAR ENDED OCTOBER 31		
	2002	2001	2000
	<i>(In thousands)</i>		
OPERATING ACTIVITIES			
Net income (loss)	\$ 28,840	\$ 27,784	\$ (5,571)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Cumulative effect of accounting change	0	0	374
Depreciation and amortization	24,710	25,722	26,432
Provision for losses on accounts receivable	360	44	1,413
Deferred income taxes	1,340	(178)	340
Change in assets and liabilities:			
Accounts receivable	(1,246)	(3,193)	(1,874)
Inventories	(5,614)	(2,088)	(2,628)
Prepaid expenses and refundable income taxes	(5,560)	2,791	(3,647)
Other assets	(141)	(205)	30
Accounts payable	4,949	2,802	5,002
Accrued expenses and claims payable	1,003	11,173	463
Total adjustments	19,801	36,868	25,905
Net cash provided by operating activities	48,641	64,652	20,334
INVESTING ACTIVITIES			
Capital expenditures	(19,704)	(14,587)	(16,557)
Net proceeds from sale of property and equipment	896	86	217
Net cash used in investing activities	(18,808)	(14,501)	(16,340)
FINANCING ACTIVITIES			
Net change in revolving credit	(24,000)	(28,000)	6,000
Principal payments on long-term debt	(2,958)	(2,954)	(2,950)
Principal payments on capital lease obligation	(220)	(205)	(195)
Dividends paid	(5,245)	(2,721)	(2,740)
Purchase and retirement of common stock	(14,640)	(739)	(2,518)
Net proceeds from common stock issued	2,597	0	0
Net cash used in financing activities	(44,466)	(34,619)	(2,403)
Net change in cash and cash equivalents	(14,633)	15,532	1,591
Cash and cash equivalents at beginning of year	24,175	8,643	7,052
Cash and cash equivalents at end of year	\$ 9,542	\$ 24,175	\$ 8,643
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Income taxes paid (refunded), net	\$ 18,675	\$ 12,372	\$ (67)
Interest paid	\$ 3,993	\$ 6,920	\$ 8,728

See accompanying notes.

notes to consolidated financial statements

SANDERSON FARMS 2002 ANNUAL REPORT

I. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The consolidated financial statements include the accounts of Sanderson Farms, Inc. (the “Company”) and its wholly-owned subsidiaries. All significant intercompany transactions and accounts have been eliminated in consolidation.

Business: The Company is engaged in the production, processing, marketing and distribution of fresh and frozen chicken and other prepared food items. The Company’s net sales and cost of sales are significantly affected by market price fluctuations of its principal products sold and of its principal feed ingredients, corn and other grains.

The Company sells to retailers, distributors and casual dining operators primarily in the southeastern, southwestern and western United States. Revenue is recognized when product is delivered to customers. Revenue on certain international sales is recognized upon transfer of title, which may occur after shipment. Management periodically performs credit evaluations of its customers’ financial condition and generally does not require collateral. Shipping and handling costs are included as a component of cost of sales.

Use of Estimates: The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Cash Equivalents: The Company considers all highly liquid investments with maturities of ninety days or less when purchased to be cash equivalents.

Inventories: Processed food and poultry inventories and inventories of feed, eggs, medication and packaging supplies are stated at the lower of cost (first-in, first-out method) or market.

Live poultry inventories of broilers are stated at the lower of cost or market and breeders at cost less accumulated amortization. The costs associated with breeders, including breeder chicks, feed, medicine and grower pay, are accumulated up to the production stage and amortized over nine months using the straight-line method.

Property, Plant and Equipment: Property, plant and equipment is stated at cost. Depreciation of property, plant and equipment is provided by the straight-line and units of production methods over the estimated useful lives of 19 to 39 years for buildings and 3 to 7 years for machinery and equipment.

Impairment of Long-Lived Assets: The Company continually reevaluates the carrying value of its long-lived assets for events or changes in circumstances which indicate that the carrying value may not be recoverable. As part of this reevaluation, the Company estimates the future

notes to consolidated financial statements

SANDERSON FARMS 2002 ANNUAL REPORT

cash flows expected to result from the use of the asset and its eventual disposal. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, an impairment loss is recognized through a charge to operations.

