

Food Industry Cash Conversion

by

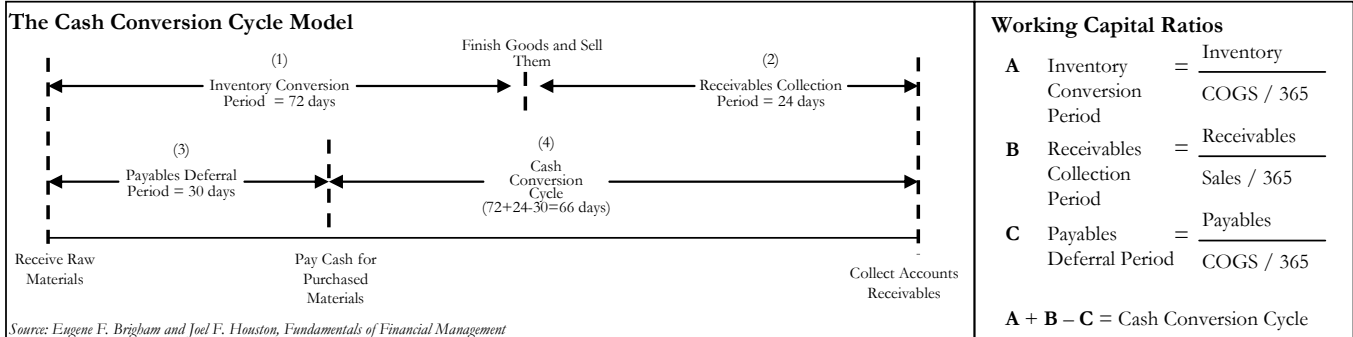
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At AgriCapital we have frequently heard complaints from food manufacturers over the past several years about pressure from consolidated retailers. Concentration of the food retail sector increased in the late 1990's with a number of large mergers, and the push by Wal-Mart into the food sector. Greater concentration at the retail end of the food chain resulted in increased pressure on suppliers. A subsequent wave of consolidation among processors should have in part combated pressure on margins and cash flows. While this story makes sense, we were interested to corroborate it with evidence from the industry. AgriCapital analyzed the sector applying data from 40 publicly traded companies to form representative samples of three sub-sector "links" in the food chain; **Upstream**-Low Value Added/ Commodity Processors, **Downstream**-Branded/ High Value Added Processors, and **Retail**. We focused on the Cash Conversion Cycle (CCC) in

up of this increased efficiency is shown by the other three lines in the chart. Days Receivable is low, and stable. While the deferral of payables is a key component in the CCC trend around 2000, this is less of a factor today as it has dropped back to the 1995 the level of about 29 days. Central to the improved CCC is more rapidly turning inventory, resulting in current average Inventory Conversion of 38.5 days for our sample versus 46.4 days in 1995. This is consistent with the rigorous supply chain management process that Wal-Mart has brought to the sector, and with anecdotal evidence from our contacts in the industry.

The food processor sets in Chart 2 both show improved average CCC. However, the Downstream set improved far more over the decade (21% or 14 days) than did the Upstream set (7% or 4 days). The Upstream set has really only made an improvement in the last few years, as

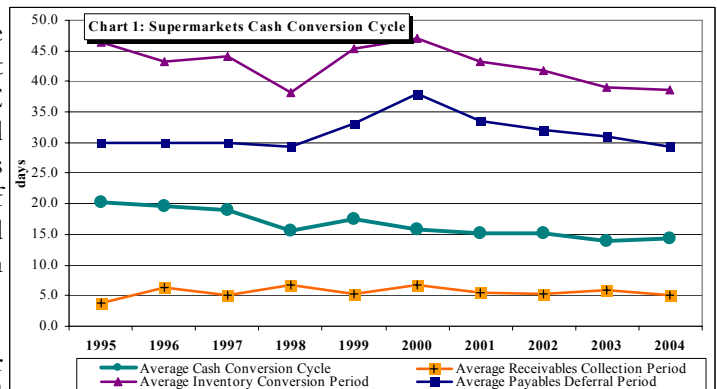


order to answer the following; how has the CCC of each sub-sector changed over the last decade, and what is the make-up of the changes in CCC?

