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Analysis Of Economic Motives For Cooperative Conversions To Corporations

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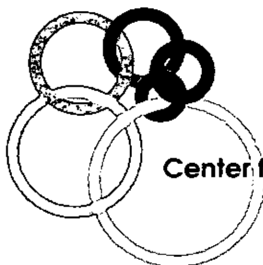

Center for Cooperatives • University of California, Davis

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Bob held a position as professor in the Agricultural Economics Department at UC Davis from 1978 to 1985. He left this position to accept an appointment at the University of Arkansas. In 1989 he joined the faculty at Santa Clara University where he continues to teach and do research in economics. He received his B.A. from Graceland College and his M.A. and Ph.D. in Economics from the University of Missouri. In his role as professor at UC Davis, University of Arkansas, Northwest Missouri State University and Columbia College, he has served on a number of academic and research committees as well as the Giannini Foundation Board of Directors. He has authored more than 24 publications in refereed journals. In 1990 Bob was awarded a grant from the Center for Cooperatives to work on a project titled *Conversion of Cooperatives to Corporations: Etiology and Deterrence*.

Analysis Of Economic Motives For Cooperative Conversions to Corporations

Robert A. Collins, Ph.D.

In recent years, a number of large, successful agricultural cooperatives have been reorganized into other business forms. This trend has created concern that the cooperative system somehow may be failing to meet the needs of modern agriculture.

These reorganizations have taken several forms. Various cooperatives have:

- Become publicly-held corporations.
- Formed publicly-held subsidiaries.
- Been acquired by publicly-held corporations.
- Become proprietorships or partnerships.

In addition, some have been acquired by other coops. In short, almost every imaginable type of reorganization of an agricultural cooperative has taken place in recent years.

Here, we examine some of these reorganizations in detail, looking at possible motivations for change and possible strategies to deter such changes.

Under today's conditions, there are three chief motivations that may cause a successful cooperative to convert to another form of business organization:

The Equity Access Motive — Since a coop's return to equity is usually low, its members may be reluctant to provide enough equity capital to meet its expansion needs. The obvious alternative, of course, is to borrow. This creates a dilemma for managers who see growth as essential for survival, but fear excessive debt in the volatile agribusiness environment. If the cooperative becomes a publicly-held corporation, equity can be raised quickly with a stock offering.

The Liquidation Motive — There may be a strong incentive to reorganize or dissolve the cooperative if the market value of its equity exceeds book value. Cooperative members usually receive only the book value of their equity when they leave the organization, but a liquidation or conversion to a corporation allows them to receive the liquidating value or market value. When the cooperative is profitable or a period of inflation has occurred, the amount they receive may substantially exceed the book value.

The Corporate Acquisition Motive — Economic pressure to convert a cooperative may come from an outside corporation whose purpose is to acquire the coop's sources of supply, processing capacity or markets. Such a corporation may be able to offer much more than the book value of equity. Since cooperative members can receive only book value otherwise, they may view the corporate bid as advantageous even if it is for much less than the true market value.

These three possible reasons for conversion apply only to successful cooperatives—those who are, in effect, in danger of being destroyed by their own success. There are other possible reasons if a cooperative is not performing well financially. However, the economic pressure on successful coops is a more significant trend in the world of agribusiness. It is the topic here.

In the following case studies, we examine four actual reorganizations in detail. In each case, the three possible motivations—equity access, liquidation and corporate acquisition are considered.

Following the case studies, potential methods of deterring cooperative reorganizations are discussed.

AMERICAN RICE

Until April, 1988, American Rice, Inc., an agricultural cooperative, owned 50 percent of a rice marketing company known as Comet American Marketing. The rest of Comet American Marketing was owned by ERLY Industries, Inc.

On that date, the cooperative was dissolved and replaced by a publicly owned corporation also called American Rice, Inc., or ARI—which owned all of Comet American Marketing. (The former cooperative will be identified here as Predecessor ARI and the new corporation as Successor ARI.)

The reorganization was accomplished by:

- Issuing 8,333,333 shares of Successor ARI common stock to Predecessor ARI and its shareholders.
- Selling 3,888,889 shares of Successor ARI common stock to ERLY for $20,000,000.
- Issuing 3,888,889 shares of Successor ARI convertible preferred stock to ERLY in return for its 50 percent of Comet.

As a result, members of the former cooperative received about 52 percent of the stock of the new corporation and ERLY received about 48 percent.

Financial Impact on Members

Two months before the reorganization, the accounting book value of Predecessor ARI's equity was about $25.3 million. However, the cooperative owned a sizable amount of real estate in downtown Houston. This property was valued at $13.5 million on the coop's books; but its market value was independently evaluated at $15-20 million.

Therefore, it added from $1.5 to $6.5 million to the liquidation value of the cooperative shareholders' equity—for a total of between $25.5 and $30.5 million.

In return for this equity, the shareholders received about $24.6 million, plus the 8,333,333 shares of Successor ARI. The total amount of their gains depends on when, and if, they chose to sell their stock. Bid prices for Successor ARI in the two years following July, 1988, ranged from $1.00 to $3.50, so that the total value of the stock during that period was between $8.3 million and $29.1 million, producing a total payoff from $32.9-$53.7 million.

Assuming a midpoint of $28 million for the $25.5-$30.5 million liquidating value of the cooperative, its shareholders received between 1.2 and 1.9 times that amount—depending on when they sold their stock. In addition, they had their illiquid equity converted to a highly liquid form.

