



Structure, Strategy, and Finance in Changing Markets: the Case of Pro-Fac Cooperative

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Brian M. Henehan and Todd M. Schmit

bmh5@cornell.edu

Dept of Applied Economics and Management
Cornell University

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Why Study Pro-Fac Cooperative?

- ❖ Original Formation Based on Highly Innovative Business Structure
- ❖ Pro-Fac Has Effectively “Re-Designed” Itself Throughout It’s History
- ❖ Useful Case for Understanding How A Cooperative Strategically Re-positioned During Times of Significant Change
- ❖ Case Includes Review of Structure, Strategy and Finance Dimensions

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Why Study PF in New York

- ❖ Economic Impact on NYS – 60,000 acres of high value crops and processing plants
- ❖ Ongoing Relationship – hosted BOD on campus, previous member survey, advised on organizational structure options
- ❖ Attended all annual meetings since 1985

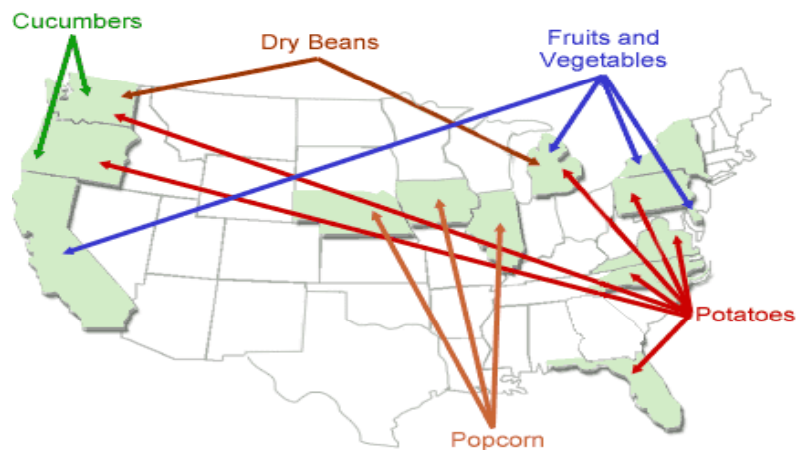
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Pro-Fac Cooperative

Pro-Fac Cooperative is an agricultural marketing cooperative of 488 members who provide fruits, vegetables and popcorn for processing facilities across the country. These commodities are marketed as branded, private label and food service products, primarily through its main customers, Birds Eye Foods and Allens, Inc. The total value of crops delivered in 2007 was \$61.1 million.

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Map of Pro-Fac Member Crops



Source: PF web site – www.profaccoop.com

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Pro-Fac Member Crops by State

- ❖ **California:** Peaches
- ❖ **Delaware:** Limas, Peas
- ❖ **Florida:** Potatoes
- ❖ **Illinois:** Popcorn
- ❖ **Michigan:** Apples, Asparagus, Blueberries, Carrots, Dry Beans, Peaches, Potatoes, Tart Cherries
- ❖ **Nebraska:** Popcorn
- ❖ **New York:** Apples, Beets, Butternut Squash, Carrots, Corn, Kraut Cabbage, Peaches, Peas, Red Cabbage, Snap Beans, Tart Cherries
- ❖ **Oregon:** Cucumbers, Potatoes
- ❖ **Pennsylvania:** Potatoes
- ❖ **Washington:** Cucumbers, Dry Beans, Potatoes

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Agenda

- ❖ Review Relevant Literature
- ❖ Discuss Why the Transformations Took Place
- ❖ Present Strategies and Structures Utilized for Redesign During Each Phase
- ❖ Review Financing Approaches
- ❖ Areas for Further Research

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Relevant Literature

- ❖ Chaddad and Cook (2004) – Understanding new cooperative models “cooperative with capital seeking entities”
- ❖ Anderson (1986) – evolution of cooperative management strategies during phases of the cooperative life cycle
- ❖ Amanor-Boadu, Boland, Barton et al (2003) – Birds Eye Foods, Inc - A Case Study
- ❖ Seeking input from this group – economic value of information, equity and risk management strategies