The Cash Conversion Cycle is the length of time between a firm's purchase of inventory and the receipt of cash from accounts receivable. A company's CCC indicates its efficiency in managing working capital, and is of particular use in benchmarking versus competitors or comparable companies. CCC is made up of Receivables Collection, Inventory Conversion, and Payables Deferral, and tells us the degree to which suppliers finance a company's inventory.

Chart 1 to the right shows the Average CCC of our Retail set over the past decade. The CCC has trended down by about 5 days over the last decade. The make-

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The Make-up of CCC

The elements of the overall change in CCC, or lack thereof are shown in Charts 3 to 5.

Change in the Average Receivable Collection Period has been pronounced for the Downstream processors set, with a spike to 37.5 days (12% higher than 1995) in the year 2000, but then a drop back to under 34 days. This peak and subsequent slide back to the “norm” correlate to the cycle of Payables Deferral Period at the Retail level. This is consistent with our understanding of changes to the industry brought about in large part by consolidation. The Average Days Receivable Period of the Upstream set has oscillated in a band between 27 and 30.5 days throughout the decade.

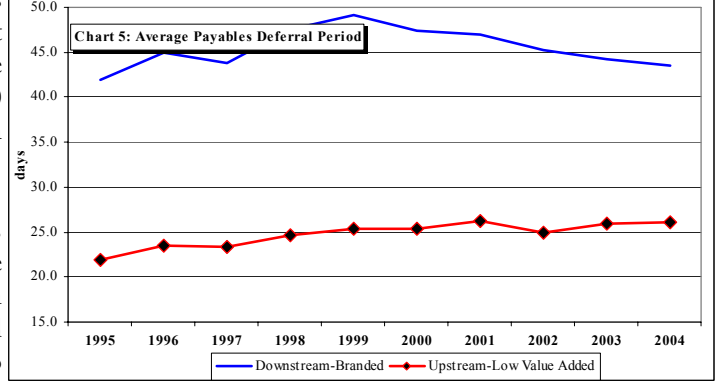
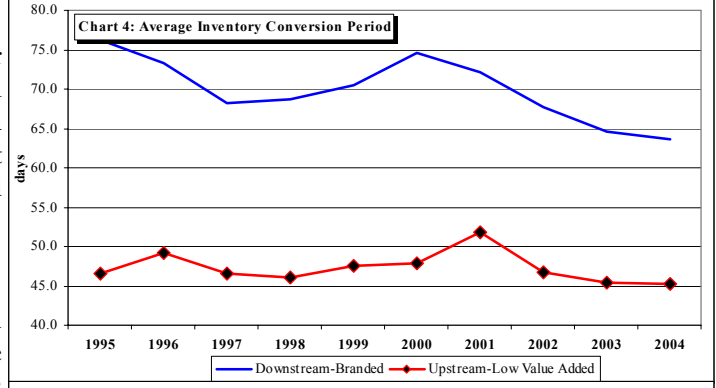
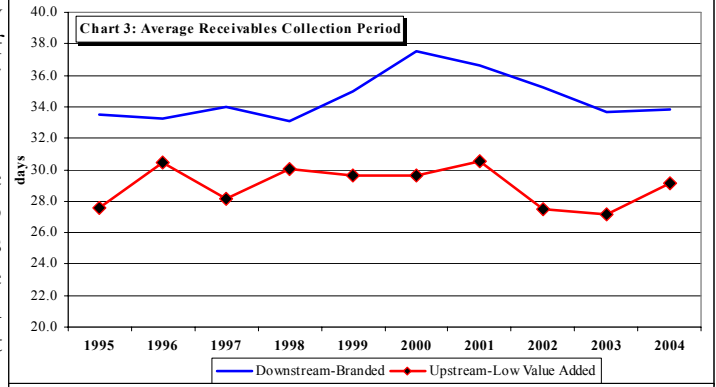
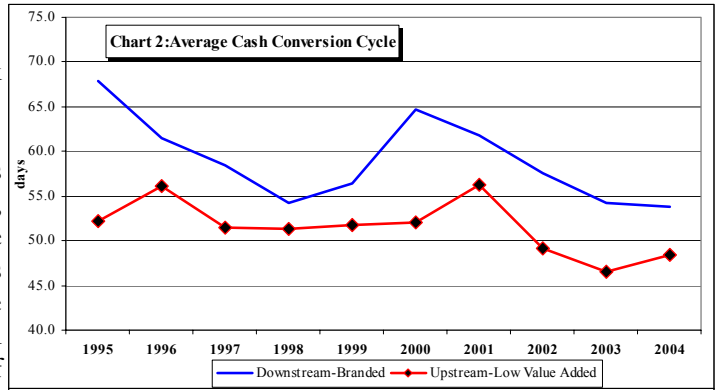
Inventory management has improved greatly for the Downstream Branded processors, showing a 17% (13 day) decrease in Inventory Conversion. This is comparable to the percentage improvement in average days Inventory Conversion seen by Retailers. Upstream processors however have seen only a modest improvement of less than 3% (1.3 days).