Income Taxes: Deferred income taxes are accounted for using the liability method and relate principally to cash basis temporary differences and depreciation expense accounted for differently for financial and income tax purposes. Effective November 1, 1988, the Company changed from the cash to the accrual basis of accounting for its farming subsidiary. The Taxpayer Relief Act of 1997 (the "Act") provides that the taxes on the cash basis temporary differences as of that date are payable over 20 years beginning in fiscal 1998 or in full in the first fiscal year in which the Company fails to qualify as a "Family Farming Corporation." The Company will continue to qualify as a "Family Farming Corporation" provided there are no changes in ownership control, which management does not anticipate during fiscal 2003.

Stock Based Compensation: The Company accounts for stock option grants in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees."

Earnings Per Share: Basic earnings per share is based upon the weighted average number of common shares outstanding during the year. Diluted earnings per share includes any dilutive effects of options, warrants, and convertible securities.

Fair Value of Financial Instruments: The carrying amounts for cash and temporary cash investments approximate their fair values. The carrying amounts of the Company's borrowings under its credit facilities and long-term debt also approximate the fair values based on current rates for similar debt.

Impact of Recently Issued Accounting Standards: Effective in fiscal 2001, the Company adopted FASB No. 133, "Accounting for Derivative Instruments and Hedging Activities," which required all derivatives to be recorded on the balance sheet at fair value. The adoption of this statement had no effect on the consolidated earnings and financial position of the Company.

In April 1998, the American Institute of Certified Public Accountants issued Statement of Position 98-5, "Reporting the Costs of Start-Up Activities," which requires that costs related to start-up activities be expensed as incurred. Prior to October 31, 1999, the Company capitalized its start-up costs. The Company adopted the provisions of the Statement of Position 98-5, "Reporting the Costs of Start-Up Activities," which required that costs related to start-up activities be expensed as incurred in its consolidated financial statements in the first quarter of fiscal 2000. The effect of adoption of SOP 98-5 during fiscal 2000 was to record a charge for the cumulative effect of an accounting change of \$234,000 (net of income taxes of \$140,000), or \$.02 per basic and diluted earnings per share.

notes to consolidated financial statements

SANDERSON FARMS 2002 ANNUAL REPORT

2. INVENTORIES

Inventories consisted of the following:

	OCTOBER 31	
	2002	2001
	<i>(In thousands)</i>	
Live poultry – broilers and breeders	\$ 33,392	\$ 30,649
Feed, eggs and other	7,389	6,597
Processed poultry	8,423	5,894
Processed food	4,507	4,918
Packaging materials	4,253	4,292
	<u>\$ 57,964</u>	<u>\$ 52,350</u>

3. LONG-TERM CREDIT FACILITIES AND DEBT

Long-term debt consisted of the following:

	OCTOBER 31	
	2002	2001
	<i>(In thousands)</i>	
Revolving credit agreement with banks (weighted average rate of 5.1% at October 31, 2002)	\$ 20,000	\$ 44,000
Term loan with an insurance company, accruing interest at 7.49%; due in annual principal installments of \$2,850,000	2,900	5,750
Term loan with an insurance company, accruing interest at 6.65%; due in annual principal installments of \$2,857,000, beginning in July 2004	20,000	20,000
Note payable, accruing interest at 5%; due in annual installments of \$161,400, including interest, maturing in 2009	957	1,065
6% Mississippi Business Investment Act bond – capital lease obligation, due November 1, 2012	3,055	3,275
Robertson County, Texas, Industrial Revenue Bonds accruing interest at a variable rate, 2.4% at October 31, 2002; with optional annual principal installments of \$900,000, due November 1, 2005	6,300	6,300
	<u>53,212</u>	<u>80,390</u>
Less current maturities of long-term debt	<u>3,243</u>	<u>3,178</u>
	<u>\$ 49,969</u>	<u>\$ 77,212</u>

notes to consolidated financial statements

SANDERSON FARMS 2002 ANNUAL REPORT

The Company has a \$100.0 million (\$80.0 million available at October 31, 2002) revolving credit agreement with four banks, which extends to fiscal 2005. Borrowings are at prime or below and may be prepaid without penalty. A commitment fee of .25% is payable quarterly on the unused portion of the revolver. Covenants related to the revolving credit and the term loan agreements include requirements for maintenance of minimum consolidated net working capital, tangible net worth, debt to total capitalization and current ratio. The agreements also establish limits on dividends, assets that can be pledged and capital expenditures.

Property, plant and equipment with a carrying value of approximately \$4,127,933 million is pledged as collateral to a note payable and the capital lease obligation.

