WP 2009-09
February 2009

Working Paper

Department of Applied Economics and Management
Cornell University, Ithaca, New York 14853-7801 USA

Serving Member Interests in Changing Markets: A Case Study of Pro-Fac Cooperative

Brian M. Henehan and Todd M. Schmit

It is the Policy of Cornell University actively to support equality of educational and employment opportunity. No person shall be denied admission to any educational program or activity or be denied employment on the basis of any legally prohibited discrimination involving, but not limited to, such factors as race, color, creed, religion, national or ethnic origin, sex, age or handicap. The University is committed to the maintenance of affirmative action programs which will assure the continuation of such equality of opportunity.

Serving Member Interests in Changing Markets:

A Case Study of Pro-Fac Cooperative

By

Brian M. Henehan and Todd M. Schmit*

* Senior Extension Associate and Assistant Professor, respectively, in the Department of Applied Economics and Management, Cornell University, Ithaca, NY, USA, 14853.

Copyright 2009 by Brian M. Henehan and Todd M. Schmit. All rights reserved. Readers may make verbatim copies of this document for non-commercial purposes by any means, provided that this copyright notice appears on all such copies.

Abstract

Since the inception of Pro-Fac Cooperative (PF) in 1960, the cooperative has undergone significant structural and organizational changes. The PF case presents a unique opportunity to examine the changes in the processed fruit and vegetable industry and the strategies adopted by a producer-owned cooperative to best represent member interests in the face of the industry structural changes over the past fifty years.

PF is an agricultural cooperative that markets crops primarily grown by its member-growers, including fruits (cherries, apples, blueberries, and peaches), vegetables (snap beans, beets, peas, sweet corn, carrots, cabbage, squash, asparagus and potatoes), and popcorn. Members are located principally in the states of New York, Delaware, Pennsylvania, Michigan, Washington, Oregon, Iowa, Nebraska, Florida, and Illinois. PF's history can be generally broken down into three distinct time periods, each representing a significant phase of restructuring. Particular attention is given to the decision to enter into the most recent and current phase of operations.

Adequate financing of operations and value-added enterprises were dominant foci over all three periods and each phase involved a different approach. A variety of strategies were also used to enhance the market security for products produced by members. Initially, PF was formed to help preserve the fruit and vegetable processing industry in New York State. At that time, owning the processing facilities was a logical strategy.

The development of alternative cooperative structures is often pursued to ameliorate financial constraints, while attempting to maintain member control. The evolution and restructuring of the PF cooperative can also be described using an ownership control rights typology framework (Chaddad and Cook 2004). Drawing from the property rights and incomplete contracts theories of the firm, Chaddad and Cook argue that alternative cooperative models differ in how ownership rights are defined and assigned to the agents of the firm, i.e., members, patrons, managers, and investors. In the current phase, investors acquired ownership rights in a separate legal entity that is partly owned by the cooperative, i.e. a *cooperative with capital seeking entities* (Chaddad and Cook 2004).

As time progressed and economic conditions changed, PF members were not able to adequately capitalize value-added operations. An arrangement was struck with a private equity firm to provide a needed infusion of capital. The case examines to decision made by the board of directors to enter into this agreement. PF has increased its capacity to serve as a preferred supplier to those firms that can afford owning and operating plants while divesting its majority, ownership position in processing assets.

Keywords

Agricultural cooperatives, fruit and vegetable processing, private equity firms, boards of directors, financing.

Acknowledgements

The authors wish to thank Jenna Van Lieshout, Gail Malone, and Kevin McAvey, former undergraduate, undergraduate, and graduate research assistants, respectively, for their assistance in collection, assimilation, and analysis of data. The authors also appreciate the helpful comments and suggestions by Stephen Wright and Kevin Murphy, General Manager/CEO and Vice President-Member Relations of Pro-Fac Cooperative, Inc., respectively. Any remaining errors are the authors'.

Serving Member Interests in Changing Markets: The Case of Pro-Fac Cooperative

Background

Since the inception of Pro-Fac Cooperative (PF) in 1960, the cooperative has undergone significant structural and organizational changes. The PF case presents a unique opportunity to examine the changes in the processed fruit and vegetable industry and the strategies adopted by a producer-owned cooperative to best represent member interests in the face of the industry structural changes over the past fifty years.

PF is an agricultural cooperative that markets crops primarily grown by its member-growers, including fruits (cherries, apples, blueberries, and peaches), vegetables (snap beans, beets, peas, sweet corn, carrots, cabbage, squash, asparagus and potatoes), and popcorn. As of June 30, 2008, there were approximately 486 PF members, located principally in the states of New York, Delaware, Pennsylvania, Michigan, Washington, Oregon, Iowa, Nebraska, Florida, and Illinois. Only growers of crops marketed through PF (or associations of such growers) can become members of PF.

Each producer approved for membership must purchase common stock in proportion to expected patronage that carries voting rights, and enter into a marketing agreement with the cooperative. Commodity committees represent the interests of members for each of the major crops marketed, and work jointly with PF customers in determining the Commercial Market Value (CMV) for each crop marketed. CMV represents the price that other processors would pay for raw product of similar quality and use. CMV is an industry-weighted average value for each commodity, with adjustments based on grading, compensation of services, and other differences in costs. To provide a fair and equitable distribution of net proceeds, members participate in a

single, multi-commodity payment pool which combines expenses and revenues generated during each fiscal year. Members' shares of patronage proceeds above CMV are distributed based on a pro-rata share of total production for each commodity.

The portion of after-tax net income from non-PF member business is assigned to equity as unallocated, tax-paid retained earnings. The non-cash portion of PF earnings generated through member patronage is generally allocated to each member's account as retained earnings (retains). Capital retained from earnings was converted to Class A preferred stock after each series of retains has been outstanding for five years. PF's Class A cumulative preferred stock is currently listed as "PFACP" on the NASDAQ market.

History

For ease of exposition, PF's history can be generally broken down into three distinct time periods, each representing a significant phase of restructuring. Particular attention will be focused on the decision to enter into the most recent and current phase of operations.

