"Cooperative Redesign in Potential and Practice: the Case of Pro-Fac Cooperative“

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by
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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

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.
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
Presentation Will Focus on Three Periods of Transformation

• Discuss Why the Transformations Took Place
• What Strategies Were Utilized for Redesign During Each Phase
• Assess the Impact on Member-Growers
• Present Lessons Learned that Might Apply to Other Agricultural Cooperatives in Today’s Demanding Markets

Three Phases of Redesign

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
Significant Changes in Processed Fruit and Vegetable Industry in the 1950’s

- Post WWII Saw Dramatic Decline in Number of Firms and Plants
- Many Small Family-owned Firms Relied on Sales to the Government During the War Years
- Two Such Firms Located in Western New York – Curtice Brothers of Rochester and the Burns-Alton Corp. of Alton Came up for Sale

U.S. Fruit and Vegetable Marketing Cooperatives Decline

- During this same period, the number of Fruit and Vegetable Marketing Cooperatives Declined
- Some Cooperatives Consolidated, Others Went Out of Business
- Needed to Invest in New Food Processing Technology, Plant Upgrades, and Product Packaging Equipment
- Locate to Large Scale Growing Areas to Support Economies of Size
From 1951 to 1971

- Number of F & V Cooperatives in the U.S. declined from 825 in 1951 to 438 in 1971

- The number of cooperative members declined from 138,200 in 1951 to 95,700 in 1971

- Significant re-structuring at both the farm and cooperative levels during this period
New York Fruit and Vegetable Cooperatives, 1951 - 1971

<table>
<thead>
<tr>
<th></th>
<th>1951</th>
<th>1961</th>
<th>1971</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number</td>
<td>24</td>
<td>21</td>
<td>11</td>
</tr>
<tr>
<td>Members</td>
<td>5,300</td>
<td>5,200</td>
<td>2,000</td>
</tr>
<tr>
<td>Gross Sales</td>
<td>$911M</td>
<td>$1.4B</td>
<td>$2.5B</td>
</tr>
</tbody>
</table>

In New York State

- The number of F&V cooperatives in NY dropped by over 50% from 1951 to 1971.

- The number of members declined as well from slightly over 5,000 in 1951 to 2,000 in 1971.

- However, total cooperatives gross sales increased from $911 million in 1951 to $2.5 billion in 1971.
GLF Steps In

- The Grange League Federation, GLF (later became Agway) was the major supply cooperative operating in the Northeast in the 1960’s
- Producer concern over the future of the Fruit and Vegetable Processing Industry in New York State
- GLF had seen the negative impact of the loss of processing firms on it’s members as well as on it’s supply and input sales

GLF as a Catalyst

- GLF Acted as a Catalyst to Effect the Merger of two family canning business to form Curtice-Burns, (CB)
- Concurrently Helped to Form and Capitalize Pro-Fac Cooperative, (PF)
- Pro-Fac is a Contraction of the terms “Producers” and “Facilities”
- GLF (and later Agway) Assisted in Developing, Financing, and Managing the Joint Venture Between CB and PF

Having Observed Fruit and Vegetable Cooperative Failures

- The Founders of Pro-Fac Observed a Number of Pitfalls that Failed Cooperatives Encountered:
  - Being under-capitalized
  - Carrying the expense of an over supply of raw product in inventory
  - Inexperienced management that did not understand the market for member products
  - Marketing single crops and a lack of product diversification
  - Not allowing professional management to operate at arms length in daily operations
  - Lack of diverse sources of capital
  - Inability to turn around unprofitable operations lacking a strong marketing focus
### Summary of Curtice Burns and Pro-Fac Cooperative integrated agreement, 1961-1994

