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FCStone Conversion to a Public Corporation

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FCStone Group (FCS) is a publicly held corporation that converted from a cooperative to a private corporation in 2005, and then converted to a public corporation in 2007. It is an integrated commodity risk management company that provides risk management consulting and transaction execution services to commercial commodity intermediaries, end users, and producers. This case study focuses primarily on the period from the first conversion in 2005 to six months after the public offering in March 2007. Because the financial benefits received by each of the cooperative owners of FCS are dependent on the timing of their sale of FCS stock, stock price information and benefit estimates are provided up to early November 2008.

Background

The primary business objective of FCS is to assist middle-market customers optimize their profit margins and mitigate their exposure to commodity price risk. Middle-market customers who first organized FCS as a cooperative were grain marketing and farm supply local cooperatives in the American Midwest. It was the cooperative member-owners of FCS who voted to convert FCS from a federated regional cooperative—owned and controlled by other cooperatives—to an investor-oriented business.

FCS consists of four primary business segments: (1) commodity and risk management services that help customers use futures, options, and other derivative instruments through FCS' Integrated Risk Management Program and use of their futures commission merchant standing on the major commodity markets; (2) clearing and execution services that give customers direct access to the trading floor; (3) financial services that assist customers who want to carry commodities through the use of sale and repurchase agreements; and (4) grain merchandising through a subsidiary grain dealer (FGDI), which includes a leased export elevator and leased rail cars.

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Organizational history

FCS traces its cooperative origins back to Agri Industries, an Iowa-based regional cooperative whose members were grain-marketing cooperatives. The risk management execution services tied to the Chicago Board of Trade were first provided to member cooperatives in 1968. This business activity was separated in 1978 into a subsidiary known as Farmers Commodities Corporation (FCC). In 1978, net revenue equivalent to gross income was US\$500,000. In 1986, FCC was spun off into a separate regional cooperative company with net revenues of US\$8 million. In 2000, FCC acquired Saul Stone, an execution services company with a presence in all the domestic commodity exchanges, giving FCC the ability to clear all U.S. exchange-traded commodity futures and options contracts. Net revenue grew to US\$42 million. In 2000, the name became FCStone Group, Inc., but the company maintained its cooperative business form until the vote to convert to an ordinary corporation on 1 March 2005.

The journey to conversion may have been inevitable if the objective were to reach FCS' full potential as a business entity, given its opportunities and the constraints of the co-op business model. What has been achieved in size and performance of the company and wealth creation for members and stockholders could not have occurred as a co-op. In hindsight, perhaps the most important question is whether its co-op members have been better off since the conversion.

The journey to conversion had several important mileposts. An important one was the hiring of Paul (Pete) Anderson as CEO in 1999. Anderson pointed out the high growth potential of FCS to the board of directors during his interview for the position. It was expressed in a vision statement that he prepared for the board, which outlined many of the potential growth opportunities and strategies that could and should be pursued. At that point, the vision statement's focus was exclusively on members and how the company could best serve their needs.

The success of that growth strategy over the next three years led to new issues. Among them were a natural limit on the growth of equity capital generated from operational profits and a shift in the mix of business from mostly patronage-based to mostly non-patronage-based. The risk management business model that FCS had created was useful to many domestic and global businesses beyond the traditional cooperative members.

Another important milestone was reached in March 2002, when Anderson again addressed to the board the growth potential and constraints, and laid out some capital and structural alternatives. Six alternative structures were described, including continuing the current traditional co-op business model and converting to a publicly held corporation through an IPO. Each alternative was evaluated in terms of advantages and disadvantages to current customer-member-owners, as well as to

the company and its employees. The alternatives were refined and further evaluated over the next two years with the help of outside consultants. Based on this information, the board recommended the conversion and IPO alternative to its members.

The FCS conversion came about by a two-stage process. First, it converted from a co-op to a private or closely held ordinary corporation (C-Corp), effective 1 September 2004, based on a membership vote taken on 1 March 2005. This vote explicitly terminated patronage rights as of 1 September 2004, the beginning of the 2005 fiscal year, even though the vote was taken six months after the fiscal year had begun. Including common and preferred shares, 96 percent of the votes cast favored the conversion. Second, it converted from a private to a public corporation on 16 March 2007. In October 2006, FCS filed for an initial public offering (IPO) of common stock. The next stockholder vote, 5 December 2006, approved the IPO and the change from an Iowa corporation to a Delaware corporation. Of the votes cast, 97 percent favored the IPO.

Demand for the new stock was initially strong. It opened at US\$24 and closed at US\$32. A total of 5.865 million shares were sold, with net receipts of US\$129.7 million. This new equity was added to the existing equity of US\$72.1 million. The pre-IPO equity consisted primarily of “original” shares converted from co-op equity with a cost basis of US\$10, additional “appraised” shares with a cost basis of zero, additional “subscription” shares purchased by existing stockholders at US\$10 per share in a supplemental subscription offering from April through June 2005, and Employee Stock Ownership Plan (ESOP) shares purchased in August 2005 by employees using a portion of their 401(k) assets.