Phase One – Formation & Integrated Agreement

The Cooperative was founded in 1960 in western New York State. The post-WWII period resulted in significant changes in the food processing industry as well as in the status of farmer-owned fruit and vegetable marketing cooperatives. Many small, family-owned and farmer-owned processors that relied on government contracts during the war years lost a key market. In addition, there were major developments in food processing and packaging technologies that required large investments in plants and equipment to stay competitive.

During this period the number of fruit and vegetable processing and marketing cooperatives saw a major decline, as cooperatives consolidated or went out of business and the number of producers declined. The number of fruit and vegetable marketing cooperatives in the U.S. declined from 825 in 1951 to 438 in 1971; by the end of 1994 less than 300 cooperatives remained (USDA 2008). However, real gross sales (deflated by the U.S. Producer Price Index for processed food commodities) continued to increase, reaching $8.4 billion by the end of this time period.

The Cooperative Grange League Federation (GLF), which later became Agway, was the dominant supply and input cooperative operating in the Northeastern U.S. in 1960. GLF members in western New York expressed concern over the potential loss of several family-owned processing firms coming up for sale. GLF acted as a catalyst to effect the merger of two family-owned canning businesses, Curtice Bros. and Burns-Alton, to form Curtice Burns, Inc. (CB). Concurrently, GLF helped to form and initially capitalize PF. The name "Pro-Fac" is a contraction of the two words – "producers" and "facilities".

As part of the arrangements, PF purchased the plant facilities of the two processing companies and leased them back CB. GLF/Agway assisted in creating, financing, and managing the integrated agreement between CB and PF. Many initial PF members were also members of the GLF/Agway cooperative. Two interlocking boards of directors were established to govern each of the integrated agreement partners, with GLF/Agway maintaining controlling interest in CB. CB became a publicly traded company in 1973 when its common stock was listed on the American Stock Exchange.

The integrated agreement spelled out the role and responsibilities of each entity in the areas of finance, management, marketing, and supply of member crops (Table 1). The founders were very careful in constructing the agreement to avoid some of the major pitfalls that they observed in previously failed marketing cooperatives. The founders of PF deliberated over the terms of the agreement to improve the chances of success as described by the first PF manager and President of CB:

> *"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."*
>
> - Morton Adams, PF's first General Manager, as well as president of CB until he retired in 1975 (PF Annual Report, 1986).

Many elements of the agreement created new organizational innovations that were not typically used by traditional, farmer-owned cooperatives at this time and were more aligned with so-called "new generation cooperative" elements. In contrast to "open" membership and deliveries, clearly defined equity and delivery requirements were established, including up-front equity in proportion to the volume of crops delivered. The management of marketing functions was separated from the overall management of the cooperative, while assuring annual crop production plans fit with the marketing plans for the associated products. With a variety of commodities and a heterogeneous membership, a single, multi-commodity pool for member payments was established. Non-member directors served on the board of directors and capital was generated from public markets via the CB common stock listing on the ASE.

In general, the integrated arrangement that was in place during this period provided an organizational foundation for generating a number of economic benefits for members including: increased market security, enhanced prices for member crops, a financially strong value-added business, and relatively good returns on member equity. The integrated operations also provided valuable information and market data to Pro-Fac members. Sales and market intelligence passed through from CB were used by PF for crop production planning. Related information on processing industry trends and inventories proved valuable to PF members in determining crop selection and planting plans.

PF was responsible for providing agricultural services to members, coordinating planting and harvesting as well as crop delivery while CB was responsible for food manufacturing, sales and marketing as well as consumer product distribution.

The number of fruit and vegetable commodities as well as snack and food products increased considerably during this phase. PF membership expanded geographically in alignment with CB's aggressive growth and diversification strategy. PF membership grew from 368 in 1974 to its high of 819 in 1982. The aggressive growth was reflected in strong increases in real CMV from the 1960s to the mid-1980s exceeding US$63 million (in 2006 dollars) by 1986, and over US$80 million by the end of 1994 (Figure 1). While increased productivity and technological advancements on farms contributed to softening membership by the end of Phase One to 625 members, as the average CMV received and deliveries per member continued to increase.

The aggressive growth through acquisitions by CB is also evident in Pro-Fac's combined operations balance sheet data (Table 2). During this phase, the combined

operations showed significant growth in assets, increasing from nearly US$400 million in 1983 to over US$950 million by 1990 (evaluated at nominal levels). However, subpar financial performance prompted the sale of poorly performing operations, and by the end of 1994, total assets were reduced to US$819 million.

Phase Two – End of Joint Venture and Additional Acquisitions

During the late 1980's and early 1990's Agway experienced poor financial performance culminating in two years of net losses in 1990 and 1991 (Anderson and Henehan 2002). Under a new CEO in 1992, the company began a major reorganization, including a renewed focus on Agway's core businesses and divesting non-core businesses. In 1994, Agway announced the potential sale of Curtice Burns Foods, CBF (renamed in 1987), and after a long, protracted, and expensive change of control, PF acquired CBF from Agway in September of that year. The transaction was historic in the sense that PF became the first farmer cooperative to acquire a publicly traded company and take it private. In 1997, CBF changed its name to Agrilink Foods (AF) and by March of 2000 PF effectively began doing business as AF, creating an overall holding company for the processing and marketing assets. The new name signified PF's role in linking the agricultural and marketing segments of the business.

While AF was a wholly-owned subsidiary of PF, each entity retained its own board of directors with AF's board being appointed by the PF board. The boards met jointly and coordinated activities. Business structures and operations were centralized and streamlined to reduce costs and inefficiencies. The acquisition allowed PF to become the first farmer cooperative with securities listed on a major stock exchange when it's

Class A cumulative preferred stock was listed on the NASDAQ in 1995 to provide increased liquidity for member equity.

Similar to the previous agreement, PF supplied crops and additional financing to AF; in return, AF provided a market (CMV of products supplied) and management services to PF. PF shared in the profits and losses of AF, and reinvested at least 70% of any additional patronage income back into AF.