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Three Phases of Redesign: Will Concentrate on Third Phase

1. First Phase starts with the Formation of the Cooperative in 1961 and runs to 1994
2. Second Phase Starts with Acquisition of Curtice-Burns Operations in 1994 and ends in 2002
3. Third Phase Begins with Inclusion of Vestar Capital, an Equity Partner Who Becomes Majority Owner of Processing and Marketing Assets in 2002 to today

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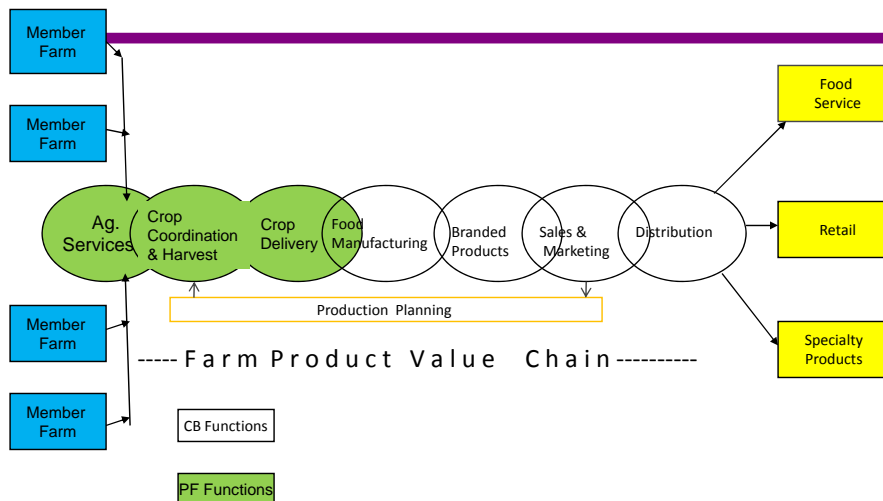
Phase 1.

- ❖ PF Formed to Help Salvage Fruit and Vegetable Processing in New York
- ❖ This Period Saw Dramatic Restructuring in the Industry in U.S. and NY
- ❖ Post WWII Saw Dramatic Decline in Number of Firms and Plants
- ❖ Two Such Firms Located in W. New York – Curtice Brothers and the Burns-Alton Corp. Came up for Sale

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Phase 1. Integrated Operations – PF & CB



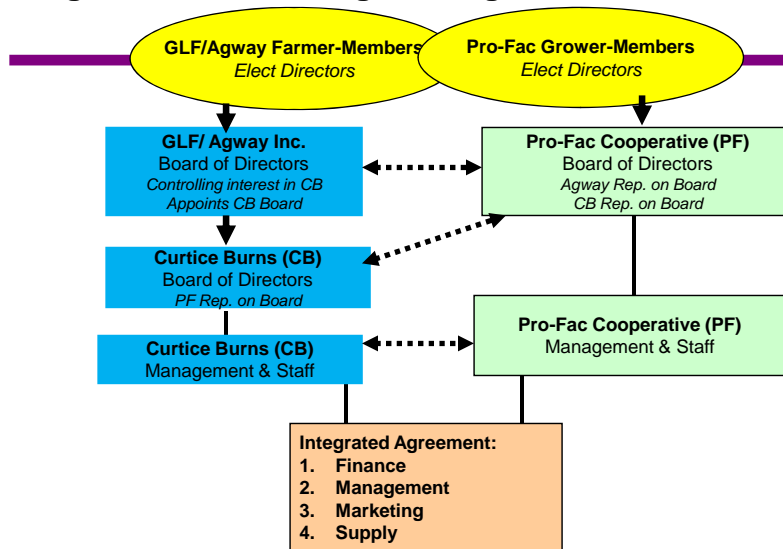
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Summary of Curtice Burns and Pro-Fac Cooperative Integrated Agreement, 1961-1994