<table>
<thead>
<tr>
<th>Curtice Burns</th>
<th>Area</th>
<th>Pro-Fac Cooperative</th>
</tr>
</thead>
<tbody>
<tr>
<td>-Net proceeds derived from total sales; shared with PF 50/50</td>
<td>Finance</td>
<td>-Equity loaned to CB; seasonal &amp; term loans from Bank for Coop’s</td>
</tr>
<tr>
<td>-Common stock listed on AMEX, 1973</td>
<td></td>
<td>-Sold delivery rights based on common stock to members</td>
</tr>
<tr>
<td>-Conducted all marketing activities</td>
<td>Marketing</td>
<td>-Recruited members from new acquisition farming areas</td>
</tr>
<tr>
<td>-Owned brands, made acquisitions</td>
<td></td>
<td>-Reserved first right to purchase brands upon dissolution</td>
</tr>
<tr>
<td>-Developed new products</td>
<td></td>
<td>-Farm products provide basis for new products</td>
</tr>
<tr>
<td>-Supervised and managed business and properties of PF</td>
<td>Management &amp; Governance</td>
<td>-PF and Agway had access to books and financial information</td>
</tr>
<tr>
<td>-Maintained relations with lenders, kept books for joint venture</td>
<td></td>
<td>-1 CB and 1 Agway director on PF board</td>
</tr>
<tr>
<td>-One PF director on CB board</td>
<td></td>
<td></td>
</tr>
<tr>
<td>-Payment for crops based on CMV</td>
<td>Supply Agreement</td>
<td>-Committee for each commodity</td>
</tr>
<tr>
<td>-As CB operations expanded, PF given first right to supply new plants</td>
<td></td>
<td>-Committees determine CMV in concert with PF management and approve crop agreements</td>
</tr>
<tr>
<td>-Developed sales plan that determined volume produced for each commodity</td>
<td></td>
<td>-Payments made from a single, multi-commodity pool</td>
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### Phase I. Strategic Goals and Hoped For Member Benefits

<table>
<thead>
<tr>
<th>Goal</th>
<th>Strategy</th>
<th>Hoped for Member Benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retain Processing Industry</td>
<td>-Own plants</td>
<td>Secure Market</td>
</tr>
<tr>
<td></td>
<td>-Partner with successful marketer</td>
<td></td>
</tr>
<tr>
<td>Effectively Compete in Consumer Product Market</td>
<td>-Acquire regional brands</td>
<td>Increased price for raw product</td>
</tr>
<tr>
<td></td>
<td>-Secure talented management</td>
<td>Improve board performance</td>
</tr>
<tr>
<td></td>
<td>-Create two board system with outside directors</td>
<td></td>
</tr>
<tr>
<td>Secure Adequate Financing</td>
<td>-Diversify sources of capital</td>
<td>Financially strong value-added operations</td>
</tr>
<tr>
<td></td>
<td>-Gain access to public capital markets</td>
<td>Enhance needed growth</td>
</tr>
<tr>
<td>Diversify products and production areas</td>
<td>-Broaden product line and brands</td>
<td>Create liquid market for member equity</td>
</tr>
<tr>
<td></td>
<td>-Acquire firms and plants in new areas</td>
<td></td>
</tr>
<tr>
<td></td>
<td>-Create payments from multi-product single pool</td>
<td></td>
</tr>
<tr>
<td>Maintain balance of raw product supply</td>
<td>-Production based on sales plans</td>
<td>Minimize price and production risks</td>
</tr>
<tr>
<td></td>
<td>-Issue stock tied to delivery rights to control raw product supply</td>
<td>Accommodate growth in memberships and crops</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Increase profitability of cooperative</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Create market for common stock</td>
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</table>
Phase II. Begins in 1992

- Agway, Holding Majority Ownership of CB, is Forced to Sell It’s Interest to Raise Cash
- The Bidding Process and Sale of CB Became an Expensive, Protracted Transaction
- The Long Standing Joint Venture with CB Came to an End in 1994 as PF Purchases Agway’s Interest
- Created Initial Leverage on PF’s Balance Sheet