Acquisitions and joint ventures with smaller companies and regional brands continued to grow during this phase. PF's most significant move came in 1998 when AF acquired Dean Foods' frozen and canned vegetable business for US$400 million, along with its Birds Eye, Freshlike, and Veg-All national brands. The Dean Foods acquisition effectively doubled the branded operations proportion of the business, a decision that was consistent with AF's strategic direction at the time, according to Dennis M. Mullen, AF president and CEO:

> *"Our strategic plan has called for growth, and, with this transaction, we are taking a significant step forward in growing our cooperative which also expands sourcing opportunities for our Pro-Fac owners. ... Together with our own strong workforce, we will collectively enhance our overall position as a leader in food processing. The addition of Dean's branded products to our portfolio is consistent with our strategy to balance our private label business with our own strong brands. This balance is critical to our success as an agriculturally-driven business."* (QFFI, 1998)

In addition to increased debt, acquiring a large, national brand brought intense competition from related brands (e.g., Del Monte, PepsiCo., Nabisco), and required a significant investment in research and development to continue to introduce new and innovative products (Amanor-Boadu, et al. 2003).

With the acquisition of CB and the formation of Agrilink Foods (AF), PF was now the owner and operator of processing facilities as well as responsible for marketing.

Through it's subsidiary AF, PF became responsible for providing agricultural services to members, coordinating planting and harvesting, crop delivery, food manufacturing, sales and marketing, as well as consumer product distribution.

After decreases in real CMV in 1995 and 1996, total CMV (inflation adjusted) increased later in Phase Two (see Figure 1). This period saw continued decline in total members as farm numbers dropped but per member deliveries increased. Due to CB's higher leveraged position, the acquisition increased PF's debt position and level of member equity capitalization significantly. In 1993, prior to the acquisition, PF's member equity level was approximately 34 percent of assets; by 1996 this figure dropped to under 20 percent (Table 2). In order to provide increased liquidity for member equity, preferred stock was listed on the NASDAQ market in1995.

Returns, on average, were relatively good, but more variable. However, substantial draws from earned surplus were required in 1996, 2001, and 2002 to offset negative earnings and maintain dividend payments.

Moreover, the acquisition of a large, national branded company increased PF's leveraged position tremendously resulting in a debt ratio of nearly 100% and a reported equity percentage of less than three percent by 2002 (Table 2). The reduced equity position was also a result of a non-cash, goodwill impairment charge of US$179 million (US$137.5 million net of taxes) charged as negative income for fiscal year 2002. As discussed in Amanor-Boadu, et al. (2003), this charge was due to a number of factors including: worsening general economic conditions in the industry, reduced asset valuations from market declines, and the valuation reached in the agreement with Vestar in 2002.

It was during this phase that internal sources of equity capital reached their limit, with average per member capitalization in excess of US$250,000, a nearly 50% increase over a six year time horizon and tighter profit margins. The higher debt load grew problematic and strategic efforts to minimize debt became a priority.

Phase Three – Outside Equity Infusion and Restructured Operations

The increased debt servicing requirements and need for increased capital investment grew beyond the means of the membership – outside equity investment was required to ameliorate these financial constraints. Following a detailed review of all the strategic options, the PF board of directors arrived at the decision, and members approved, to enter into an agreement with Vestar, LLC (Vestar) a private equity firm.

In August, 2002, when an outside equity infusion by majority investor Vestar was secured, Agrilink Holdings (AH) was created. PF contributed all shares of its AF common stock (valued at approximately US$32 million) for Class B common units of AH and representing 40.72% of the common equity ownership. Vestar contributed a total of US$175 million in cash. Of that total, US$137.5 million was invested in a preferred stock instrument while US$35.5 million was invested in Class A common units and representing 56.24% of common equity ownership. Selected management of PF and AF acquired US$1.3 million of Class C and D common units, or the remaining 3.04% of common equity interest. In 2003, AF and AH changed names to Birds Eye Foods (BEF) and Birds Eye Holdings (BEH), respectively.

As specified in an agreement with Vestar, PF received annual payments of US$10 million for five years, and could utilize a US$1 million line of credit for each of the five years. Furthermore, an amended marketing and facilitation agreement was created

identifying PF as the preferred supplier of crops under a 10-year supply agreement. BEF would continue to pay CMV for all crops supplied by PF. BEF would continue to provide PF members services related to planning, consulting, sourcing, and harvesting crops. With an eye towards reducing debt and improving member equity position, the Vestar transaction was consistent with the financing needs of the cooperative, as explained by Dennis Mullen, AF president and CEO:

> *"De-leveraging our balance sheet with these investment proceeds will strengthen the company's position in the highly competitive food industry."* (RFF, 2002)

Vestar restructured the BEF business by trimming payroll expenses, changing the management team, and selling off selected brands and assets. In 2006, BEF elected to concentrate its resources on its branded business and increase its focus on new products and marketing. As a result, BEF put its non-branded frozen facilities up for sale, including plants in NY, GA, and WI. PF was no longer interested in owning the processing side of its operations, as indicated by then Board President Peter Call.

> *"Any opportunity must be economically beneficial to growers and consider the well-being of the communities where these facilities are located. Pro-Fac's expertise lies in producing raw products, not in operating processing facilities, so a partnership between the Cooperative and an operating entity is an option that will actively be pursued."* (Pro-Fac press release, July 25, 2006)

In November 2006, Allen Canning Company (now Allens, Inc.) acquired substantially all of the operating assets of BEF's non-branded frozen vegetable business, including the five plants in NY, GA, and WI. As part of the transaction, BEF assigned to Allens the portion of the supply arrangements under the marketing and facilitation agreement with PF. While PF continues to sell products to BEF, primarily fruit products, its private label business and non-branded vegetable business were transferred to Allens.

Conceptual Framework

An accepted definition of a cooperative is "a user-owned and user controlled business that distributes benefits on the basis of use" (Cobia 1989). And so, members of a marketing cooperative can derive economic benefits from their cooperative in various ways: as a supplier of raw products (prices, services), an owner of assets (return on equity, strategic value of assets) that are related to cooperative operations and through control exerted by member-based governance structures (market security, strategic direction). The decision to enter into the Vestar agreement will be viewed in light of the potential member benefits generated from the transition for members as both suppliers and equity holders. Management theory will be used to review the "pros and cons" of each potential strategic option open to PF and how various alternatives were evaluated by the board of directors.

