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COMPANY INTERVIEW

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Village Farms Income Fund

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Village Farms Income Fund (VFF_UN:TSX)



MICHAEL A. DEGIGLIO, Chairman, Director and Chief Executive Officer of Village Farms and Trustee of the Fund. He is a co-Founder of Village Farms and has served as Chief Executive Officer of Village Farms since its inception in 1990. Mr. DeGiglio joined EcoScience (the former parent company of Village Farms) upon its acquisition of Agro Dynamics, Inc. (ADI) in November 1992, and served as President and Chief Executive Officer of

EcoScience from July 1995 to 2001. Prior to co founding ADI, Mr. DeGiglio served on active duty in the United States Navy as an officer and jet aviator from July 1976 through January 1983, and the Naval Air Reserves from 1983 to 2001, retiring at the rank of Captain with the United States Naval Reserve. Throughout his Naval career, he held various department head positions, completed a tour as commanding officer of a jet aviation squadron, performed multiple tours overseas, and has completed numerous senior advanced management courses. Mr. DeGiglio received a Bachelor of Science degree in Aeronautical Science and Aviation Management from Embry Riddle Aeronautical University in Daytona Beach, Florida.

SECTOR – FOOD

(AMK602) TWST: We'd like to begin with a brief historical sketch of the company and a picture of the things you're doing at the present time.

Mr. DeGiglio: Village Farms has been doing business for the past 20 years. Our primary focus is in the production, sales and marketing of high quality greenhouse grown hydroponic produce. Village Farms' primary crop is tomatoes, and we distribute bell peppers and seedless English cucumbers from third party growers. We grow indoors on a large scale using highly sophisticated greenhouse technology. Our primary footprint of 120 acres is in West Texas and we have an equal number of acres located just outside of Vancouver, Canada. We market product under our brand name

Village Farms, as well as for our third party growers under various brands grown in their facilities in Canada, United States and in Mexico..

We are a vertically integrated corporation from seed to retail. In addition, we design the facilities, finance and own the assets. We grow the product, pack it for the end-user, facilitate all marketing, sales and fulfillment, including distribution and transportation, and delivery directly to retail outlets. Our primary customers are grocery stores located in the United States and Canada, as well as a limited amount of product exports to Japan. In addition, we are currently in the development stages of an international division that will provide consultation for the construction and management of high technology greenhouses outside of North America.

TWST: What is the current state of the hydroponic farming industry and what is the outlook?

Mr. DeGiglio: The outlook for hydroponic greenhouse production technology and particularly the products we produce is positive for a number of reasons in the context of economic and environmental efficiencies. First, a sophisticated greenhouse growing tomatoes hydroponically can produce approximately 20-30 times the yield per acre compared to conventionally grown field tomatoes. This brings the obvious cost benefits by allowing more products to be grown in less of an area but further encourages land preservation.

“Village Farms is the largest producer and marketer of greenhouse grown produce in North America. Our primary goal is to increase market share and we will continue to do just that. We will achieve this goal both through internal organic expansion and expansion of new technology. We will continue to market for third party growers and we are always looking to bring new growers into the Village Farms family.”

Second, the produce grown in an enclosed greenhouse is shielded from any outside conditions or Mother Nature so to speak, be it drought, severe weather. All climatic conditions are controlled in an enclosed environment. And because optimum growing conditions can be monitored and maintained in a greenhouse setting, higher yields are achieved as well as a higher quality product. Greenhouse grown produce is a cleaner, safer product free of environmental contaminants.

And finally, in an enclosed greenhouse, we can affectively create the ideal growing conditions so we are more efficient and thus more environmentally friendly. For example, we filter

and re-circulate our water up to five times for our plants. This equates to a huge water savings and, in fact, for tomatoes, uses only one-fifth of the amount of water per pound to grow compared to field grown tomatoes. We take environmental stewardship seriously and use natural biological controls such as integrated pest management (IPM) to control pests.