Present business

FCS has evolved from a business that provides commodity exchange execution services into a diversified company that focuses on integrated risk management. Their IPO prospectus described the firm as follows:

We are an integrated commodity risk management company providing risk management consulting and transaction execution services to commercial commodity intermediaries, end-users and producers. We assist primarily middle-market customers in optimizing their profit margins and mitigating their exposure to commodity price risk. In addition to our risk management consulting services, we operate one of the leading independent clearing and execution platforms for exchange-traded futures and options contracts. We serve more than 7,500 customers, and in the twelve months ended November 30, 2006, executed 50.2 million derivative contracts in the exchange-traded and over-the-counter (“OTC”) markets. As a natural complement to our commodity

risk management consulting services, we also assist our customers with the financing, transportation and merchandising of their physical commodity requirements and inventories. Our net income increased \$8.7 million, or 131.8%, from \$6.6 million in fiscal 2005 to \$15.3 million in fiscal 2006, and increased \$2.9 million, or 85.3% from \$3.4 million in the three months ended November 30, 2005, to \$6.3 million in the three months ended November 30, 2006.

We began offering commodity risk management consulting services to grain elevators in 1968. Since that time, our business has evolved to meet the changing needs of our customers. In response to these changing needs, we expanded our risk management services from a focus on agricultural futures and options to a wider array of instruments, including OTC (“over the counter”) derivatives, and to other commodities, including energy commodities, forest products and food products. We operated as a member-owned cooperative until 2005, when we converted to a stock corporation to improve our access to capital and to facilitate continued growth in our operations.

FCS divides their company into four operating segments:

1. Commodity and Risk Management Services (CRM) is the foundation of the company, and provides the largest portion of net income. Roughly 117 risk management consultants assist customers to mitigate their exposure to commodity price risk and maximize the amount and certainty of their operating profits.
2. Clearing and Execution Services (CES) supports CRM by providing lower-margin clearing and execution services to risk management customers. A wide array of other customers are further served, including commercial accounts, professional traders, managed futures funds, and introducing brokers who provide risk management services to retail customers.
3. Financial Services (FS) helps customers finance physical grain inventories and other commodity inventories.
4. Grain Merchandising (GM) uses a separate company, FGDI, to function as a dealer in and manager of physical grain and fertilizer. FGDI links merchandisers of grain products through a network of industry contacts, and serves as an intermediary to facilitate the purchase and sale of grain. On 1 June 2007, FCS reduced its ownership in FGDI from 70 percent to 25 percent (Agrex, a subsidiary of Mitsubishi, owns the remaining 75 percent). As a consequence

of this reduced ownership, grain sales are not included as revenues in the 2008 fiscal year, as reported in table 1.

Operations and financial performance history

From 1999 through 2004, prior to the conversion, FCS grew at a rapid rate in its two most profitable segments, CRM and CES. That growth continued following the conversion. Several key metrics are reported in table 1. Net income before taxes for the CRM segment increased from US\$7.9 million in 2004 to US\$21.9 million in 2006 and US\$45.7 million in 2007. The CES segment saw similar improvements, with net income before taxes increasing from US\$3.4 million in 2004 to US\$11.0 million in 2006 and US\$9.6 million in 2007.

Measuring size by total revenues or sales can be misleading because revenues are driven heavily by the buying and selling of commodities, such as grain and fertilizer, which is a high-volume, low-margin business with volatile prices. For example, total revenues in 2004 were US\$1.6 billion, but declined to US\$1.3 billion in 2007.

A better measure of economic activity is net revenues or sales net of the cost of commodities sold, which increased from US\$105.1 million in 2004 to US\$181.9 million in 2006 and US\$257.4 million in 2007.

Net income for the total company increased from US\$3.6 million in 1998 to US\$6.4 million in 2004, its last year as a co-op. Patronage income averaged about 42 percent of net income (after taxes and before pension adjustment) and cash patronage refunds averaged about 70 percent in the three years prior to conversion. After converting from a cooperative corporation to an ordinary private corporation, net income increased to US\$6.6 million in 2005, US\$15.3 million in 2006, US\$33.3 million in 2007, and US\$33.2 million for the first nine months in 2008.