The development of alternative cooperative structures is often pursued to ameliorate financial constraints, while attempting to maintain member control. The evolution and restructuring of the PF cooperative can also be described using an ownership control rights typology framework (Chaddad and Cook 2004). Drawing from the property rights and incomplete contracts theories of the firm, Chaddad and Cook argue that alternative cooperative models differ in how ownership rights are defined and assigned to the agents of the firm, i.e., members, patrons, managers, and investors. They use a broad definition of ownership rights including both residual claims (i.e., who has first claim to the net income) as well as control rights (i.e., who 'owns' and controls assets).

Within this framework, the traditional cooperative and the investor-owned firm are identified as polar organizational forms. They argue that the "vaguely defined" property rights associated with the traditional cooperative imply constraints to investment and governance (Chaddad and Cook 2004). "New generation cooperatives", structured similar to the original PF operational and governance features, relieve some investment constraints whereby delivery rights are acquired on the basis of expected patronage as well as the required equity capital investment. This structure within PF helped to reduce the free-rider problem inherent in traditional cooperative structures when property rights are not transferable or unassigned (Cook 1995). Further, when ownership rights are not restricted to member-patrons, outside equity capital may become available to support increased capital requirements. In Phase 3., investors acquired ownership rights in a separate legal entity that is partly owned by the cooperative, i.e. a *cooperative with capital seeking entities* (Chaddad and Cook 2004).

The principal-agent problem within a property rights theoretic approach is also evident in most cooperative forms as member boards of directors (the principals) and management (the agent) can have differing interests. Typically member-directors act to improve member returns, while management may be pursuing their own goals, such as compensation and bonuses (Fulton 1995). As such, asymmetries in information arise and the agent's decisions (and motivations) are not fully observable.

Analysis of the Decision to Restructure with Outside Equity Investment

PF's debt position under the integrated agreement was relatively stable during 1970s and 1980s; however, more aggressive expansion in the latter stages of phase one, resulted in increasing debt ratios from around 40 percent in the mid-1980s to over 60

percent by 1993 (Table 2). Total member equity investment grew considerably over this period, with average per member equity/capitalization growing from less than US$24,000 in 1974 to over US$180,000 by 1992. By 2002, PF found itself burdened with a higher level of debt and the associated interest expense, which limited access to needed capital. During this time, growers were experiencing several years of low crop prices and limited farm income. PF members already had significant levels of equity invested in the cooperative and were not in a position to invest more. The board of directors found it necessary to explore other sources of capital to maintain viable operations and address financial challenges.

The options that PF management and board explored included the following six alternatives: increase public stock offering, seek a strategic investor, find a synergistic partner to enter into a LLC, secure a private equity infusion, "tough it out", or sell the company (Wright 2003). A summary of the "pros and cons" for each option is presented in Table 3. The board chose to pursue a capital infusion from a private equity firm. A request for proposals was issued to seek responses from various equity investment firms. The board decided to enter into an agreement with the firm that offered the best terms including a supply agreement, termination payments, and support for continued payment of dividends payments. The board selected Vestar Capital Partners, LLC (Vestar) as their choice and the decision was overwhelmingly approved by a vote of PF members.

Along with the decision to seek financing from a private equity firm, PF made significant changes in its operations, basically shifting from an operating and marketing cooperative that owned processing assets and branded products to a bargaining

cooperative that became a supplier to key processing firms. PF withdrew from processing and marketing activities to focus on crop supply coordination and delivery (Figure 4).

While BEF and Allens are currently PF's two major customers, PF serves multiple firms, both big and small, across the country in relation to its major commodity production areas. Regional agreements, such as PF's membership interest and agreement with Farm Fresh First, LLC in New York State, provide PF with agricultural, marketing, and administrative services for the sale of agricultural products grown by PF members that are not otherwise subject to supply agreements. Farm Fresh First is also responsible for providing agricultural services to members, coordinating planting and harvesting, and crop delivery. BEF, Allens, and other PF customers are responsible for manufacturing, sales and marketing, as well as consumer and food service product distribution.

PF member numbers and the CMV received have remained relatively stable during this phase; the outside equity infusion has not altered members' ability to receive competitive prices for their products (Figure 1). Strategies to invest in national brands also remained, but were now under the ownership control of Vestar. Management of these operations, along with the processing facilities associated with them, had been shifted to outside parties with the available equity capital.

Reporting and access to information from BEH, now a private company, are restricted. The loss of ownership rights can limit access to information that might be valuable to members or was previously available in earlier phases. In considering the principal-agent problem, this is particularly relevant. Reduced information can enhance the principal-agent problem, particularly in this instance where an additional agent is involved outside of the cooperative organization and with controlling interest in

marketing and sales operations. BEH's actions are clear in terms of enhancing returns to stakeholder investment. However, it was also clear to cooperative members that management expertise and access to sufficient capital in the highly competitive branded processed fruit and vegetable market were needed even though principal-agent issues might arise.

As specified in an agreement with Vestar, PF received annual payments of US$10 million for five years, and could utilize a US$1 million line of credit for each of the five years. Furthermore, an amended marketing and facilitation agreement was created identifying PF as the preferred supplier of crops under a 10-year supply agreement. BEF would continue to pay CMV for all crops supplied by PF and would continue to provide PF member services related to planning, consulting, sourcing, and harvesting crops.

Due to changes in reporting procedures and accounting methods, direct comparisons across phases are problematic; however, general changes from the shift in ownership control can be highlighted. While net income was supported by termination payments for a specified time, these proceeds largely supported the maintenance of dividends on preferred stock. Reported balance sheet data now reflects only PF operations, with no reporting of (minority owned) assets, liabilities, or equity holdings under BEH (Table 2). Even with considering the initial US$32 million PF investment in BEH, the outside equity infusion has ameliorated PF's debt servicing requirements and substantially reduced PF member equity and capitalization levels (Figure 2).