Today when you look at worldwide population increases coupled with increasing demand for a reliable and sustainable food supply, there are real limitations in not only the availability, but quality of viable land to meet this demand. Hydroponics does not grow in soil, but instead in a sterile medium and, as I mentioned, uses less land to grow more food. There is no loss of soil due to erosion or threat to products grown hydroponically from soil-borne contaminants. The threat of food-borne illness is further eliminated by the mere fact that we filter our water used to grow our products and do not have to worry about run off or salmonella, say, from the farmer whose cow pasture is in close proximity. This is a problem field grown products have to contend with and just recently became a reality again with last summer’s salmonella outbreak. So as I mentioned, there is no threat of ground water or soil contamination and there is no depletion of soil nutrients as compared to traditional outdoor farming that constantly grows the same crops in the same soil. Hydroponic greenhouse production is a very sustainable business, more so probably than any other segment of agriculture for those reasons and more. The technology is improving and eventually we will be able to locate greenhouses nearly anywhere, directly addressing increasing food demand due to an increasing population.

TWST: What about price and quality when the product gets to the store?

Mr. DeGiglio: Our products do command premiums compared to field grown products. This is because of the significant differences in quality and flavor, particularly for tomatoes. For example, Village Farms tomatoes are hand picked and vine ripened. Vine-ripened tomatoes have a significantly higher sugar content and thus taste much better, with more real tomato flavor. Field tomatoes, for the most part, are picked green before the specific gene within the tomato has the opportunity to turn on the natural ripening process. This enables the product to be shipped greater distances and ethylene gas is used, similar to what bananas go through, to ripen the product on location. Since field tomatoes picked in this manner never really have the opportunity to ripen naturally, this affects taste dramatically. Our product is packed at the field and we can have it literally to a food chain within 24 hours, assuring a quality product that is at the peak of freshness and flavor.

“Advancing our technology will further lower our cost of production, increasing our profitability. Developing our intellectual property to further international expansion will not affect our core markets here in North America, but allow other countries to advance in greenhouse technology for their own countries’ consumption and food security.”

TWST: What impediments are there for large-scale growth of the industry? What could get in the way of the industry?

Mr. DeGiglio: Greenhouse production is very capital intensive compared to field production. This is primarily due to the fact the startup costs for the technology to build a greenhouse are substantial. If you’re looking at field farming, let’s just say that a particular farmer owns

the land so his only costs are his input costs for the seed, fertilizer and labor. Hydroponic greenhouse technology, while more sophisticated, has a very high capital component. Most farmers do not have the equity or the means to build a greenhouse that can cost between \$500,000 and \$1 million plus per acre.

Yet regardless of these costs, substantial investment has occurred in this industry over the past 10 years and this industry continues to see growth. The Canadian industry, for example, throughout the 1990s made a number of investments in high tech greenhouses. Another example is Mexico. Ten years ago, there was not much greenhouse production while today there are a number of investments for technology in this country. And as consumer perception is changing and awareness of the industry increases due to market demand there is certainly further growth potential.

The market differentiation will come from not only the variability in types of technology being employed in the greenhouse but the expertise in operations. Simply put, in addition to using state of the art greenhouse technology, a business is only as strong as its labor capital, so you have to employ the right people, the best greenhouse production staff, top facility managers and an efficient grading and packing line. The more vertically integrated you can become, the more you can keep costs down throughout the chain, especially if you are able to do your own fulfillment, sales and marketing as Village Farms has been able to do successfully all these years.

