

Three Ag Cooperatives Raise Cash in the Public Market

by

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During the past 26 months three agricultural cooperatives, CF Industries Holdings Inc. (NYSE: CF), Diamond Foods Inc. (NasdaqNM: DMND), and Gold Kist Inc. (NasdaqNM: GKIS), have completed initial public offerings of their equity. While these companies operate in different sectors of the agribusiness & food world, and face different challenges, we believe it both interesting and relevant to view them side by side. The reasons to make the transition from cooperative to public company vary in their specifics, but a number of commonalities exist across companies.

Several general benefits accrue to any company that floats its equity to the public. These commonly include: greater access to capital, increased shareholder liquidity, availability of “currency” for acquisitions, creation of non-cash compensation, and increased visibility.

An increase in access to capital typically begins with the initial public offering, or IPO, when the company raises cash for its benefit by selling shares to a bank group of underwriters, who in turn list those shares for sale on an exchange.

Going public typically greatly increases shareholder liquidity. In the case of a cooperative, which may have scheduled redemptions to members, some liquidity already exists, but since redemptions can be restricted, the cooperative structure provides little better liquidity than a private company. Along with greater liquidity comes greater price transparency, as the value of shareholding is available in the marketplace, as opposed to the value of privately held shares which typically need to be negotiated in the event of a sale.

Public shares are often used as “currency”, for either a portion of or the entire consideration, in an acquisition. The issuance of new shares for acquisitions allows the buying company to bypass the capital raising process. Other possibilities include alternative acquisition structures, such as the attachment of warrants to the purchase, effectively pushing some of the cost out into future periods. The Securities and Exchange Commission maintains oversight of acquisitions involving listed companies, and caps the size of a share

issuance that is not to be approved through shareholder vote. The cap is typically at 20% of the outstanding shares, but may be less under certain circumstances.

Compensation and recruiting are also improved by having a liquid public equity. Typically management pay is enhanced with equity-linked incentives such as stock options. This is intended to provide both compensation for past performance, and as a bonus for future performance. Since a call option would typically not be exercisable until the value of the entire company increased, a manager’s incentive should be more aligned with shareholders. In past years, options were not recognized as an expense to the company, that has changed in the wake of recent scandals and greater scrutiny, so diminishes this benefit to the company.

Increased visibility is often cited as a benefit to a public company, but it is likely the least tangible. The idea is that any media coverage afforded a public company, increases public awareness, and is assumed to be beneficial. There is likely merit to this assumption, but it is questionable how much benefit is truly accrued to the companies.

We performed a brief analysis of each of the three companies pre- and post-IPO capitalization, and relative stock performance versus an index of its peers, as well as versus an appropriate S&P Midcap 400 –Index. While only Gold Kist has a full year of trading history, we were interested in the markets receptivity to these firms.

Gold Kist Inc.

Gold Kist priced its initial public offering in October of 2004, raising a total of \$123 million, excluding fees. Approximately \$77 million was used to repay debt and associated prepayment penalties. The remainder of the offering proceeds were used to redeem nonqualified patronage equity. After exercise of the underwriters’ over allotment, distributions to members and former member equity holders were approximately \$107 million, and 36 million shares.

Since its IPO, Gold Kist has performed in line with both a Peer Group of publicly traded protein companies and the Midcap 400 – Consumer Staples Index. As of June the stock is trading in the \$14 to \$15 range.

CF Industries Holdings Inc.

CF Industries, a former federated cooperative, was owned by eight regional agricultural cooperatives: CHS Inc., Growmark, Inc., Intermountain Farmers Association, La Coop fédérée, Land O'Lakes, Inc., MFA Incorporated, Southern States Cooperative, Incorporated and Tennessee Farmers Cooperative. The company priced its stock at \$16 per share this past August. The offering raised \$622 million, excluding fees and the underwriter's over-allotment. The cash proceeds of the offering were distributed to the cooperative owners of CF in the reorganization in addition to 7.5 million shares of common stock.

Shortly after pricing, CF Industries' stock hit a high of \$18 per share. Since then it has trended lower, trading during June in the \$16 range. However, the stock has outperformed a Peer Group Index made up of fertilizer companies, and performed on par with the S&P Midcap 400 – Materials Index.

Although CF management has indicated that they are seeking to grow through acquisitions, they have not yet announced any.

Diamond Foods Inc.

Diamond Foods raised \$95 million in its July public offering and after the underwriters' exercise of their over allotted shares, excluding fees. Approximately \$71 million of the offering was retained by the company.

After the offering, the company expected to apply approximately \$17 million to paying down its 7.2% notes and associated prepayment fees. An additional \$17 million was ear-marked for members of Diamond Growers. In addition to the effect of the offering, the capitalization summary shown at the left reflects effects of the conversion such as the estimated acquisition cost of walnuts. Post conversion, walnuts will be booked on a historical cost basis by the company as opposed to a net realizable value basis, which was applicable for walnuts delivered by members.

Gold Kist Summary Capitalization*		
(in thousands)		
	Historical	Post IPO
Cash	136,699	90,894
Debt	304,121	235,166
Equity	284,615	308,874
Total Capitalization	588,736	544,040
Diamond Foods Summary Capitalization*		
(in thousands)		
	Historical	Post IPO
Debt	35,464	20,000
Equity	50,086	87,939
Total Capitalization	85,550	107,939
<i>Capitalization equal to the sum of Long-Term Debt and Equity</i>		
<i>*as presented in offering documents filed with the Securities and Exchange Commission</i>		

The shares, which priced at \$17, as of June 2006 are trading in the \$15 range. Since pricing, it has underperformed both the Midcap 400 – Consumer Staples index and a Peer Group index made up of small capitalization nuts and snacks companies.

It would appear that on balance the benefits of being a public company outweigh the costs for the three companies listed here. Each IPO has offered shareholders and the companies liquidity, press and analyst coverage, and incentives for management.



If you would like to discuss this material, or any other issues related to corporate finance and the agribusiness & food sector, feel free to contact Bill Goodbar (goodbar@agricapital.com) or Doug Sterkel (sterkel@agricapital.com) by phone or e-mail.

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