Curtice Burns	Area	Pro-Fac Cooperative
<ul style="list-style-type: none"> -Net proceeds derived from total sales; shared with PF 50/50 -Common stock listed on AMEX, 1973 	Finance	<ul style="list-style-type: none"> -Financed ownership of plants, leased facilities to CB -Equity loaned to CB; seasonal & term loans from Bank for Coop's -Sold delivery rights based on common stock to members
<ul style="list-style-type: none"> -Conducted all marketing activities -Owned brands, made acquisitions -Developed new products 	Marketing	<ul style="list-style-type: none"> -Recruited members from new acquisition farming areas -Reserved first right to purchase brands upon dissolution -Farm products provide basis for new products
<ul style="list-style-type: none"> -Supervised and managed business and properties of PF -Maintained relations with lenders, kept books for joint venture -One PF director on CB board 	Management & Governance	<ul style="list-style-type: none"> -PF and Agway had access to books and financial information -1 CB and 1 Agway director on PF board
<ul style="list-style-type: none"> -Payment for crops based on CMV -As CB operations expanded, PF given first right to supply new plants -Developed sales plan that determined volume produced for each commodity 	Supply Agreement	<ul style="list-style-type: none"> -Committee for each commodity -Committees determine CMV in concert with PF management and approve crop agreements -Payments made from a single, multi-commodity pool

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Pro-Fac Cooperative, GLF/Agway, and Curtice Burns Organization and Integrated Agreement, 1961 – 1994.



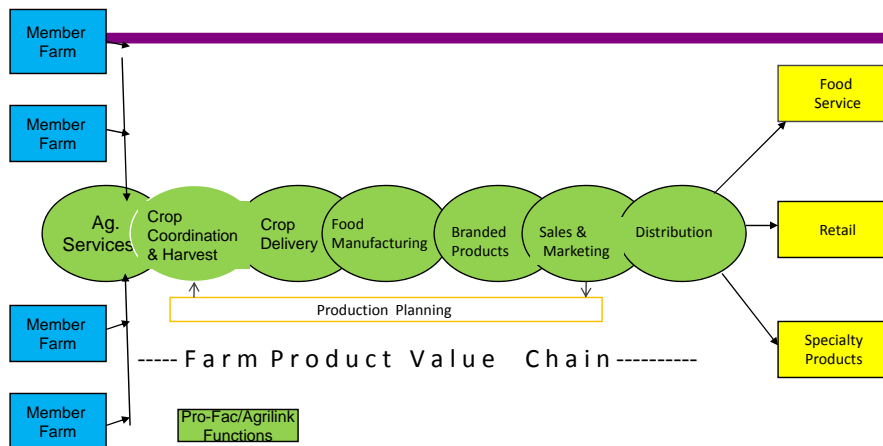
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Phase 2. Begins in 1994

- ❖ Agway is Forced to Sell It's CB Majority Interest to Raise Cash
- ❖ The Long Standing Integrated Agreement Venture with CB Came to an End in 1994 as PF Purchases Agway's Interest
- ❖ CB buyout creates Initial Leverage on PF's Balance Sheet (Debt financing at 50% in '96)
- ❖ BE acquisition results in highly leveraged position in 2000 (Debt financing at 80% in 2001)

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Phase 2. Vertically Integrated Operations - Pro-Fac & Agrilink Foods



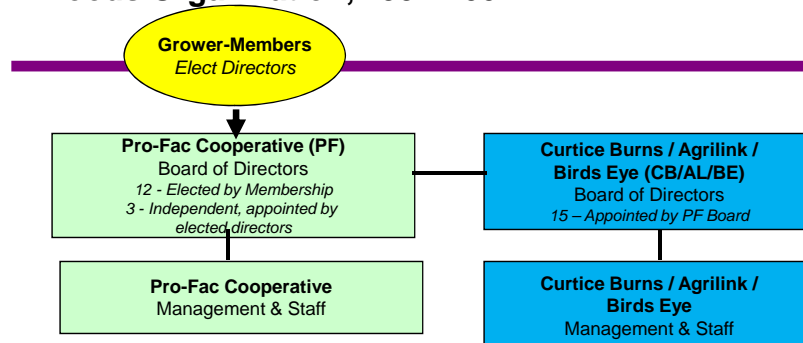
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Phase 2. Developments