Annual distributions from BEH to PF are made at the discretion of Vestar and were not expected, by PF. This is reflected in the minimal net proceeds available to members early in phase three. In fact, equity income losses from BEH in 2005 and 2006

resulted in additional draws from earned surplus accounts. However, in July of 2007 (FY2008), BEH distributed approximately $120 million to PF as an investor in BEH. PF used the distribution to redeem selected shareholder equity and pay dividends on selected securities, in some cases retroactively. PF used a portion of this distribution to redeem all retained earnings allocated to its members, repay principal and interest owed under its credit agreement with BEF and to redeem all of its non-cumulative preferred stock and 64% of its Class A cumulative preferred stock. An additional 22% of Class A cumulative preferred stock was redeemed on October 31, 2008 (in FY2009).

It remains to be seen what the future holds for the strategies adopted in the latest phase of operations. Typically, private equity firms hold onto firms that they have invested in for a limited number of years to improve profitability and earnings, and then sell their interest to achieve a capital gain. When (and if) BEH is sold, PF and its members would receive a share of any gain from the sale proportionate to their share of total common equity invested in BEH at that time. It remains difficult to project what return on equity to members might derive from such a sale.

Conclusions

There are a number of common issues that cut across each of the three phases discussed above. Each phase used various strategies to attempt to address the issues for the benefit of members. These issues or performance areas include: financing, market security, relationships with processors, management, and governance. This case has looked closely at the first three evolving issues.

Adequate financing of operations and value-added enterprises were dominant foci over all three periods and each phase involved a different approach. A variety of

strategies were also used to enhance the market security for products produced by members. Initially, PF was formed to help preserve the fruit and vegetable processing industry in New York State. At that time, owning the processing facilities was a logical strategy. As time progressed and economic conditions changed, PF members and the cooperative have increased their capacity to serve as a preferred supplier to those firms that can afford owning and operating plants.

The current situation for most members is positive. Prices for most crops rose in 2008, although the costs of inputs are increased as well. Processors for many crops are increasing projected deliveries or anticipating greater volumes. The recent US$120 million distribution created a more viable future for PF, as well as generated a high, short term return on equity for individual members. It should be noted that the situation for growers varies. For example, cucumber producers in the Northwest have lost a key buyer. However, most members are deriving economic benefits both as suppliers (relatively high prices and increased deliveries) and as investors (improving return on equity). As can be the case in agricultural businesses, prosperity can unfold in cycles; it remains to be seen how long this period of higher prices and a relatively secure market will last.

The PF story presents a unique case in the world of agricultural cooperatives including the first farmer cooperative to mount a leveraged buyout of a publicly-traded company and take it private, and the first agricultural cooperative to have a security listed on a major exchange. PF has continued to adopt and redesign in a world of ever-changing markets. PF was an early adopter of a number of innovative strategies to overcome potential constraints to agricultural cooperative success including: transferable

delivery rights, a multi-commodity single earnings pool, conversion of member equity to publicly-traded securities, and partnering with successful marketing firms and private equity groups. The next phase in PF history remains to be written, however Steve Wright, the current General Manager and CEO summarizes it well:

> *"Pro-Fac Cooperative has produced many "firsts" in the Cooperative world and successfully weathered the storms of dramatic external and internally driven change. We firmly believe that when the final chapter is written about our Cooperative, it will reveal that Pro-Fac members derived great benefit from their Pro-Fac affiliation in terms of supply, crop valuations and returns on equity."*
>
> Steve Wright (2008), Pro-Fac General Manager & CEO (1995-present)

Other cooperatives struggling to finance value-added operations may benefit from some of the lessons learned from PF. A cooperative may avoid conversion to an investor oriented firm and retain its member oriented structure through restructuring operations and entering into a creative relationship with a private equity firm.

References

Agrilink Foods, Inc. *Annual Reports*, 1997-2002.

Amanor-Boadu, V., M. Boland, D. Barton, B. Anderson, and B. Henehan. 2003. "Birds Eye Foods, Inc. – A Case Study" Case Study Series No. 03-06, Arthur Capper Cooperative Center, Kansas State Univ. Manhattan, KS. http://www.agmanager.info/agribus/research/case_studies.

Anderson, B.L. and B.M. Henehan. 2002. "What Went Wrong at Agway." *Cooperative Business Journal*, National Cooperative Business Association. Washington, DC. November.

Chaddad, F. and M.L. Cook. 2004. "Understanding New Cooperative Models: An Ownership-Control Rights Typology." *Review of Agricultural Economics* 26(3):348-360.

Cook, M.L. 1995. "The Future of U.S. Agricultural Cooperatives: a Neo-Institutional Approach." *American Journal of Agricultural Economics* 77(5):1153-1165.

Cook, M.L. and F.R. Chaddad. 2004. "Redesigning Cooperative Boundaries: The Emergence of New Models." *American Journal of Agricultural Economics* 86(5):1249-1253.

Curtice Burns Foods, Inc. *Annual Reports*, 1987 – 1994.

Fulton, M. 1995. "The Future of Canadian Agricultural Cooperatives: a Property Rights Approach." *American Journal of Agricultural Economics* 77(5):1144-1152.

Pro-Fac Cooperative, Inc. *Annual Reports*, 1985-1997.

Pro-Fac Cooperative, Inc. 1986. *Annual Report for the 25th Anniversary*

Quick Frozen Foods International (*QFFI*). 1998. "Agrilink Foods to Acquire Dean's Vegetable Business; Transaction Nearly Doubles Company Size." October 1.

Refrigerated & Frozen Foods (*RFF*). 2002. "Bird Eye Frozen Vegetable Processor Agrilink Foods." March 1.

U.S. Securities and Exchange Commission (SEC). 1994-2007. *Pro-Fac Cooperative, 10-K Annual Reports*. Washington, D.C. http://www.sec.gov/edgar/.

USDA, Rural Development, Cooperatives Program. Current and archived data, 1951-2006. http://www.rurdev.usda.gov/rbs/coops/data.htm

Wright, S. 2003. "Executing Difficult Strategies: Changing Business Structures." Presentation, Farmer Cooperatives Conference, October 31, Kansas City, MO.

Wright, S. 2008. Personal communications, December 3, 2008.