- CB/AL/BE wholly-owned subsidiary of PF (1994)
- Pro-Fac Board & CB/AL/BE Board meet jointly as a single board, separate votes as necessary
- 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
Phase II. 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

Phase II. Strategic Goals and Hoped For Member Benefits

<table>
<thead>
<tr>
<th>Goal</th>
<th>Strategy</th>
<th>Hoped for Member Benefit</th>
</tr>
</thead>
</table>
| Retain and Grow Presence in Processing Industry | - Acquire former JV partner’s assets  
- Acquire major national brand firm | Secure Market                                                            |
| Effectively Compete in Consumer Product Market | - Acquire national brands and R&D  
- Secure talented management  
- Roll out more new products | Increase price for raw product                                             |
| Secure Adequate Financing | - Diversify sources of capital  
- Gain access to public capital markets  
- Increase borrowing to finance acquisitions | Added financial support value-added operations  
Enhance needed growth  
Create liquid market for member equity |
| Diversify products and production areas | - Acquire brands and plants in new areas  
- Create multi-product single payment pool | Minimize price and production risks  
Accommodate growth in memberships |
| Maintain balance of raw product supply | - Production based on sales plans  
- Issue stock tied to delivery rights | Increase profitability of cooperative  
Create market for common stock |
Phase III. Begins in 2002

- Agrilink is in a Highly Leveraged Position
- Exhausting the Capacity of Member to Provide Needed Equity
- Board Explores Other Sources and Reviews Many Options
- Accepts Proposal from Vestar Capital Partners and Approved by Member Vote

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

- Grower-Members: Elected Directors
- Pro-Fac Cooperative (PF): Board of Directors
  12 - Elected by Membership
  3 - Independent, appointed by elected directors
- Pro-Fac Cooperative: Management & Staff
- Vestar Capital Partners: Private Equity Firm
- Vestar LLC: Capital Investment
- Birds Eye Holdings LLC: Board of Directors
  9 – Vestar
  2 – Appointed by PF board
- Birds Eye Foods, Inc.: Management & Staff

Notables:
- Vestar holds controlling interest in Birds Eye Holdings LLC
- Birds Eye Holdings owns facilities (assets) and Birds Eye brands
- Allens Inc. purchased NY plant facilities and private label brands in 2006
- PF received $120 million distribution from Birds Eye Holdings in 2007, used primarily for equity redemption and dividend payments
Phase III. 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

Phase III. Developments

• Bird Eye Foods Rolls Out Successful new Products
• Vestar Sells Processing Plants and Private Label Business to Allens, Inc. in 2006
• Vestar Subsidiary- BE Holdings Distributes 120 Million to PF
• PF Uses Distribution to Redeem Equity and Pay Dividends on Selected Securities
Phase III. Strategic Goals and Hoped For Member Benefits

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<tr>
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<th>Strategy</th>
<th>Hoped for Member Benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retain and Grow Presence in Processing Industry</td>
<td>- Develop preferred supplier relationship with successful firm</td>
<td>Secure Market</td>
</tr>
<tr>
<td>Effectively Compete in Consumer Product Market</td>
<td>- Supply firm with national brands and R&amp;D capacity</td>
<td>Increase price for raw product</td>
</tr>
<tr>
<td></td>
<td>- Support new product development</td>
<td>Opportunity for increased production volume</td>
</tr>
<tr>
<td>Secure Adequate Financing</td>
<td>- Diversify sources of capital</td>
<td>Added financial support value-added operations</td>
</tr>
<tr>
<td></td>
<td>- Maintain access to public capital markets</td>
<td>Protect and increase return on member equity</td>
</tr>
<tr>
<td></td>
<td>- Sell assets to holding company managed by private equity firm</td>
<td>Increased long term ROE</td>
</tr>
<tr>
<td>Focus on most profitable products and production areas</td>
<td>- Develop strong relationships with processing and marketing firms</td>
<td>Minimize price and production risks</td>
</tr>
<tr>
<td>Maintain balance of raw product supply</td>
<td>- Production based supply agreements</td>
<td>Increase profitability of cooperative</td>
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<td>- Issue stock tied to delivery rights</td>
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Quote from **Morton Adams**, First PF general manager as well as president of CB until he retired in 1975