- ❖ PF Becomes the First Farmer Cooperative to Acquire a Publicly Traded Company
- ❖ Later Becomes the First Farmer Cooperative with a Security (cumulative preferred stock) Listed on a Major Exchange – NASDAQ (symbol PFACP)
- ❖ To Signify It's Role in Linking the Agricultural and Marketing Segments, CB Changed It's Name to Agrilink

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Pro-Fac Cooperative, Curtice Burns/Agrilink/Birdseye Foods Organization, 1994-2002.

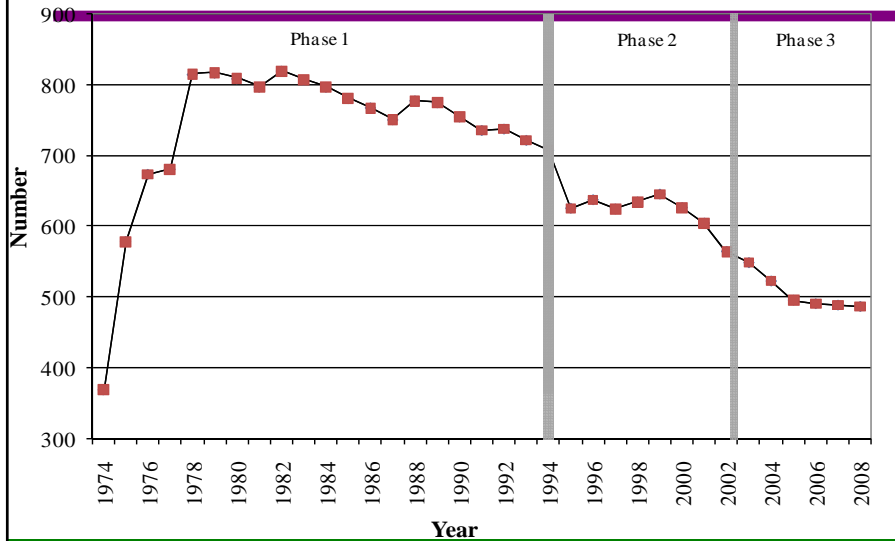


Notables:

- CB/AF/BE wholly-owned subsidiary of PF (1994)
- Pro-Fac Board & CB/AL/BE Board meet jointly as a single board, separate votes as necessary
- CB changes name to Agrilink Foods (1997) & to Birds Eye Foods (2003)
- Agrilink controlled brands, including acquisition of Birdseye & other brands from Dean Foods Vegetable Co. (1998)
- Dean's acquisition effectively doubles size of Birds Eye Foods
- Birds Eye Foods finds itself in a highly leveraged position

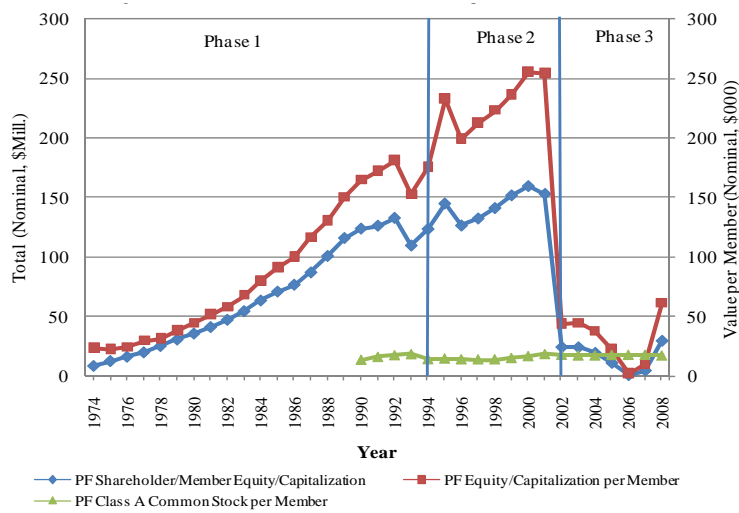
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Number of Pro-Fac Members, 1974 - 2008