The aggregate annual maturities of long-term debt at October 31, 2002 are as follows (in thousands):

FISCAL YEAR	AMOUNT
2003	\$ 3,243
2004	6,264
2005	11,285
2006	11,306
2007	11,333
Thereafter	9,781
	<u>\$ 53,212</u>

4. INCOME TAXES

Income tax expense (benefit) consisted of the following:

	YEAR ENDED OCTOBER 31		
	2002	2001	2000
	<i>(In thousands)</i>		
Current:			
Federal	\$ 14,670	\$ 15,518	\$ (3,600)
State	1,630	1,450	(44)
	16,300	16,968	(3,644)
Deferred:			
Federal	1,226	(264)	325
State	114	284	15
	1,340	20	340
	17,640	16,988	(3,304)
Less income tax expense applicable to cumulative effect of accounting change	0	0	140
Income tax expense (benefit) applicable to income (loss) before cumulative effect of accounting change	<u>\$ 17,640</u>	<u>\$ 16,988</u>	<u>\$ (3,164)</u>

notes to consolidated financial statements

SANDERSON FARMS 2002 ANNUAL REPORT

Significant components of the Company's deferred tax assets and liabilities were as follows:

	OCTOBER 31	
	2002	2001
	<i>(In thousands)</i>	
Deferred tax liabilities:		
Cash basis temporary differences	\$ 2,994	\$ 3,193
Property, plant and equipment	14,986	13,937
Prepaid and other assets	1,066	278
Total deferred tax liabilities	19,046	17,408
Deferred tax assets:		
Accrued expenses and accounts receivable	3,736	3,156
State net operating loss and credit carryforwards	0	282
Total deferred tax assets	3,736	3,438
Net deferred tax liabilities	\$ 15,310	\$ 13,970
Current deferred tax assets		
(included in prepaid expenses)	\$ 1,728	\$ 1,855
Long-term deferred tax liabilities	17,038	15,825
Net deferred tax liabilities	\$ 15,310	\$ 13,970

The differences between the consolidated effective income tax rate and the federal statutory rate are as follows:

	YEAR ENDED OCTOBER 31		
	2002	2001	2000
	<i>(In thousands)</i>		
Income taxes (benefit) at statutory rate	\$ 16,268	\$ 15,670	\$ (3,018)
State income taxes (benefit)	1,511	1,754	(19)
State income tax credit	0	(627)	0
Increase in deferred taxes			
for change in income tax rate	0	367	0
Other, net	(139)	(176)	(267)
Income tax expense (benefit)	\$ 17,640	\$ 16,988	\$ (3,304)

notes to consolidated financial statements

SANDERSON FARMS 2002 ANNUAL REPORT

5. EMPLOYEE BENEFIT PLANS

The Company has an Employee Stock Ownership Plan ("ESOP") covering substantially all employees. Contributions to the ESOP are determined at the discretion of the Company's Board of Directors. Total contributions to the ESOP were \$2,500,000 and \$2,300,000 in fiscal 2002 and 2001, respectively. The Company did not make a contribution to the ESOP in fiscal 2000.

The Company has a 401(k) Plan which covers substantially all employees after six months of service. Participants in the Plan may contribute up to the maximum allowed by IRS regulations. Effective July 1, 2000, the Company matches 100% of employee contributions to the 401(k) Plan up to 3% of each employee's compensation, and 50% of employee contributions between 3% and 5% of each employee's compensation. The Company's contributions to the 401(k) Plan totaled \$1,463,000 in fiscal 2002, \$1,411,000 in fiscal 2001 and \$457,000 in fiscal 2000.

6. STOCK OPTION PLAN

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for its employee stock options because the alternative fair value accounting provided for under FASB Statement No. 123, "Accounting for Stock-Based Compensation," requires use of option valuation models that were not developed for use in valuing employee stock options.

Under the Company's Stock Option Plan, 750,000 shares of Common Stock have been reserved for grant to key management personnel. Options granted in fiscal 2002, 2001 and 2000 have ten-year terms and vest over four years beginning one year after the date of grant.

Pro forma information regarding net income (loss) and earnings (loss) per share is required by Statement 123, and has been determined as if the Company had accounted for its employee stock options under the fair value method of that Statement. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions: risk-free interest rate of 3.5% in fiscal 2002 and 5.0% in fiscal 2001 and 6.6% in fiscal 2000; dividend yields of 2.0% for fiscal 2002 and fiscal 2001 and 2.7% for fiscal 2000; volatility factors of the expected market price of the Company's Common Stock of .325 for fiscal 2002, .350 for fiscal 2001 and .302 for fiscal 2000; and a weighted-average expected life of the options of four years.