Of the two processor sub-sets, only Upstream processor companies saw a significant change in Payables Deferral Period since 1995 (18.5%), stretching payables from an average 22 to 26 days. Although the Downstream set peaked at 49 Days Payable in 1999, this has since leveled off at about 44 days (4% over 1995).

Releasing Cash from the Balance Sheet

Improving CCC is an excellent way to release cash from the balance sheet. Increased free cash flow can be applied to growing the business. The food sector has seen tremendous growth over the last decade. Market weighted indexes of the two processing sub-sets we discussed have outperformed or equaled the S&P 500 over the last ten years, indicating the markets recognition of improved efficiencies.

While improving CCC is a virtuous endeavor, it is important recognize the components that make up the improvements or cause CCC to remain flat. While both sets of processors improved CCC, Downstream Branded / High Value Added food companies have been able to make much greater strides. While both days Receivables Collection Period and days Payables Deferral Period rose and fell over the last decade, Downstream processors have shown a definitive ability to decrease the Inventory Conversion Period. This indicates a



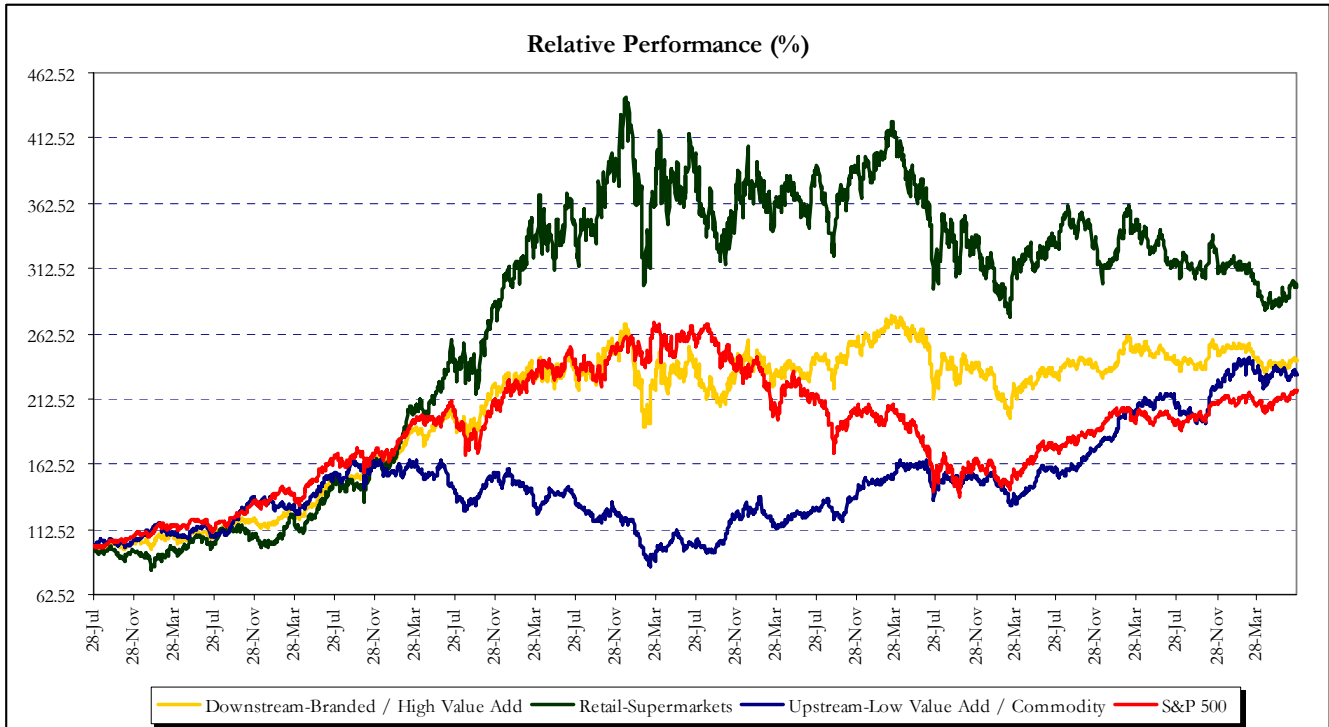
fundamental improvement to the business we believe is a result of implementation of new technologies such as supply chain management systems, scanning, and other inventory management processes.