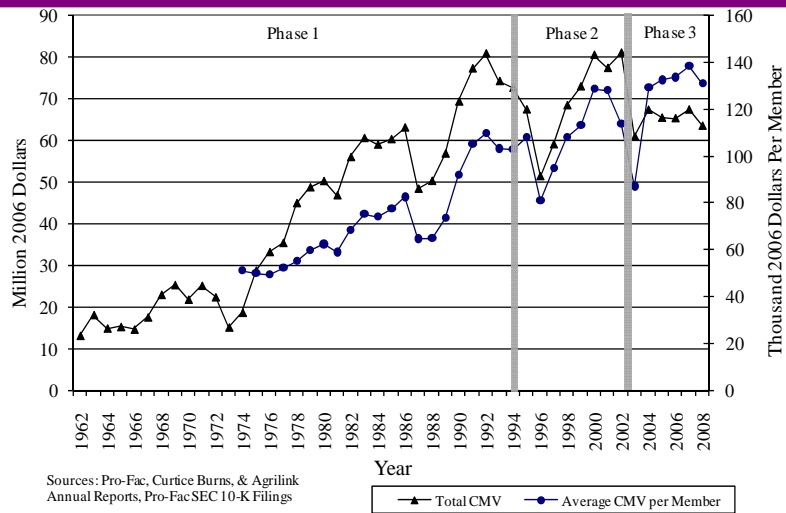
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Pro-Fac shareholder and member capitalization and investment, 1974-2008.



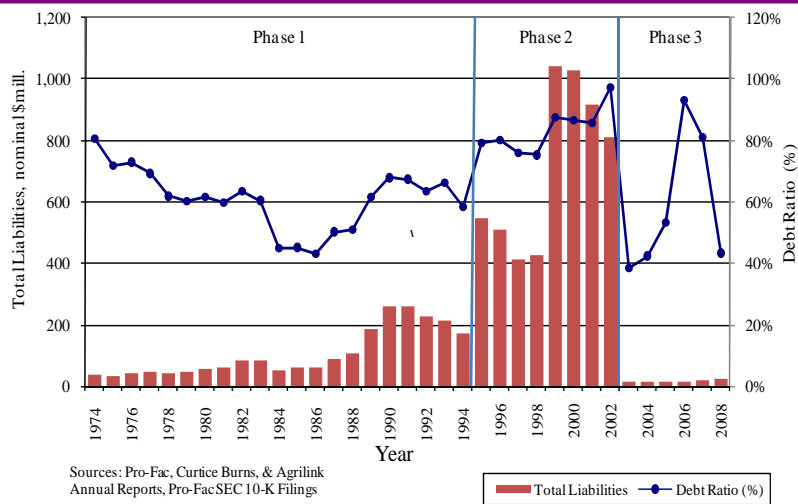
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Commercial market value (CMV) of raw product deliveries, total and per member, 1962-2008



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Pro-Fac debt levels and debt ratio, 1974 - 2008