The weighted-average fair value of options granted was \$4.73 in fiscal 2002, \$3.24 in fiscal 2001 and \$1.94 in fiscal 2000. The pro forma effect of the estimated fair value of the options granted was insignificant to the Company's net income (loss) and net income (loss) per share in fiscal 2002, 2001 and 2000.

notes to consolidated financial statements

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A summary of the Company's stock option activity and related information is as follows:

	SHARES	WEIGHTED-AVERAGE EXERCISE-PRICE
Outstanding at November 1, 1999	582,000	\$ 12.90
Granted	141,000	7.47
Forfeited	(84,000)	11.60
Outstanding at October 31, 2000	639,000	11.83
Granted	71,500	11.10
Forfeited	(87,500)	11.11
Outstanding at October 31, 2001	623,000	11.81
Granted	322,886	18.05
Exercised	(222,150)	11.79
Forfeited	(2,000)	7.47
Outstanding at October 31, 2002	721,736	\$ 14.41

The exercise price of the options outstanding as of October 31, 2002, ranged from \$7.19 to \$18.55 per share. At October 31, 2002, the weighted average remaining contractual life of the options outstanding was 8 years and 305,537 options were exercisable.

In fiscal 2000, the Company granted 141,000 "phantom shares" to certain key management personnel. Upon exercise of a phantom share, the holder will receive a cash payment or an equivalent number of shares of the Company's Common Stock, at the Company's option, equal to the excess of the fair market value of the Company's Common Stock over the phantom share award value of \$7.47 per share. The phantom shares have a ten-year term and vest over four years beginning one year after the date of grant. Compensation expense of \$421,000 and \$555,000 is included in selling, general and administrative expense in the accompanying consolidated statement of income for fiscal 2002 and fiscal 2001, respectively. No compensation expense was recognized applicable to the phantom shares in fiscal 2000 because the award value exceeded the fair market value of the Company's Common Stock.

7. SHAREHOLDER RIGHTS AGREEMENT

On April 22, 1999, the Company adopted a shareholder rights agreement (the "Agreement") with similar terms as the previous one. Under the terms of the Agreement a one share purchase ("right") was declared as a dividend for each share of the Company's Common Stock outstanding on May 4, 1999. The rights do not become exercisable and certificates for the rights will not be issued until ten business days after a person or group acquires or announces a tender offer for the beneficial ownership of 20% or more of the Company's Common Stock. Special rules set forth in the Agreement apply to determine beneficial ownership for members of the Sanderson family. Under these rules, such a member will not be considered to beneficially own certain shares of Common Stock, the economic

notes to consolidated financial statements

SANDERSON FARMS 2002 ANNUAL REPORT

benefit of which is received by any member of the Sanderson family, and certain shares of Common Stock acquired pursuant to employee benefit plans of the Company.

The exercise price of a right has been established at \$75. Once exercisable, each right would entitle the holder to purchase one one-hundredth of a share of Series A Junior Participating Preferred Stock, par value \$100 per share. The rights may be redeemed by the Board of Directors at \$.01 per right prior to an acquisition, through open market purchases, a tender offer or otherwise, of the beneficial ownership of 20% or more of the Company's Common Stock, or by two-thirds of the Directors who are not the acquirer, or an affiliate of the acquirer prior to the acquisition of 50% or more of the Company's Common Stock by such acquirer. The rights expire on May 4, 2009.

8. OTHER MATTERS

On April 5, 2000, thirteen individuals claiming to be former hourly employees of the Company's processing subsidiary (Sanderson Farms, Inc. (Processing Division) (the "Processing Division")) filed a lawsuit in the United States District Court for the Southern District of Texas claiming that the Processing Division violated requirements of the Fair Labor Standards Act. The Plaintiffs' lawsuit also purported to represent similarly situated workers who filed consents to be included as plaintiffs in the suit. A total of 109 individuals consented to join the lawsuit.