Table 1. Summary of Curtice Burns and Pro-Fac Cooperative Integrated Agreement.

Curtice Burns	Area	Pro-Fac
-Net proceeds derived from total sales; shared with PF 50/50 -Common stock listed on AMEX, 1973	**Finance**	-Financed ownership of plants, leased to CB -Equity loaned to CB; seasonal & term loans from Bank for Coop's -Sold delivery rights based on common stock to members
-Conducted all marketing activities -Owned brands, made acquisitions -Developed new products	**Marketing**	-Recruited members from new acquisition farming areas -Reserved first right to purchase brands upon dissolution -Farm products provide basis for new products
-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**	-PF and Agway had access to books and financial information -1 CB and 1 Agway director on PF board
-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**	-Committee for each commodity -Committees determine CMV in concert with PF management and approve crop agreements -Payments made from a single, multi-commodity pool

Table 2. Pro-Fac balance sheet data, selected fiscal years ending June 30 (nominal, million US dollars).[a]

Year		1983				1993	1996
Entity	PF	CB	PF+CB	PF	CB	PF+CB	PF Agrilink
Assets	$ 137.6	$ 260.1	$ 397.6	$ 324.9	$ 493.7	$ 818.6	$ 637.3
Liabilities	$ 82.9	$ 215.4	$ 298.2	$ 215.0	$ 403.6	$ 618.6	$ 510.6
Equity	$ 54.7	$ 44.7	$ 99.4	$ 109.9	$ 90.1	$ 200.0	$ 126.7
% Equity	39.8%	17.2%	25.0%	33.8%	18.3%	24.4%	19.9%

Year	1999		2002	2003	2005	2007	2008
Entity	PF Agrilink		PF Agrilink	PF	PF	PF	PF
Assets	$1,196.5		$ 836.2	$ 31.5	$ 23.9	$ 25.3	$ 52.4
Liabilities	$1,044.4		$ 811.7	$ 12.1	$ 12.7	$ 20.5	$ 22.5
Equity	$ 152.1		$ 24.5	$ 24.3	$ 11.2	$ 4.4	$ 29.4
% Equity	12.7%		2.9%	77.3%	47.0%	17.3%	56.1%

Sources: Pro-Fac (PF), Curtice Burns (CB), and Agrilink Annual Reports, PF SEC 10-K filings.
[a] Following 2002, balance sheet data does not include PF investment in Birds Eye Holdings, LLC (BEH), 321,429 Class B common equity units, original value of US$32 million.

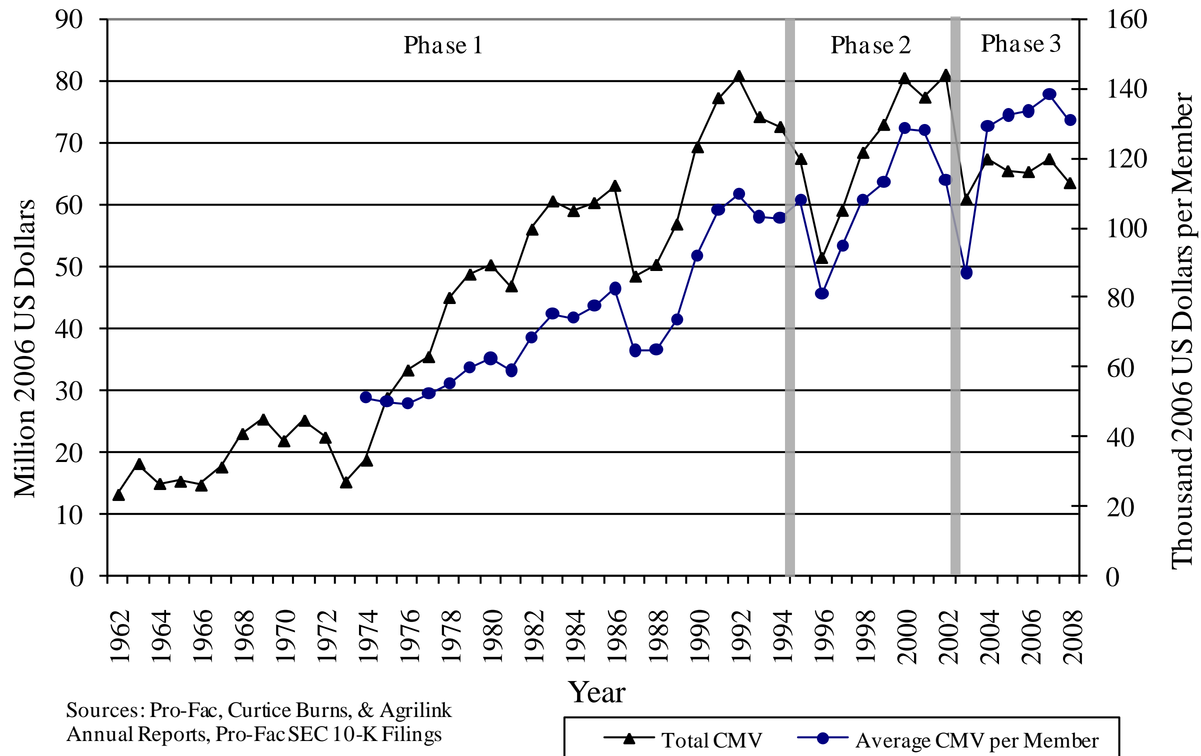

Figure 1. Commercial Market Value (CMV) of Raw Product Deliveries, Total and per Member, 1962 – 2008.