Technology is paramount. Our greenhouses are run by state of the art computer systems that monitor and control all of the plants’ needs, including the irrigation — where each plant is fed individually. The CO₂ and humidity levels in the greenhouse are constantly tweaked to the optimum

climatic conditions, and the greenhouses are heated using energy efficient boilers. We supplement CO₂ into the greenhouse to promote plant growth because plants, as you know, during the process of photosynthesis, take in CO₂ and in exchange produce oxygen. It has been our experience that this industry is dependent on a solid, knowledge base that is highly specialized to be successful. Globally there are large greenhouse holdings in places like China, Japan and Europe especially, although the level of technology varies greatly. Many of these countries don't have the climate to grow outdoors or they're looking for a much greener sustainable growing environment. And so due to these aforementioned factors, we see the outlook to be very positive globally in the long term for our industry.

"From a hygiene perspective, food safety perspective, nutritional perspective, health perspective, as well as environmental responsibility, we're right in that sweet spot. And as food safety remains a salient theme in the eyes of the consumer, we are positioned well and work to remain on the forefront in our industry in this category."

TWST: Would you tell us about the type of research that is going on?

Mr. DeGiglio: We have an applied research division in our organization and have built a state of the art greenhouse adjacent to our facilities in Marfa, Texas, that is truly like no other in the world. Our advances in technology constantly strive for improving and building new systems, new designs, and we have developed some unique intellectual property that helps us achieve the greatest efficiencies and maximize yield. For example, in the 1960s, just to use a metric on production cycles, tomatoes produced in greenhouses on

a world class level were about 25 kilos to 30 kilos per square meter per year. Today that level has increased to 60 kilos. Two years ago, our multi-million dollar research facility in Marfa, known as GATES, was a paradigm shift in design, totally enclosed, much like a biosphere, to use a comparison. And last year we had the highest yield recorded for annual tomato production anywhere in the world at over 100 kilos per square meter.

Technology is playing a strong role in driving business. And because technology is, in fact, delivering on expectations, more so than any other segment of agribusiness, its role is key in driving our business model.

TWST: What were the reasons for your focus on tomatoes, peppers and cucumbers?

Mr. DeGiglio: Tomatoes, cucumber and peppers are staples in almost any diet regardless of ethnicity. For example, the fresh tomato market in the US alone is a 7.5 billion pound market. This number is not inclusive of processed tomatoes. Tomatoes are in the number one, two and three spots respectively in sales dollar and volume for the fresh produce category consistently. Tomatoes are a staple and they are a high value product. So taking into consideration the higher capital costs, we are not interested in producing lower value crops like cabbage or broccoli. By staying with higher value products, we can differentiate within the product mix, choosing unique varieties, for example, further distinguishing our products from field grown products and promoting these value attributes to the consumer. So at the end of the day, the advancement in technology and staying on the high value side of our product mix are two very important factors adding to our brand's overall value and helping to define our company.

TWST: What are the main ideas on your agenda as you look out over the next two to three years?

Mr. DeGiglio: Today, Village Farms is the largest producer and marketer of greenhouse grown produce in North America. Our primary goal is to increase market share and we will continue to do just that. We will achieve this goal both through internal organic expansion and expansion of new technology. We will continue to market for third party growers and we are always looking to bring new growers into the Village Farms family. This will enable Village Farms to maximize efficiencies within our distribution channels while maximizing return. Advancing our technology will further lower our cost of production, increasing our profitability. Developing our intellectual property to further international expansion will not affect our core markets here in North America, but allow other countries to advance in greenhouse technology for their own countries' consumption and food security.

In the past, our focus has been looking at acquisitions on the distressed side due to the fact that we have the necessary resources in place, human, financial and otherwise, to develop our own greenhouses. We look at consolidation first and foremost. In certain cases, if a distressed asset makes sense in terms of its geographical location, its critical mass and other competitive factors, we would look at that acquisition potential. So we see our growth happening organically from our advances in the area of new technology, continuing to expand our marketing, increasing market share and profitability, looking at acquisitions of distressed assets, as well as furthering the expansion of our international business for our technology. So ideally, our goals are that we are looking to really drive our costs lower and profitability higher and in the end increase shareholder value.

TWST: How does your success relate to the general economy?