Table 1. FCStone operations and financial performance, 1997–2007

	Co-op Prior to Conversion										Private Corp.		Public Corp.		
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2007	2008	
<i>in \$US millions</i>															
Revenue	\$332.3	\$346.6	\$399.7	\$452.3	\$658.4	\$858.4	\$1,169.3	\$1,623.6	\$1,400.1	\$1,294.8	\$1,341.7	\$249.3	\$1,341.7	\$249.3	
Net Revenue ^a	\$27.5	\$29.8	\$33.9	\$41.8	\$56.2	\$65.7	\$76.1	\$105.1	\$126.8	\$181.9	\$257.4	\$62.7	\$257.4	\$62.7	
Net Proceeds/ Net Income	\$0.04	\$3.6	\$4.6	\$6.3	\$6.0	\$3.4	\$4.3	\$6.4	\$6.6	\$15.3	\$33.3	\$33.2	\$33.3	\$33.2	
Cash Patronage /Dividends ^b	\$4.0	\$2.1	\$0.7	\$1.5	\$2.1	\$1.8	\$0.9	\$1.4	\$1.9	\$2.9	\$6.1		\$6.1		
Equity ('000s) Redemptions	\$151	\$205	\$101	\$272	\$111	\$419	\$217	\$1,436	\$613	\$0	\$40,779		\$40,779		
Total Assets	\$92.6	\$100.4	\$115.4	\$234.9	\$271.9	\$399.5	\$504.7	\$603.8	\$805.5	\$1,057.2	\$1,420.2	\$2,426.3	\$1,420.2	\$2,426.3	
Total Equity	\$21.4	\$24.2	\$27.2	\$31.1	\$35.1	\$35.2	\$35.8	\$39.8	\$49.7	\$58.9	\$173.7	\$217.2	\$173.7	\$217.2	
Equity to Assets	23.2%	24.1%	23.6%	13.2%	12.9%	8.8%	7.1%	6.6%	6.2%	5.6%	12.2%	9.0%	12.2%	9.0%	
Return on Equity	0.2%	15.0%	17.1%	20.1%	17.0%	9.6%	12.0%	16.1%	13.2%	25.9%	19.2%	15.3%	19.2%	15.3%	
Shares Outstanding ^c	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	4.8	4.8	27.4	28.0	27.4	28.0	
Return per share	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	\$1.36	\$3.15	\$1.21	\$1.19	\$1.21	\$1.19	
Cash return per share	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	\$0.39	\$0.60	\$0.22	\$0.00	\$0.22	\$0.00	
Share Price ^d	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	\$31.16	\$20.47	\$31.16	\$20.47	
Price to Earnings	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	25.67	17.26	25.67	17.26	
Market Capitalization	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	\$854.3	\$573.1	\$854.3	\$573.1	

^a Revenues, net of cost of commodities sold; equal to gross income

^b Cash Patronage amounts in year paid, not earned, for 1997-2005. Cash dividends declared of \$0.60 per share on 25 October 2005 and \$0.42 per share on 9 November 2006.

^c Millions of outstanding shares; three-for-one stock split on 26 February 2007 and three-for-two stock split on 17 September 2007.

^d As of fiscal year end 31 August 2007 and 2008.

Pre-conversion situation

FCS grew rapidly prior to conversion due to its success in offering risk management services and commodity exchange services through its Integrated Risk Management Program to an expanded set of customers and commodities beyond agriculture and its cooperative members.

Sustaining this growth required reliable access to capital, primarily for meeting the regulatory capital levels required by the Commodity Futures Trading Commission. It also created the potential for cooperative members to capture the market value of the company and receive a bigger portion of the income stream beyond the patronage-based business benefits of cash patronage refunds and equity redemption of retained patronage refunds. Another potential opportunity was the ability to award employees and management, including the board of directors, shares of stock, and stock options.

Conversion Rationale and Proposal Overview

Stated reasons for conversion

Eight reasons for the conversion were identified, based on a set of statements made in the 2005 Registration Statement's letter to members and in the answer to the question, "Why is the company proposing to restructure?" They are:

1. *Improve access to new equity capital.* "The company will need significant capital resources to fund ongoing and future activities to stay competitive. If the business were to continue operating on a cooperative basis, our ability to raise and retain capital would be limited."
2. *Improve liquidity of current allocated equity and unallocated equity to capture the market value of ownership.* "We believe the proposed restructuring will... enhance the value of the ownership interests in the company by converting the existing patronage-based relationship with members into an investment-based relationship."
3. *Improve liquidity of current allocated equity to facilitate equity exchanges among owners.* "We believe that the restructuring may improve the liquidity of your investment in the company. Currently, common and preferred stock (the equity class used for retained patronage refunds) may be transferred only as an incident of membership in the company. After the restructuring, a stockholder may transfer its common shares to (a) any other holder of common shares (unless the transferee would hold more than 5% of the issued and

outstanding shares of common stock after the transfer), or (b) any person approved in advance by the board of directors.”

4. *Distribute non-patronage income directly to owners.* “The restructuring will allow us to make distributions to our stockholders based on their equity interests rather than their patronage.”
5. *Maintain total or majority control by traditional or existing members.* “The restructuring will allow us to retain most aspects of our current system of corporate governance. We intend to limit the transfer of common stock of the company to cooperatives and the ESOP. We will also maintain our existing system of nominating eight Class I board members on a regional basis, with one Class II board member being nominated by the 12 largest stockholders and the ESOP, and one Class III board member being nominated by the other board members. However, after the restructuring, the nominating procedure will only indicate the stockholders’ preference for certain nominees. The board of directors will be responsible for selecting all nominees, after consideration of the stockholders’ preferred nominees.”
6. *Provide the ability to form an Employee Stock Ownership Program (ESOP).* “The proposed bylaws will limit the ESOP to ownership of 20% of the new common stock of the company. Sales of new common stock to the ESOP will be at its appraised value. Sales of shares of common stock to the proposed ESOP will allow us to raise capital while capturing certain tax advantages. In addition, ownership of a percentage of our equity through the ESOP may assist us in retaining and attracting quality employees, and will align the interests of the employees and the stockholders.”
7. *Provide a mechanism to compensate current patron-owners for giving up patronage-based rights.* No specific justification was stated but it was implied that patron-owners were giving up past patronage-based earnings already earned in the first six months of the year, as well as future patronage earnings. The mechanism used was subscription rights described above.
8. *Respond to the growth in non-patronage business relative to patronage business.* “Growth of our business with non-members has reduced the significance of our cooperative status and pushed us closer to the boundaries of the definition of a cooperative under applicable law.”