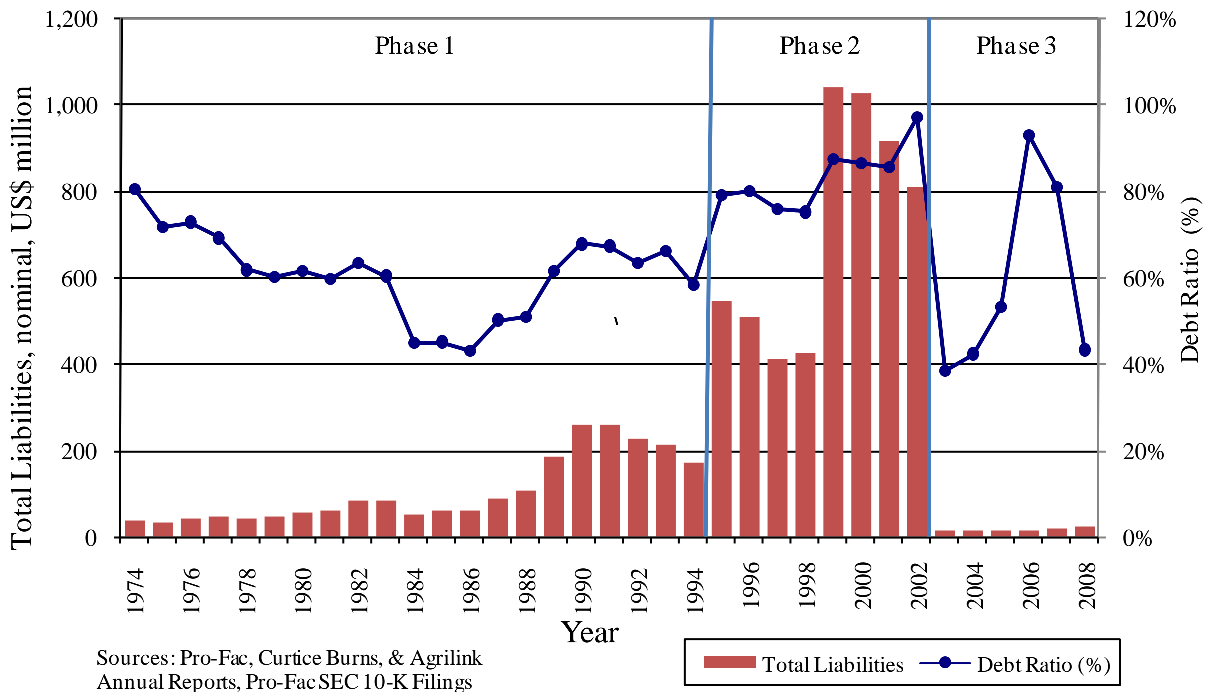

Figure 2. Pro-Fac Debt Levels and Debt Ratios, 1974 – 2008.

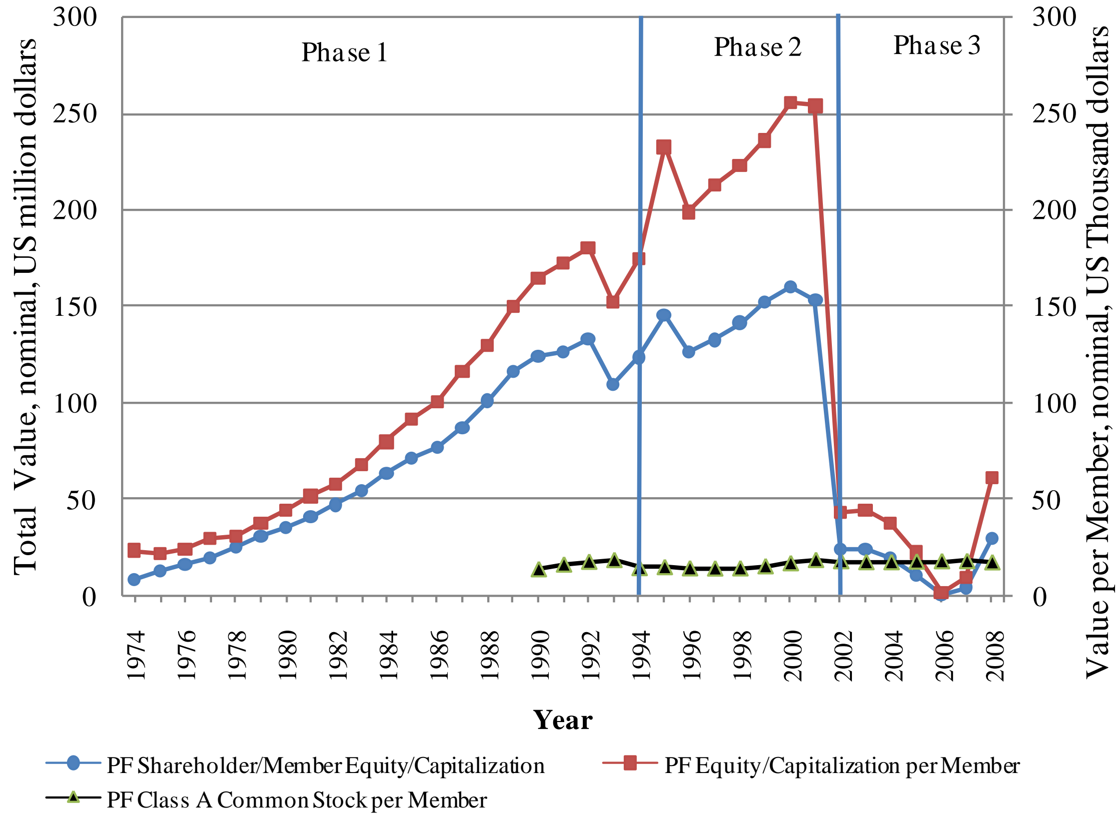

Figure 3. Pro-Fac Shareholder and Member Capitalization and Investment, 1974 - 2008.