The lawsuit alleges that the Processing Division (1) failed to pay its hourly employees "for time spent donning and doffing sanitary and safety equipment, obtaining and sharpening knives and scissors, working in the plant and elsewhere before and after the scheduled end of the shift, cleaning safety equipment and sanitary equipment, and walktime," and (2) altered employee time records by using an automated time keeping system. Plaintiffs further claim that the Processing Division concealed the alteration of time records and seek on that account an equitable tolling of the statute of limitations beyond the three-year limitation period back to the date the automated time-keeping system was allegedly implemented.

Plaintiffs sought an unspecified amount of unpaid hourly and overtime wages plus an equal amount as liquidated damages, for present and former hourly employees who file consents to join in the lawsuit. There were 6,476 hourly workers employed at the Processing Division's plants as of October 31, 2002.

On April 24, 2001, the Court granted the Processing Division's summary judgment motion and entered a final judgment in favor of the Processing Division. Plaintiffs appealed that decision to the United States Fifth Circuit Court of Appeals. On March 7, 2002, the United States Fifth Circuit Court of Appeals affirmed the decision of the United States District Court granting the Processing Division's motion for summary judgment. The plaintiffs had 90 days from March 7, 2002, to request that the United States Supreme Court hear an appeal of this case, which time has expired.

notes to consolidated financial statements

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On May 15, 2000, an employee of the Company's production subsidiary (Sanderson Farms, Inc. (Production Division) (the "Production Division")), filed suit against the Production Division in the United States District Court for the Southern District of Texas on behalf of live-haul drivers to recover an unspecified amount of overtime compensation and liquidated damages. Approximately 26 employees filed consents to join in this lawsuit.

Previously, the United States Department of Labor ("DOL") filed a similar suit against the Production Division in the United States District Court for the Southern District of Mississippi, Hattiesburg Division, on behalf of live-haul employees at the Production Division's Laurel, Mississippi facility. Both lawsuits were brought under the Fair Labor Standards Act and seek recovery of overtime compensation, together with an equal amount as liquidated damages, for live-haul employees (i.e., live-haul drivers, chicken catchers, and loader-operators) employed by the Production Division. The lawsuits assert that additional overtime compensation and liquidated damages may be owed to certain employees. The lawsuits also seek an injunction to prevent the withholding of overtime compensation to live-haul employees in the future.

On January 18, 2001, the United States District Court for the Southern District of Texas granted the Production Division's request to move the suit pending before that court to the Southern District of Mississippi, Hattiesburg Division. The Production Division later filed its motion with the United States District Court for the Southern District of Mississippi to have the two cases consolidated, which motion was granted. On February 4, 2002, the Production Division reached a settlement with the Department of Labor that fully and completely compromised and settled the claims of all live-haul employees in the Production Division, other than certain Production Division employees represented in a collective bargaining agreement in Texas. The settlement, approved by the court on March 11, 2002, and pursuant to which the Production Division paid during its second fiscal quarter (accrued during its first fiscal quarter) approximately \$450,000 in back pay and interest to the involved current and former employees in the Production Division's Mississippi and Texas operations, terminates the private rights of these employees under the Fair Labor Standards Act with respect to the claims made in this suit. With respect to approximately 74 employees represented under a collective bargaining agreement in Texas, the court entered its Order Granting Joint Motion for Court Approval of Settlement on November 4, 2002. The final settlement of this matter will become effective upon a ruling by the court on the plaintiff's request for award of attorney's fees. The court is scheduled to hear arguments on the attorney's fees issue on January 7, 2003. The Production Division will pay approximately \$188,000 in back pay to the Texas employees as part of the settlement, and this amount is accrued and reflected in the Company's accompanying consolidated financial statements.

Substantially similar lawsuits to those described above have been filed against other integrated poultry companies. In addition, organizing activity conducted by the representatives or affiliates of the United Food and Commercial Workers Union against the poultry industry has encouraged worker participation in these and the other lawsuits.

notes to consolidated financial statements

SANDERSON FARMS 2002 ANNUAL REPORT

On September 26, 2000, three current and former contract growers filed suit against the Company in the Chancery Court of Lawrence County, Mississippi. The plaintiffs filed suit on behalf of "all Mississippi residents to whom, between on or about November 1981 and the present, the Company induced into growing chickens for it and paid compensation under the so-called 'ranking system'." Plaintiffs allege that the Company "has defrauded plaintiffs by unilaterally imposing and utilizing the so-called 'ranking system' which wrongfully places each grower into a competitive posture against other growers and arbitrarily penalizes each less successful grower based upon criteria which were never revealed, explained or discussed with plaintiffs." Plaintiffs further allege that they are required to accept chicks that are genetically different and with varying degrees of healthiness, and feed of dissimilar quantity and quality. Finally, plaintiffs allege that they are ranked against each other although they possess dissimilar facilities, equipment and technology. Plaintiffs seek an unspecified amount in compensatory and punitive damages, as well as varying forms of equitable relief.