Conversion proposal description

The initial conversion was from a traditional or open Iowa cooperative to an Iowa ordinary corporation. The cooperative members were informed of the following stock issues and voting rights in the 2005 Registration Statement.

1. *Common and preferred stock (i.e., retained patronage refunds) will be converted to new common stock with an equivalent par value [referred to as "original" shares].* "Currently, members hold Class A common stock or subscriptions, Class B common stock, and preferred stock in the company and earn patronage-based rights. We will recapitalize by converting the Class A common stock and subscriptions, Class B common stock, and preferred stock into newly issued shares of common stock ("new common stock"). If the restructuring is effected by approval of the amendments to the articles of incorporation and the plan of conversion, you will receive 500 shares of new common stock issued by the company for each fully paid share of Class A common stock, \$5,000 par value, or 10,000 shares of new common stock for each fully paid share of Class B common stock, \$100,000 par value, and one share of new common stock for each \$10.00 in par value of each preferred share you hold as of the effective date of the restructuring."
2. *Unallocated equity and residual value above book value will be converted to new common stock based on the last three years of patronage business [referred to as "appraised value" shares].* "If the restructuring is approved by the stockholders, the company will issue a total of 4.31 million shares of new common stock. This number of shares was determined by dividing the appraised value of the equity of company, \$43.1 million, by \$10.00. Each member's existing stock ownership represented by common stock or subscriptions, and preferred stock will be converted by distribution of shares of new common stock at a conversion rate of one share of new common stock per \$10.00 in current stock held. The remaining shares of new common stock will be distributed based on each member's pro-rata share of patronage determined by a formula which considers patronage for the last three fiscal years, including the year ended August 31, 2004. In the case of Class A members, the formula utilizes the actual patronage paid during the three-year period. In the case of Class B members, the patronage will be limited to \$1.35 per round turn trade, which is less than the patronage paid to those members. The value of the stock to be issued with respect to patronage-based rights will be approximately \$26.4 million, which is the \$43.1 million appraised value of the equity of the company less the August 31, 2004 common and preferred stock value of \$16.7 million. This amount represents approximately 5.4 times the

total of all members' three year defined patronage. Each member's share will likewise be 5.4 times its individual three year defined patronage. One share of new common stock will be issued for each \$10.00 of such value. If the proposal is approved, the distribution of new common stock and subscription rights is expected to take place on or after March 3, 2005."

3. *Current member-stockholders will be offered the right to purchase additional common stock at the cost of \$10 [referred to as "subscription" shares].* A total of 100 shares of nontransferable subscription rights were issued for each 200 shares received in the conversion exchange. Each member had the option to exercise the right to purchase additional shares of new common stock at a purchase price of \$10.00 per share within 60 days after the distribution of new common stock and subscription rights. The closing was 29 June 2005. Out of 553 member-stockholders, 56 exercised this right and purchased 174,372 shares of stock for US\$1.7 million out of the maximum that could be purchased of 2.15 million shares for US\$21.5 million. Only about 8 percent of the subscription shares were purchased. These new common shares were split 3 for 1 prior to the March 2007 IPO along with all outstanding shares which reduced the cost basis of the shares to \$3.33 per share. As it turned out later, the IPO was priced at \$24 and the stock price has averaged around \$50 (prior to 27 September 2007 3 for 2 stock split), so exercising this right was very profitable.
4. *Voting will shift from one-member, one-vote to voting by shares of common stock.* "Currently, each member of the company is limited to owning one share of Class A or Class B common stock. Following the restructuring, each stockholder will own the number of shares of new common stock distributed in the restructuring and any shares of new common stock acquired upon exercise of the subscription rights. Holders of common stock will continue to vote on matters such as the election or removal of directors, mergers, sales of all or substantially all of the assets of the company, dissolution of the company and amendments to the articles of incorporation. After the restructuring, each share of common stock will continue to carry one vote, but stockholders will be able to vote the number of shares of common stock held. As a result, instead of each member having one vote, stockholders with more new common stock in the company will have greater proportionate voting power after the restructuring."

The membership approved the plan of reorganization at a meeting held 1 March 2005, with 96 percent voting in favor. The reorganization was retroactively effective to 1 September 2004.