Conversely, Upstream Low Value Added / Commodity processors have had limited success improving inventory management, and have slid somewhat in their ability to collect receivables. The primary contributor to CCC improvement of the Upstream set has been the trend towards deferring payables. Payables Deferral is the easiest component of the CCC equation to control.

However, stretching payables is the least sustainable approach. Improved Cash Conversion from longer payables translates into a worse cash position for the supplier, which may not be sustainable over the long haul.

Components of the Sub-sets of the food chain used in this analysis

Upstream - Low Value Added / Commodity		Downstream - Branded / High Value Added	
American Italian Pasta Co. (NYSE:PLB)	Fresh Del Monte Produce Inc. (NYSE:FDP)	Sara Lee Corp. (NYSE:SLE)	JM Smucker Co. (NYSE:SJM)
Archer-Daniels-Midland Co. (NYSE:ADM)	Gold Kist Inc. (NasdaqNM:GKIS)	Hershey Co. (NYSE:HSY)	William Wrigley Jr. Co. (NYSE:WWY)
Bunge Ltd. (NYSE:BG)	Hormel Foods Corp. (NYSE:HRL)	Groupe DANONE (NYSE:DA)	Ralcorp Holdings Inc. (NYSE:RAH)
Calavo Growers Inc. (NasdaqNMCVGV)	Imperial Sugar Co. (NasdaqNM:IPSU)	Lance Inc. (NasdaqNMLNCE)	Hain Celestial Group Inc. (NasdaqNM:HAIN)
Cal-Maine Foods Inc. (NasdaqNMCALM)	MGP Ingredients Inc. (NasdaqNM:MGPI)	McCormick & Co. Inc. (NYSE:MCK)	Kraft Foods Inc. (NYSE:KFT)
Chiquita Brands International Inc. (NYSE:CQB)	Pilgrim's Pride Corp. (NYSE:PPC)	Campbell Soup Co. (NYSE:CPB)	Flowers Foods Inc. (NYSE:FLO)
ConAgra Foods Inc. (NYSE:CAG)	Provena Foods Inc. (AMEX:PZA)	General Mills Inc. (NYSE:GIS)	Retail - Supermarkets
Corn Products International Inc. (NYSE:CPO)	Sanderson Farms Inc. (NasdaqNM:SAFM)	HJ Heinz Co. (NYSE:HNZ)	Safeway Inc. (NYSE:SWY)
Dean Foods Co. (NYSE:DF)	Smithfield Foods Inc. (NYSE:SFD)	J&J Snack Foods Corp. (NasdaqNM:JJSF)	Albertson's Inc. (NYSE:ABS)
	Tyson Foods Inc. (NYSE:TSN)	Kellogg Co. (NYSE:K)	Kroger Co. (NYSE:KR)
			Wal-Mart Stores Inc. (NYSE:WMT)
			Koninklijke Ahold NV (NYSE:AHO)



AgriCapital is an investment bank that specializes in the agribusiness and food sectors. 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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