The Company is vigorously defending and will continue to vigorously defend this action. On November 22, 2002, the Court denied the Company's motions to compel arbitration, challenging the jurisdiction of the Chancery Court of Lawrence County, Mississippi, and seeking to have the case dismissed pursuant to rule 5(c) of the Mississippi Rules of Civil Procedure. The Company then filed its motion for interlocutory appeal on these issues with the Mississippi State Supreme Court. On December 6, 2002, the Mississippi State Supreme Court agreed to hear this motion and stayed the action in the Chancery Court pending disposition of this motion. This matter is pending. As with the wage and hour and donning and doffing lawsuits discussed above, substantially similar lawsuits have been filed against other integrated poultry companies.

On August 2, 2002, three contract egg producers filed suit against the Company in the Chancery Court of Jefferson Davis County, Mississippi. The Plaintiffs filed suit on behalf of "all Mississippi residents who, between June 1993 and the present, the Company fraudulently and negligently induced into housing, feeding and providing water for the Company's breeder flocks and gathering, grading, packaging and storing the hatch eggs generated by said flocks and who have been compensated under the payment method established by the Company." Plaintiffs alleged that the Company "has defrauded Plaintiffs by unilaterally imposing and utilizing a method of payment which wrongfully and arbitrarily penalizes each grower based upon criteria which are under the control of the Company and which were never revealed, explained or discussed with each Plaintiff." Plaintiffs allege that they were required to accept breeder hens and roosters which are genetically different, with varying degrees of healthiness, and feed of dissimilar quantity and quality. Plaintiffs further allege contamination of and damage to their real property. Plaintiffs alleged that they were "fraudulently and negligently induced into housing, feeding and providing water for the Company's breeder flocks and gathering, grading, packaging and storing the hatch eggs produced from said flocks" for the Company. Plaintiffs seek an unspecified amount of compensatory and punitive damages, as well as various forms of equitable relief. The Company will vigorously defend this lawsuit.

notes to consolidated financial statements

SANDERSON FARMS 2002 ANNUAL REPORT

On July 25, 2002, a current contract grower and her husband filed suit against the Company and Farmers State Bank, N.A. in the District Court of Milam County, Texas. The Plaintiffs alleged “a conspiracy to defraud Plaintiffs in connection with the Company’s promotion of a get-rich-quick scheme portrayed to Plaintiffs as a good investment for Plaintiff’s future.” The Plaintiffs further alleged that the Company and Farmers State Bank “conspired to defraud Plaintiffs by convincing them to purchase farm land, execute loan documents for the construction of chicken barns, and then forcing them to sign contracts of adhesion that made Plaintiffs the domestic servants of the defendants.” The Plaintiffs further alleged that the Company and Farmers State Bank violated the Texas Deceptive Trade Practices-Consumer Protection Act. Plaintiffs seek an unspecified amount in compensatory damages, treble damages, attorney’s fees, pre- and post-judgement interest and all costs of court. The Plaintiffs also seek a Permanent Injunction enjoining the Farmers State Bank from foreclosing on or otherwise taking possession or control of Plaintiff’s real estate and the improvements thereon and other equitable relief. On August 8, 2002, the court heard arguments on the Plaintiff’s motion for permanent injunction and on the Company’s motion to stay the proceeding with respect to its pending arbitration of the matter as required by the Egg Producers Contract entered into by and between one of the Plaintiffs and the Company. On August 19, 2002, the court granted the Company’s motion to compel arbitration in this case with respect to the Company and its grower pursuant to the arbitration provision of the contract. The case before the District Court of Milam County, Texas will be stayed pending arbitration between the Company and its grower. No arbitration date has been set. The Company will vigorously defend this matter.

The Company is also a party plaintiff to lawsuits against various vitamin and methionine suppliers arising out of alleged price fixing activities by the defendants. For more information about these lawsuits, please see Management’s Discussion and Analysis on page 21.