IPO proposal description

On 5 December 2006, FCS received 97 percent stockholder approval to convert from a private to a public corporation and change the charter from an Iowa corporation to a Delaware corporation. FCS then issued a prospectus for an IPO scheduled 16 March 2007. The proposal had the following components and results:

1. Issued 5.865 million shares at an initial offer price of US\$24.00, which resulted in additional net proceeds of US\$129.67 million and total outstanding shares of 18.2 million.
2. Use of proceeds included:
 - (a) Redeemed 2.159 million shares, or 15% of existing common stock prior to the offering, at a price of about US\$22.32, for a total cost of about US\$48.21 million.
 - (b) Used the balance to reduce debt and build assets as needed.
3. Notice was made that cash dividends could be paid on stock in the future, although it was expected they would be less than past dividends paid.
4. Notice was made that a three-for-one stock split was being implemented as a stock dividend for prior stockholders. That split occurred as of 26 February 2007.

Economic Justification

Patron-owner-members organize cooperative businesses for one or more well-known economic reasons. Co-ops are converted to another business form when those reasons no longer exist or the advantages of another business form outweigh the original reasons for forming and operating a cooperative. The economic justification of the cooperative business form centers primarily around correcting market failures, including: (1) reducing or eliminating monopolistic pricing by increasing competition; (2) reducing costs through vertical and horizontal coordination or integration and achieving economies of size; (3) providing missing services and information; (4) reducing risk through the pooling of risk; and (5) forming a spatial monopoly operating on a service-at-cost basis. Some co-ops seek to create or increase market power, and thereby increase market failure for other parties. The cooperative predecessor to FCS, Farmers Commodities Corporation, was organized for the first three reasons.

Co-ops convert to another business form for a wide variety of reasons. Five general categories can be identified, with more specific behavioral sub-categories under each. Only the broadest sub-categories are listed. They are:

1. Patron-owner rationale
 - (a) Improve access to capital
 - i. Replace or redeem current ownership
 - ii. Support asset growth
 - (b) Improve liquidity of allocated and unallocated equity capital
 - i. Facilitate equity exchanges
 - ii. Capture market value of allocated equity in exchanges
 - (c) Improve income distribution
 - i. Distribute non-patronage income directly to owners
 - ii. Provide more tax efficient distribution of income to owners
 - iii. Address high non-patronage income issues
 - iv. Provide returns to owners who no longer use the co-op as customer-patrons
 - (d) Provide more operating flexibility by eliminating contractual patron-owner delivery requirements
2. Member control rationale
 - (a) Maintain total or majority control by traditional or existing members
 - (b) Shift control from members to owners
3. Customer access and treatment rationale
 - (a) Provide competitive access for products and services to traditional member-patron customer base
 - (b) Provide competitive access for products and services to rapidly growing non-member customer base
 - (c) Provide more risky multi-year marketing or supply agreements to a heterogeneous customer base
4. Management, employee and director incentives and expertise rationale
 - (a) Provide improved management and employee recruiting and retention incentives
 - (b) Provide improved flexibility to expand director expertise, diversity and incentives
 - (c) Provide employee stock ownership plans (ESOP)
5. Other

- (a) Provide mechanism to switch claims on income from patronage to ownership basis
- (b) Provide mechanism to address unique co-op restrictions such as the majority of business must be with member-patrons

FCS claimed that the primary reasons for conversion were: (1) to gain access to capital to support rapid growth opportunities in non-member business segments; and (2) to allow members to participate in the financial benefits of non-member business. Eight reasons were stated in the 2005 SEC Registration Statement, as previously noted. FCS also said that member customers would still have access to all their traditional customer services in a competitively priced environment and would initially have a controlling interest in the company through voting stock ownership and the board of directors.

Conversions can be made in several ways, including: (1) converting co-op patron-owner rights into investor-oriented firm (IOF) ownership rights through the issue of stock or (2) purchasing co-op patron-owner rights for cash. FCS was converted using the first method, issuing ownership rights in the successor company to members in exchange for their ceding patron-owner-member rights in the co-op.

Post Conversion and IPO Analysis

Company performance

Up to May 2008, FCS continued to perform at a very high level after the conversion and IPO. Net revenues and net income continued to grow rapidly. Return on equity in the pre-conversion period ranged from a low of 9.6 percent in 2002 to a high of 20.1 percent in 2000. Return on equity in the post-conversion period was 13.2 percent in 2005, 25.9 percent in 2006, 19.2 percent in 2007 and 15.3 percent through the first nine months of 2008, as reported in table 1. The return on equity in 2007 and 2008 is higher than it might appear because solvency measured by equity to assets more than doubled from 5.6 percent to 12.2 percent between 2006 and 2007.