Mr. DeGiglio: I think on a macro level, we are a consumer product, but we are thankful that we are in food because food is a requirement that people must have, not like high end clothing. There are no perfect substitutes for fresh tomatoes. To that degree, I think we are in a solid position being in the fresh food industry and the requirements are increasing globally, with increasing food consumption, and several countries we are working with have no food security, importing virtually 99% of their food needs. We are targeting and working with countries in these situations, some of them in the Middle East where the requirements and the needs to grow outdoors are just not there due to extreme climate, lack of viable land and mitigated water supplies. These are all food production problem areas that greenhouse technology can solve. These countries are looking to increase their ability to grow their own food internally to establish food security, which means access to a year-round, consistent and reliable food supply. Village Farms has the technology and expertise to help solve these types of food security issues.

TWST: What would you expect the company to look like in about three years?

Mr. DeGiglio: We are positioned as a growth company. I really can't make predictions as a public entity, but I believe that we would like to see consistent double-digit growth for our revenue stream, in turn driving profitability. We are a fixed cost business in the farming sector such that if we can continue to increase our yields, reduce our input costs and maintain or increase our selling prices, we will enhance our profitability and grow the business. We think that the ability to drive growth, especially in today's economic times, makes us attractive not only in our industry segment but makes us much more viable compared to other segments.

TWST: Would you tell us about your background and expertise and the same for one or two of your colleagues?

Mr. DeGiglio: Our organization has a tremendous amount of talent with a combined expertise in the agricultural industry across all disciplines. Chiefly, we have numerous years of expertise in greenhouse production and the technical facets of the business. We are fortunate enough to have people who have spent their entire careers in greenhouse production on a global scale throughout Europe, the Middle East and North America. We are very fortunate to employ and retain a highly rated talent pool within the production side of the business.

The same can be said of our sales organization. Because of the nature of our business, perishables are extremely challenging for any sales organization. This is because from the moment you harvest the product, you're on the clock because it is perishable. Some companies may struggle with having too much inventory, but it is not perishable. So while inventory carrying costs can be a detriment, the fact is, you cannot keep fresh produce around too long or it will spoil. So there's a different mindset in how we market and sell the products we produce. We have a lot of talent within our sales force, marketing and distribution team to deal with the limitations and challenges presented in selling a fresh product.

Myself, I have a military background. I was a naval officer and aviator for 26, including actual and reserve time, but I've been in the agricultural industry on the supply and biotech side and in the greenhouse sector for about 25 years. My knowledge base is in operating the organization and my knowledge of agriculture comes from experience gained from surviving in this industry for as long as I have. I am a co-founder of Village

Farms along with the President of the company, Albert Vanzeyst.

TWST: What occupies your own attention most on a day-by-day basis?

Mr. DeGiglio: It really varies by quarter, by year and by cycle of the company. There are times when I drill down quite a bit, but I think I certainly like to drive and support more of the vision and direction of the company and provide the managers and the personnel with the tools they need to fulfill their obligations to the company. I focus equally on production as well as on the sales and marketing strategy and the tactics that are used. I visit our customers as well. I'm very concerned with how employees are aligned with the company and try to maintain a level of clarity in the direction that we're all marching and help align us all with consistent goals and a primary vision. We're still somewhat of a small company and there's not one particular area that I focus on all the time; it varies, but ultimately it must drive shareholder value.

TWST: How many employees do you have?

Mr. DeGiglio: We have around 1,500 employees.

TWST: Do you see any need to improve the company's capital structure?

Mr. DeGiglio: Not immediately, but in time. We are unique in that we are an income trust in Canada. Due to changes in Canadian legislation, all income trusts will be abolished by December 2010. Our intention is to remain a public company and to convert our units to common stock. So right now we are in a pretty good position balance sheet wise, cash wise, and with our debt to equity ratio. But as we do go forward, I think we will be looking at raising additional capital to implement our growth strategies.

TWST: Would you tell us about the situation with income trusts. Why are they going to disappear?