The Company is also involved in various claims and litigation incidental to its business. Although the outcome of the matters referred to in the preceding sentence cannot be determined with certainty, management, upon the advice of counsel, is of the opinion that the final outcome should not have a material effect on the Company’s consolidated results of operation or financial position.

report of independent auditors


SANDERSON FARMS 2002 ANNUAL REPORT

The Board of Directors and Stockholders
Sanderson Farms, Inc.

We have audited the accompanying consolidated balance sheets of Sanderson Farms, Inc. and subsidiaries as of October 31, 2002 and 2001 and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended October 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sanderson Farms, Inc. and subsidiaries at October 31, 2002 and 2001, and the consolidated results of their operations and their cash flows for each of the three years in the period ended October 31, 2002, in conformity with accounting principles generally accepted in the United States.

The signature of Ernst & Young LLP is written in a black, cursive script. The words "Ernst & Young" are in a larger, more stylized font, and "LLP" is in a smaller, simpler font to the right.

Jackson, Mississippi
December 10, 2002

board of directors

SANDERSON FARMS 2002 ANNUAL REPORT

Joe F. Sanderson, Jr.
*Chairman of the Board,
President and Chief Executive
Officer, Sanderson Farms, Inc.*

John H. Baker, III
*Proprietor of
John H. Baker Interests*

Lampkin Butts
*Vice President—Sales,
Sanderson Farms, Inc.*

Mike Cockrell
*Treasurer and Chief Financial
Officer, Sanderson Farms, Inc.*

Phil K. Livingston
*Retired Chairman and
Chief Executive Officer,
Deposit Guaranty National
Bank of Louisiana,
Hammond, Louisiana*

Gail Jones Pittman
President, Gail Pittman, Inc.

Charles W. Ritter, Jr.
*President and Director,
JRS, Inc., Kosciusko, Mississippi*

Hugh V. Sanderson
*Manager of Customer
Relations
Sanderson Farms, Inc.*

Robert Buck Sanderson
*Corporate Live
Production Assistant,
Sanderson Farms, Inc.*

William R. Sanderson
*Director of Marketing,
Sanderson Farms, Inc.*

Rowan H. Taylor
*Retired Chairman,
Mississippi Valley Title
Insurance Company; Counsel
for First American Title
Insurance Company of Santa
Ana, California*

Donald W. Zacharias
*President Emeritus,
Mississippi State University*

executive officers

Joe F. Sanderson, Jr.
*Chairman, President and
Chief Executive Officer*

Lampkin Butts
Vice President—Sales

Mike Cockrell
*Treasurer and
Chief Financial Officer*

James A. Grimes
*Secretary and Chief
Accounting Officer*

corporate information

SANDERSON FARMS 2002 ANNUAL REPORT

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Atlanta, Georgia 30339
(770) 916-4186

INDEPENDENT AUDITORS

Ernst & Young LLP
One Jackson Place
Suite 400
188 East Capitol Street
Jackson, Mississippi 39201

FORM 10-K

The Company's Form 10-K, including the financial statements and schedules thereto, for the year ended October 31, 2002, as well as other information about Sanderson Farms, may be obtained without charge by writing to Mr. Mike Cockrell, Treasurer and Chief Financial Officer, at the Company's corporate offices.

market and dividend information

The Company's common stock is traded on the NASDAQ National Market System under the symbol SAFM. As of January 7, 2003, Sanderson Farms had approximately 4,319 beneficial holders of its common stock. Of that total, 2,400 were stockholders of record.

	STOCK PRICE		DIVIDENDS
	HIGH	LOW	
Fiscal Year 2002			
First Quarter	\$ 22.14	\$ 13.55	\$.10
Second Quarter	\$ 27.49	\$ 20.93	\$.10
Third Quarter	\$ 27.50	\$ 18.20	\$.10
Fourth Quarter	\$ 20.62	\$ 15.83	\$.10

The following table shows quarterly cash dividends and quarterly high and low prices for the common stock for the past two fiscal years. National Market System quotations are based on actual sales prices.

	STOCK PRICE		DIVIDENDS
	HIGH	LOW	
Fiscal Year 2001			
First Quarter	\$ 10.44	\$ 6.75	\$.05
Second Quarter	\$ 11.50	\$ 7.62	\$.05
Third Quarter	\$ 13.89	\$ 10.62	\$.05
Fourth Quarter	\$ 14.26	\$ 11.25	\$.05

On December 31, 2002, the closing sales price for the common stock was \$20.91 per share.