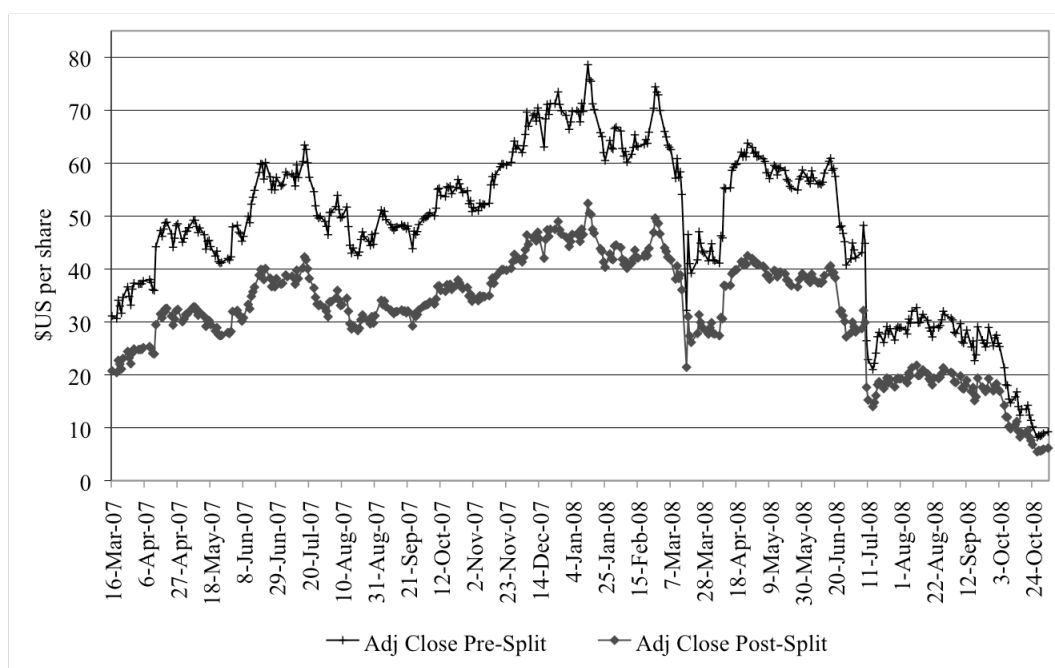
Following conversion, total book value of equity increased from US\$39.8 million in 2004 to US\$49.7 million in 2005. Equity further increased in 2006 to US\$58.9 million. After the IPO, total equity increased to US\$162.2 million on 31 May 2007 and ended at US\$173.7 million in 2007. Total equity grew to US\$217.2 million after the first nine months of 2008, as reported in table 1.

A three-for-one stock split was made in February 2007, prior to the IPO, and a three-for-two stock split was made in September 2007, after the IPO. The post-split stock price increased significantly after the IPO to a high of US\$53.25 on 15 January 2008. It ranged from around US\$40 to US\$50 per share from November 2007

through May 2008, and then trended downward, closing at US\$6.16 on 3 November 2008. On 3 November, adverse information about a reported US\$25 million dollar loss on a customer's account was announced, and the next day the price dropped to a low of US\$2.90, before closing for the day at US\$3.69. (See figure 1 for a history of prices.)

FCS' market capitalization has varied widely. On 15 January 2008, it was US\$1.38 billion, based on 27.4 million shares currently trading at about US\$50.55 per share at closing. On 4 November 2008, it was US\$101.1 million, based on a closing price of US\$3.69, only about seven percent of the highest capitalization value. The financial benefits achieved by the original cooperative owners varied widely based on when and if they sold their stock.

Figure 1. FCStone Daily Stock Price, 2007–2008



Conversion reasons and achievement

All eight reasons for the conversion (listed above) have been achieved. Access to equity capital has been increased through sales of stock, which has supplemented the previous primary source, net income. There have been several stock sales, including the subscription rights offered to member-stockholders in 2005 and the ESOP sales in 2005, and following the IPO in March 2007. Reducing debt and increasing the equity to asset ratio from 5.6 percent in 2006 to 12.2 percent in 2007

has strengthened the balance sheet. A second public offering in August 2007 did not add equity to the FCS balance sheet, but instead was used by existing co-op stockholders to sell some of their stock.

The conversion from a cooperative to a non-cooperative private corporation and subsequent public stock issue has increased the liquidity of allocated and unallocated member equity by capturing the market value of that equity. The conversion distributed the pre-conversion appraised value of the ownership to stockholders at a rate of US\$10 per share. The two public stock offerings allowed members to sell all or part of their original, appraised, and purchased subscription stock for a substantial gain.

Non-patronage income can now be distributed to co-op stockholders in the form of dividends on equity. Substantial dividends were paid in 2006 and 2007.

Traditional co-op members have controlled FCS through a significant ownership of voting shares amounting to about 45 percent (as of March 2008). (The level of sales of Series 2 and 3 stock by cooperative owners since that time is not known.) More importantly, the current board of directors is comprised primarily of local co-op managers who have substantial influence on future nominees to the board, suggesting that they may continue to hold greater influence than the proportional share of voting shares owned by local co-ops. An ESOP was formed, an equity incentive program implemented, and stock option awards made to the leadership team of executives and directors after the conversion to a public company in 2007. These actions may better align the interests of leaders and employees with those of stockholders.

Member benefits

The ultimate test of a conversion is the benefits that it actually provides compared to the benefits that could have been achieved had the co-op business form continued. This is difficult to measure because economic conditions and firm performance are always changing in unforeseen ways, and the basis for income distribution changes from patronage and non-patronage sources to shares of stock owned.