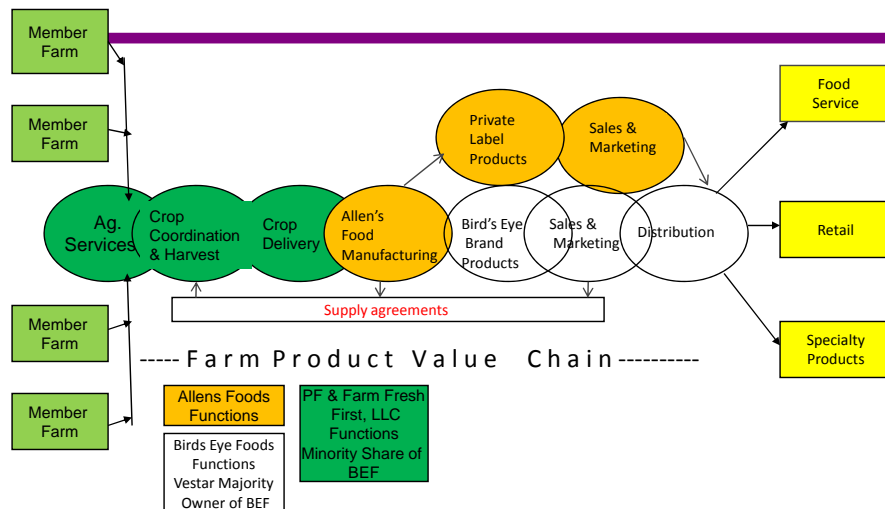
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Phase 3. Begins in 2002

- ❖ Agrilink is in a Highly Leveraged Position
- ❖ Thin Margins Limit Earnings
- ❖ Capacity of Members to Provide Needed Equity is Being Tested
- ❖ Board Explores Other Sources and Reviews Many Options
- ❖ Accepts Proposal from Vestar Capital Partners and Approved by Member Vote

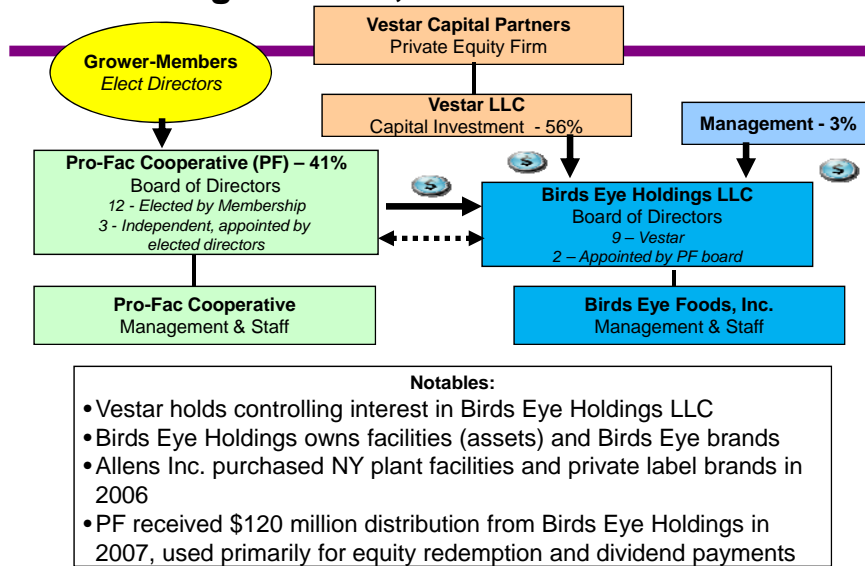
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Phase 3. Vestar, PF, and Allens Operations



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Pro-Fac Cooperative, Vestar, & Birds Eye Foods Organization, 2008



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Need for Capital Infusion

- ❖ Non-cash goodwill impairment charge of \$179 million results in negative income for FY 2002 and reduces equity
- ❖ Increased debt to finance acquisition of large, national branded business
- ❖ Exhaust members capacity to supply more equity
- ❖ Increased interest expenses

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Options the PF Board Considered in 2002

- ❖ Increase public stock offering
- ❖ Seek strategic investor
- ❖ Find synergistic partner, LLC
- ❖ Seek private equity firm
- ❖ “tough it out”
- ❖ Sell the company

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Pete Call, PF Chairman and BEF Board Member

- ❖ “PF’s expertise lies in producing raw products not in operating processing facilities, so a partnership with an operating entity is an option that will be actively pursued”

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Selecting a Private Equity Partner