Mr. DeGiglio: The income trust structure was created in Canada. It's a dividend-based type of structure where it pays out dividends on a fairly consistent basis and impacts the corporation as dividends pass through to shareholders and are taxed at that level. There were so many companies transitioning into an income trust structure that the Canadian government believed that their tax revenue base would shrink pretty dramatically, so they passed legislation two years ago to end any more income trusts and grandfathered the existing trusts for four years.

TWST: How well understood is Village Farms by the investment community?

Mr. DeGiglio: Not very well at all. We were privately held and we did an acquisition two years ago of the largest Canadian greenhouse company and when we bought that company, we assumed the income trust. We decided we would focus on digesting the acquisition, which two years later has gone extremely well for us. This year we have done what we said we would do and our numbers reflect that. We will be communicating more to shareholders in 2009 about our direction..

TWST: What would be the two or three best reasons for the long-term investor to look closely at Village Farms?

Mr. DeGiglio: One for sure is the segment we're in. As I said earlier, being in high value food and in food in general — I wouldn't say it's recession proof, because it's not. We may feel downward pressure in pricing. However, provided that the industry doesn't have an overcapacity situation, people need to eat. I was reading an article recently outlining a less than favorable forecast for consumer products companies for

2009 and 2010, but food is an area that is different and as the population increases globally and domestically, the requirement for more food supply is a given. The fact that we're in fresh food is ideal compared to processed food, due to the ever-increasing trends toward health and wellness combined with consumer demand for fresh, wholesome and safe food.

Hydroponic greenhouse grown produce is some of the safest food available today, free from any environmental containments. Our facilities undergo strict third party audits for food safety several times a year. We have achieved consistently the highest food safety scores in the industry today. During our most recent GAP (Good Agricultural Practices) audit we recorded scores of 100% across the board for all categories. I would have to say from a hygiene perspective, food safety perspective, nutritional perspective, health perspective, as well as environmental responsibility, we're right in that sweet spot. And as food safety remains a salient theme in the eyes of the consumer, we are positioned well and work to remain on the forefront in our industry in this category.

I believe that we are leveraged correctly and we have a clear vision on where we need to go. We have people who have been in our organization for up to 20 years with very little turnover, so they understand the job and they're very aligned with the company. We are committed to the retention as well as the corporate well being of our talent pool.

TWST: The potential would seem to be great in the Middle East, considering the aridity of the soil and the amount of money that is flowing around there.

Mr. DeGiglio: I agree. When it's 140 degrees outside, it's difficult to sustain plant growth in sand. I think in countries like that, their mindset

is changing. After a lot of the money came in, you have seen places like Dubai that have invested tremendous amounts of money in building infrastructure and they're really coming back down now to look at food and food security and things of that nature. Of course, the climate, as you said, is difficult with scarce resources not to mention lack of viable land.

TWST: Is there anything that you would like to add?

Mr. DeGiglio: I think people could always go to our Website. Everything is on our Website, all our policies, all our financials. It illustrates the type of production facilities we have and how sophisticated they are in the products we produce. So I think that would give someone a pretty good overview of who we are.

TWST: Your own personal level of satisfaction must be pretty high, being in such a useful and interesting industry.

Mr. DeGiglio: From a corporate balance sheet perspective, we contribute a lot. We've been sustainable from day one by the nature of our business, as this is the most efficient way to operate and has the benefit of

being environmentally friendly. We like to say at Village Farms, "what is good for the earth is good for business."

We take a lot of pride in the fact that we've been operating with an eye on environmental stewardship from day one, which makes us a good corporate citizen. We take a lot of pride in being able to be successful, being a good citizen in the surrounding communities where we operate our facilities as well. But at the end of the day, the success that I feel is really driven by implementation strategies that can eventually generate profits and increase shareholder value. That's really what I'm concerned with and what I concentrate on the most.

TWST: Thank you. (MC)

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