One key metric is the relative ability of co-op member-customers of FCS to obtain risk management and commodity trading services before conversion compared to after. It appears that member-customers did receive, both before and after conversion, roughly the same competitive or market-based access to FCS and its competitors. Therefore, the benefits of being a “customer” of FCS appeared to be about the same, before and after conversion.

A second key metric is the impact on their investment in FCS and the income received. Because the co-op members continue to be the biggest block of owners, measures of interest are (1) the cash dividends received per share (roughly equiv-

alent to the cash patronage refund per unit); (2) the change in stock price; and (3) the cash received by selling some or all of the stock. Some rough indicators are the cash flows reported in table 1 and the stock prices reported in table 1 and illustrated in figure 1.

FCS profitability, as measured by return on equity and absolute net income, has grown since the conversion. Compared to other, similar co-ops, cash patronage rates and redemption rates were relatively high while FCS was a co-op. After conversion to a private corporation, cash distribution was significant, but still a smaller percentage of net income in 2005 and 2006. However, this should be viewed in the context of the move toward an IPO, and so includes the 2007 cash flows paid by FCS directly to co-ops. In 2007, a substantial dividend of US\$6.1 million was paid, of which 90 percent could be assigned to co-op owners and the remainder paid to the ESOP.

But more significantly, 15 percent of co-op equity was repurchased or redeemed by FCS in the amount of US\$48.2 million, of which US\$43.2 million went to former co-op members and the balance to employees and other owners. This alone is several times the cash flow received by members while FCS operated as a co-op. As table 2 demonstrates, this first redemption had a net realized gain to co-op owners of US\$40.8 million, or about 2.4 times the total book value of all stock (US\$16.7 million). All sales after that point increased the multiple of book value received by co-op owners.

After the 15 percent mandatory redemption to all co-op owners, the remaining stock was divided into three equal parts, designated as Series 1, 2, and 3. Each series had its own release date, as noted in table 2. However, each co-op had an opportunity to sell any or all of its stock in a secondary offering on 3 August 2007. A surprisingly low number of shares, 1.86 million, were sold at a price of US\$48.24, creating an additional net realized gain of US\$87.4 million. Some co-ops tendered all their shares, while others tendered none. Hindsight suggests that selling at the secondary offering was highly beneficial compared to selling when each of the three series windows opened.

Stock prices varied widely, but because of the low cost basis of US\$0.86 per share, the potential realized gain is substantial, even when shares are marketed at the lowest price on record. Table 2 provides an accounting of these transactions, subsequent transactions, and an estimate of total potential net capital gain to co-op members under alternative marketing strategies.

Table 2. Member co-op investment in FCStone: Net gain due to conversion and IPO

Original Co-op Stock	Transaction Value	Additional Shares	Cumulative Total Shares	Cumulative Total Value	Book Value ^d	BV/ share based on orig. BV	Net Market Price	Realized & Imputed Net Gain
3-Mar-2005 Original earned stock - at conversion	\$16,738,522	1,673,853	1,673,853	\$16,738,522	\$16,738,522	\$10.0000		
3-Mar-2005 Additional appraisal stock - at conversion	\$26,361,478	2,636,147	4,310,000	\$43,100,000	\$16,738,522	\$3.8836		
26-Feb-2007		8,620,000	12,930,000	\$43,100,000	\$16,738,522	\$1.2945		
3-for-1 Stock split - before IPO								
21-Mar-2007 15% Redemption ^a	\$43,289,640	-1,939,500	10,990,500	\$40,589,222	\$14,227,744	\$1.2945	\$22.32	\$40,778,862
3-Aug-2007 Secondary offering sale ^b	\$89,760,988	-1,860,717	9,129,783	\$38,180,432	\$11,818,954	\$1.2945	\$48.24	\$87,352,198
17-Sep-2007		4,564,892	13,694,675	\$38,180,432	\$11,818,954	\$0.8630		
3-for-2 Stock split								
17-Sep-2007 Remaining stock value ^c			13,694,675	\$38,180,432	\$11,818,954	\$0.8630	\$48.36	\$650,455,505
If Sold Series 1, 2, and 3^e on release date							Total	\$778,586,565
17-Sep-2008 If sold Series 1			4,564,892	12,726,811	3,939,651	\$0.8630	\$48.36	\$216,818,502
15-Mar-2008 If sold Series 2			4,564,892	12,726,811	3,939,651	\$0.8630	\$21.44	\$93,931,622
11-Sep-2008 If sold Series 3			4,564,892	12,726,811	3,939,651	\$0.8630	\$18.09	\$78,639,236
							Total if sold Series 1, 2, 3	\$517,520,420
4-Nov-2008 If sold Series 1, 2 and 3 market low			13,694,675	38,180,432	11,818,954	\$0.8630	\$2.90	\$27,895,602
							Total if sold at market low	\$156,026,662

^a The total shares of common stock held by co-op members and others that were redeemed totaled 2,159,997. Only co-op member stock shown.