- ❖ Good fit with portfolio
- ❖ Worked with current management
- ❖ Acceptable Terms:
 - Option for individual members and management to invest
 - Termination payments
 - Line of credit
 - 10 year supply agreement
 - Representation on BEF board

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Public Stock Offering vs. Private Equity Placement

Publically Traded Offering	Private Equity Investment
❖ ST Horizon	❖ Longer Horizon (7yrs)
❖ 1/4ly earnings driven	❖ Driven to improve firm performance
❖ Market Volatility	❖ Less volatility
❖ Broad Stockholder Interests	❖ Narrow Investor Group
❖ High Cost of Listing & SEC Compliance	❖ Possess management talent
❖ SOX requirements	❖ Ultimately sell acquired businesses for gain

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Phase 3. Developments

- ❖ In August 2002, Vestar Becomes Majority Owner of Agrilink (approx. 56%)
- ❖ Agrilink Name Changed to Birds Eye Foods, BEF
- ❖ PF:
 - Maintains significant minority ownership of BEF (approx. 40%) with management accounting for (approx.4%)
 - Has 10 year supply agreement
 - Receives \$10 million annually for 5 years
 - Can secure \$1 million line of credit for each of 5 years

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Phase 3. Developments

- ❖ Bird Eye Foods Rolls Out Successful New Products
- ❖ Vestar Sells Processing Plants and Private Label Business to Allens, Inc. in 2006
- ❖ Vestar Subsidiary- BEF Holdings Distributes 120 Million to PF in 2007
- ❖ PF Uses Distribution to Redeem Equity and Pay Dividends on Selected Securities

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Financing Through Each Phase

❖ Phase 1.

- Innovative diversification of sources – members, loans from BC, and publicly traded securities
- Relatively strong, consistent earnings supported use of retained earnings
- Upfront member purchase of stock tied to deliveries raised additional member equity

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Financing: Phase 2

- ❖ Maintained diversification of sources – members, loans from BC, and publicly traded securities
- ❖ High costs of acquisitions eroded equity
- ❖ Weaker earnings reduced use of retained earnings
- ❖ Limited new member purchases of stock tied to deliveries raised additional member equity
- ❖ Increased Debt Level to Support Buyouts Results in Highly Leveraged Position and Increased Interest Expense

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Financing: Phase 3.

- ❖ PF Accepts Proposal from Private Equity Firm
- ❖ Vestar Investment Significantly Reduces BE Debt (approx. \$175M)
- ❖ Agreement with BE Holdings Generates Annual Payments for 5 years
- ❖ Annual Payments Used to Support PF Operations and Pay Dividends on Preferred Stock

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Research Questions

- ❖ Does a Private Equity Firm Do a Better Job Managing Member Equity than a Cooperative?
- ❖ Are Specialty Crop Producers Gaining Market Power that Minimizes Market Risk (and need to own plants & brands)?
- ❖ How Do We Measure the Value of Market Intelligence and Information that Cooperatives Generate for Members?

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Summary

- ❖ The PF story present a unique case in the world of cooperatives
- ❖ A Number of “**Firsts**” for a farmer cooperative:
 - leveraged buyout of publicly traded company,
 - having a security listed on a major exchange
- ❖ Continue to Change and Adapt to New Players and Markets

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Summary, cont'd

- ❖ Utilized a number of innovative strategies to overcome potential constraints encountered by traditional agricultural cooperatives:
 - Transferable delivery rights
 - Multi-commodity pool
 - Diverse set of crops and products
 - Board geographic membership base
 - Conversion of equity to publicly traded securities to create liquidity for member investment
 - Partnering with successful firms and capital groups

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Current Situation for Most Members

- ❖ Significant Increase in Prices for Most Crops (Input costs also increasing)
- ❖ Growing Demand Results in Increased Acreage for Most Crops
- ❖ \$120M Distribution in 2007 Generated Higher ROE
- ❖ Situation Varies Across Crops and Regions
- ❖ It Remains to Be Seen, How Long It will Last