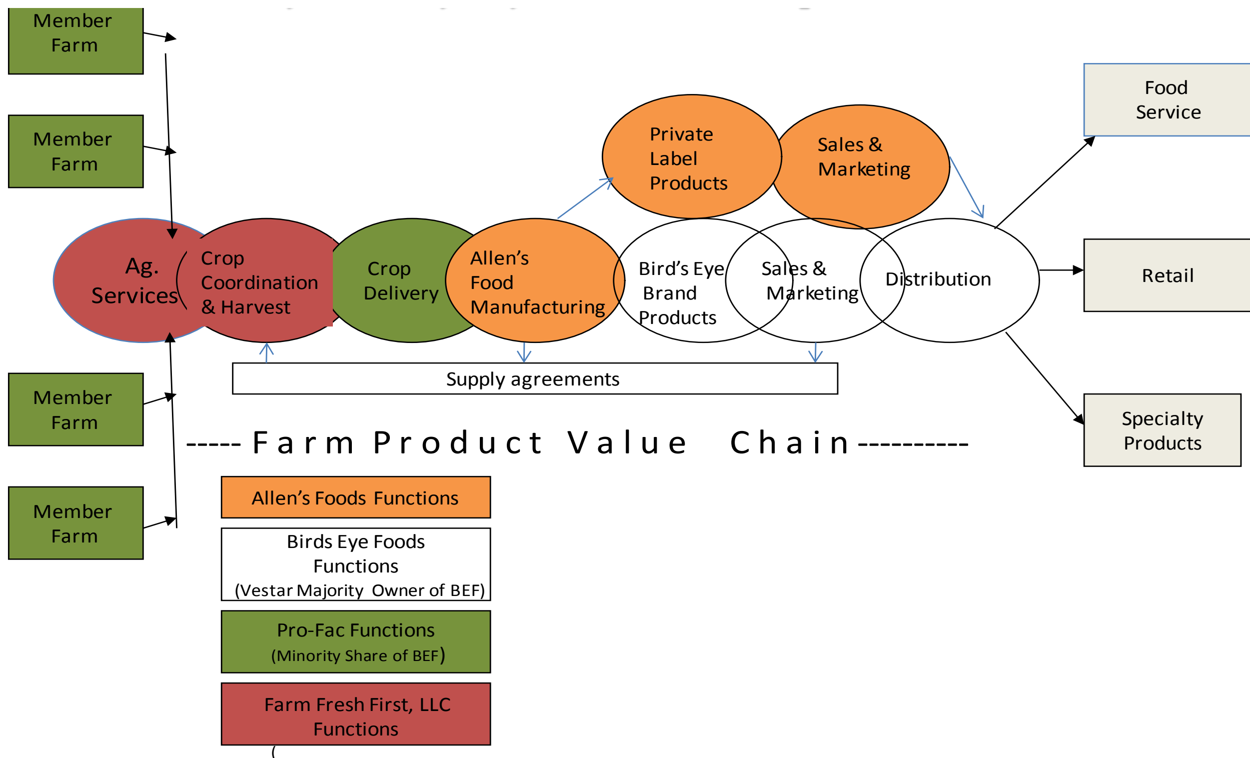

Figure 4. Current Pro-Fac Integrated Operations with National Firms and Outside Equity Partner

Table 3. Pros and Cons of Various Outside Equity Options

Outside Option	Pro	Con
Public Offering	Potential to raise needed capital Previously utilized public markets Diversify sources of capital	Strong emphasis on short term performance Driven by quarterly earnings results Market volatility High costs of listing SEC & Sarbanes-Oxley compliance Dilute member control
Strategic Investor	Potential to raise needed capital Might find investor with compatible goals for business	Limited pool of potential investors Dilute member control Could have goals conflicting with members
Synergistic Partner	Potential to raise needed capital Might find partner in similar industry compatible goals for business Create synergy that brings mutual benefits	Limited pool of potential partners Dilute member control Could have goals conflicting with members
"Tough It Out"	Avoid brining in outside investors Maintain higher level of member control	Creditors could lose patience Dim outlook for future success Could result in significant erosion of the value of member equity and other stock holders
Private Equity Firm	Ability to select firm of choice Identify firm with compatible goals and management culture Bring additional management talent into operations Negotiate supply agreement	Limited pool of potential firms Dilute member control Could have goals conflicting with members Incompatible management culture
Sell the company	Generate immediate revenues from sale Get out from under high debt load	Low valuation of company based on current EBITDA and debt Uncertainty about future owner Lose any member control

OTHER A.E.M. WORKING PAPERS

WP No	Title	Fee (if applicable)	Author(s)
2009-08	Investment Decisions and Offspring Gender		Bogan, V.
2009-07	Intergenerationalities: Some Educational Questions on Quality, Quantity and Opportunity		Kanbur, R.
2009-06	A Typical Scene: Five Exposures to Poverty		Kanbur, R.
2009-05	The Co-Evolution of the Washington Consensus and The Economic Development Discourse		Kanbur, R.
2009-04	Q-Squared in Policy: The Use of Qualitative and Quantitative Methods of Poverty Analysis in Decision-Making		Shaffer, P., Kanbur, R., Hang, N. and E. Aryeetey
2009-03	Poverty and Distribution: Twenty Years Ago and Now		Kanbur, R.
2009-02	Why Might History Matter for Development Policy?		Kanbur, R.
2009-01	Product Differentiation and Market Segmentation in Applesauce: Using a Choice Experiment to Assess the Value of Organic, Local, and Nutrition Attributes		James, J., Rickard, B. and W. Rossman
2008-24	Import Demand for Horticultural Commodities in Developed and Emerging Countries		Rickard, B., St. Pierre, C. and G. Becker
2008-23	Domestic support reform? A closer look at the EU policies applied to processed fruits and vegetables		Rickard B. and D. Sumner
2008-22	Measuring the Effects of the Clean Air Act Amendments on Ambient PM10 Concentrations: The critical importance of a spatially disaggregated analysis		Auffhammer, M., Bento, A. and S. Lowe
2008-21	The Optimal Minimum Wage for Poverty Minimization		Goto, H.
2008-20	Labor Market Competitiveness and Poverty		Goto, H.
2008-19	Do Investors Learn about Analyst Accuracy?		Chang, C., Daouk, H. and A. Wang
2008-18	Regional Inequality in China: An Overview		Fan, S., Kanbur, R. and X. Zhang

Paper copies are being replaced by electronic Portable Document Files (PDFs). To request PDFs of AEM publications, write to (be sure to include your e-mail address): Publications, Department of Applied Economics and Management, Warren Hall, Cornell University, Ithaca, NY 14853-7801. If a fee is indicated, please include a check or money order made payable to Cornell University for the amount of your purchase. Visit our Web site *(http://aem.cornell.edu/research/wp.htm)* for a more complete list of recent bulletins.