^b Total stock sold during the secondary offering was 1,865,042 which included other stockholders besides co-ops.

^c 17 September 2007 was the date that the Series 1 were released from restriction. The Series 2 and 3 restriction expiration dates are 15 March 2008 and 11 September 2008, respectively. Valued at market price on 17 September 2007.

^d Assumed received as a qualified patronage refund distribution.

^e If sold when series window opened. Valued at market price on 17 September 2007, 17 March 2008 and 11 September 2008.

As noted above, FCS repurchased or redeemed about 15 percent of these shares, as well as other shares, for around US\$22.32 per share. This is a multiple of about 17.3 over cost basis and a gain of US\$21.03 per share sold. The net realized gain for the co-ops totaled US\$40.8 million.

More significantly, the remaining 85 percent of these shares could be sold at market prices. Some co-ops took advantage of the second public offering to sell a part or all of their remaining shares. Over 1.86 million shares were tendered for sale in a secondary offering on 3 August 2007, generating net proceeds of US\$48.24 per share. This is a multiple of 37.4 over cost basis and a gain of US\$46.95 per share. The total realized net gain from this transaction was US\$87.4 million.

On 17 September 2007, there was a three-for-two stock split, reducing the cost basis on these shares to about US\$0.86 per share. If all the remaining original stock had been sold on 17 September 2007 at the market price of US\$48.36, the total gain would have been around US\$650.5 million. Even though only Series 1 stock was available for sale on that date, many co-ops arranged to “sell short” their Series 2 and 3 at a very advantageous net price prior to the release date. The maximum realized net gain for the co-op owners of FCS who employed this strategy was US\$778.6 million.

A more conservative strategy is to pretend that each co-op sold their Series 1, 2, and 3 stock on the first day that each block was available for normal sale. As table 2 reports, if sold at the closing price on the first day, the total realized net gain would have been US\$517.5 million. The worst-case scenario would have been to hold all the blocks and sell at the low of the market on 4 November 2008 at US\$2.90 per share. The net realized gain would have totaled US\$156.0 million to the co-op community of owners. Even this worst-case scenario is still 9.8 times the original book value of US\$16.7 million [(gain of US\$156.0 + book value of US\$16.7)/ book value of US\$16.7 = 9.8 times book value].

The conversion of FCS and its IPO has captured a phenomenal amount of market value compared to cost or book value. Multiples of this magnitude are unparalleled and unlikely to be matched by any future conversion of a co-op to an IOF business form. This conversion has added substantial wealth to the farmer co-op owners of FCS and, indirectly, to the producer-owners of these co-ops. The funds have been used for a variety of purposes, including adding assets, reducing debt, and increasing to producers equity redemptions and other cash flows. These funds have been made available at a time when the co-op owners are growing rapidly and in need of capital to finance this growth.

A third key metric is governance or control. The ownership of FCS most likely still includes substantial local co-op investment. As of November 2008, the board of directors still consisted of the same ten local co-op CEOs, and the CEO remains the same. Two additional directors were added to the board, FCS' CEO (but not as

chairman of the board) and an outside financial expert. The nomination process for new directors specified in the IPO is designed to keep the board relatively stable and composed of local co-op CEOs, at least for the next few years.

Conclusions

FCStone had overwhelming cooperative member-owner support to convert from a federated regional cooperative to an investor-oriented business. It first converted to a private corporation in 2005 and then converted to a public corporation in 2007. There were two primary objectives in the conversion. The first was to provide substantial financial benefits to its traditional customers, the agricultural cooperative patron-owner members, while maintaining or improving its risk management services. The second was to achieve the full potential of FCS as a risk management service provider to non-cooperative customers in a broad array of industries beyond agriculture and on a global scale.

Members strongly supported the conversion and have achieved substantial financial benefits while maintaining access to the risk management services as ongoing customers. FCS has gained access to substantial additional capital to finance its continued growth into non-member business sectors and regions.

The conversion to a publicly held company has provided significant new challenges to the co-op customer-owners and to the FCS leadership team of executives and board of directors. Co-op owners had to decide when and if to sell FCS stock based on their individual situation and expectation for future dividends and stock price levels. All co-op owners realized a gain of 17 times the book value on the mandatory redemption of the first 15 percent of their stock. With regards to the remaining 85 percent of stock, some chose to cash out as soon as possible while others chose to speculate by holding the stock. Those who immediately sold the remaining 85 percent in the secondary offering in August 2007 realized a gain of about 37 times the book value. Those who may have sold at the high point of the market in January 2008 realized a gain of about 58 times the book value. Those who may have sold at the low end of the market in November 2008 realized a gain of about 3.3 times the book value. However, the actual distribution of sales over this time period, August 2007 to November 2008, is unknown.

The board and management team have had to deal with the responsibilities, expectations, costs, and scrutiny of being a publicly held corporation. Stock prices have been volatile and declined to low levels at the end of 2008. Some shareholders are unhappy with the information provided by the company and the performance of the stock. Several lawsuits were filed against the company in July and August 2008 claiming violations of securities laws. It is not known whether any co-op owners are among the plaintiffs.