“The history of fruit and vegetable marketing cooperatives is littered with failures and very few successes. The originators of Curtice-Burns and Pro-Fac studied these histories. They became convinced that there were several basic needs which had to be provided. They include management of the cooperatives by experienced professionals who are kept at arms length in daily operation; product diversification; financing the total operation through commercial as well as the Bank for Cooperatives borrowing; and the opportunity for public investment through trading on one of the stock exchanges. CB and PF have remained successful by emphasizing the policy that they limit their activities to the marketing of products that are profitable to both companies.”*

Key Issues Continued to Be Addressed in Each Phase

- Financing
- Maintaining Market Security for Members
- Relationships with Processors and Marketers
- Management and Governance

Sources of Financing for Farmer Cooperatives

<table>
<thead>
<tr>
<th>Source</th>
<th>Pros</th>
<th>Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td>Members</td>
<td>Can be low cost Maintains Member control Members may be more “patient” for returns</td>
<td>Limited number of members Limited Ability of members to invest Usually relies on ability for cooperative to generate strong earnings and retains</td>
</tr>
<tr>
<td>Debt</td>
<td>Cooperatives may have access to lower cost debt through Farm Credit Can leverage member equity</td>
<td>High interest costs Constraints of loan covenants Can become too leveraged</td>
</tr>
<tr>
<td>Public Capital</td>
<td>Diversify sources of financing Access to large amount of capital Support needed growth or profitable expansion</td>
<td>Expensive filing fees and costs Must comply with listing standards of exchange Expensive reporting and regulatory requirements Loss of member control</td>
</tr>
<tr>
<td>Private Equity</td>
<td>Diversify sources of financing Could result in long term gain</td>
<td>Loss of member control Greater focus on ROI could come at expense of member interests</td>
</tr>
</tbody>
</table>
Financing Through Each Phase

• Phase I.
  – 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

• Phase II.
  – 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
Financing Through Each Phase

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

Market Security Strategies for Each Phase

• Phase I.
  • Own Processing Plants
  • Create Joint Venture with Successful Marketer
  • Enter into Supply Agreement

• Phase II.
  • Own Processing Plants
  • Acquire Marketer and Brands

• Phase III.
  • Maintain minority interest in plants and brands
  • Enter into Long term Supply agreement
  • Become Preferred Supplier
## Relationship with Marketers for Each Phase

<table>
<thead>
<tr>
<th>Phase</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>• Create Joint Venture with Successful Marketer Who Has Brands</td>
</tr>
<tr>
<td>II</td>
<td>• Acquire and Own Marketer and Brands</td>
</tr>
<tr>
<td>III</td>
<td>• Hold minority interest in plants and brands</td>
</tr>
<tr>
<td></td>
<td>• Become Preferred Supplier to Other Firms as Well</td>
</tr>
</tbody>
</table>

## Management and Governance for Each Phase

<table>
<thead>
<tr>
<th>Phase</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>• Joint Venture Agreement Includes Management</td>
</tr>
<tr>
<td></td>
<td>• Interlocking Boards of Directors</td>
</tr>
<tr>
<td>II</td>
<td>• Create Board for Subsidiary and Meet Jointly</td>
</tr>
<tr>
<td></td>
<td>• Manage All Phases of Operations</td>
</tr>
<tr>
<td>III</td>
<td>• Board Representation on Holding Company Board</td>
</tr>
<tr>
<td></td>
<td>• PF Manages Supply and Procurement Operations Only</td>
</tr>
</tbody>
</table>
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
- Recent $120M Distribution Generated Higher ROE
- Situation Varies Across Crops and Regions
- It Remains to Be Seen, How Long It will Last

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
- Continued to Change and Adapt to New Players and Markets
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