Financial Impact on Managers

As a result of the reorganization, $844,055 in back pay went to seven executives. Also, the thrift and pension plans of Predecessor ARI were assumed by its successor. In addition, four directors who were also shareholders received payments, totalling $426,377, that they were entitled to as members.

Beyond this, however, the conversion generated some other payments to various officers and directors of Predecessor ARI:

- A bonus of $1.3 million was paid to six officers.
- Stock options on 805,566 shares went to certain officers. These gave the holder the right to purchase common shares at $5.14 before March, 1993. Even though it is now clear that these options will most likely have no value, their estimated value at the time of conversion was $160,104.
- A group of 17 officers and directors of Successor ARI received 145,400 shares of common stock, valued at from $145,400 to $508,900 depending on when sold. Some or all of these shares may have been given to them because of membership patronage.

Performance of the New Firm

In its first year of operation, ending March 31, 1989, Successor ARI earned about 1 cent per share. This poor performance was attributed to losses on inventory of $3,500,000 resulting from overvaluation at time of the conversion. (Sales were up slightly, but liquidity was down substantially.) At the end of 1989, earnings for the previous nine months were only about 3 cents per share.

As of February 29, 1988, Predecessor ARI had a debt-asset ratio of 78.4%. A little over a year later, on March 31, 1989, Successor ARI's debt-asset ratio was 81.2%.

Motivation for Change

Analyzing the three possible reasons for converting a cooperative—equity access, liquidation and corporate acquisition—throws some light on the case of the rice cooperative.

<u>The Equity Access Motive</u> — Even though the stated purpose of the reorganization was to "...attract additional capital through equity investment by new investors..." (page 3, prospectus), it is clear that the reorganization did not have this effect. The reorganization took a highly leveraged firm and made it more so; furthermore, nothing in the reorganization plan suggested that the firm would emerge with less leverage. So it does not appear that lack of access to equity capital can be given as the driving force behind the reorganization of American Rice.

<u>The Liquidation Motive</u>—The monetary value of being a member of a marketing cooperative is the greater of (1) the book value of the equity, or (2) the present value of the stream of benefits from being a member. The purchase agreements with the members of Predecessor ARI were non-transferrable and had a term of up to two years. During those two years, members had the option of selling their rice on the same contract terms as before. Meanwhile, Successor ARI offered additional pricing options, intending to get a substantial number of growers to terminate their old contracts. Since the details of these offers and the average age of the members are not available, it is difficult to compare the discounted value of being a cooperative member to the benefit of selling.

However, since members of Predecessor ARI still held a majority of the shares, they theoretically had the power to make sure that their new contracts were equivalent to the old ones. Assuming this, they would have had an incentive to vote for reorganization if they could liquidate their equity for more than book value. That was the case, since members directly received more than book value and may have expected to receive more than twice that amount. So in the case of the American Rice reorganization, equity liquidation was a reasonable motivation.

<u>The Corporate Acquisition Motive</u> — The restructuring of Predecessor ARI also may be regarded as a corporate buyout. ERLY started with 50% of Comet American Marketing and ended up with 48% of Successor ARI, which included Comet as a wholly owned subsidiary. The cost to ERLY may be regarded as the $20 million cash plus 2% of its $8 million equity in Comet, for a total of $20,160,000. For this outlay, they received 7,777,778 shares of Successor ARI, at an effective cost of $2.59 per share.

Given the earnings history of ARI, this could have been regarded as a bargain purchase by ERLY. Therefore, while equity access does not appear to be significant, the liquidation and corporate acquisition motive may have been important in the case of ARI.

ROCKINGHAM POULTRY MARKETING COOPERATIVE

In January, 1988, Rockingham Poultry Marketing Cooperative (RPMC) was acquired by Wampler-Longacre, Inc. (WL). It is now one of six subsidiaries of WLR Foods, the corporation that resulted from the acquisition. Payment to members of the cooperative was made with about 1,450,000 shares of WL stock.

At the time of the acquisition:

- RPMC's book value was about $23.5 million. Meanwhile, its market value as a going concern was professionally appraised at $74.9 million.
- WL stock, which was not traded on the open market at that time, was appraised (by the same outside firm) at $54 per share. Thus, the 1,450,000 shares were declared to be worth $78.3 million.

Financial Impact on Members

At the time of their decision to convert the cooperative, its members had reason to believe that they would receive about 3.3 times book value for their equity. Six months later, after the deal was completed and the market for shares had time to adjust, WL shares were selling for only $19—roughly equal to book value of the cooperative. This was a low point, presumably resulting from economic problems throughout the poultry industry at that time. A year later (July, 1989, following a 3 for 2 split), the share price had recovered to $26.75, or about 2.5 times book value. No substantial benefit to managers of RPMC can be identified.

Therefore, the financial impact on individual members of RPMC depends on when they sold their stock, but it is likely that many did not realize the gain they had anticipated.

Financial Performance of the New Firm

WLR Foods earned only 39 cents per share in 1988, presumably because of the industry-wide slump. Earnings in 1989 recovered to $2.48 per share. This was well below the pre-acquisition peak of $3.41 in 1986, but that had been a very good year for the entire industry. In short, the new firm is doing well, but industry-wide variations make it difficult to tell whether the acquisition resulted in a positive or negative impact on shareholders.

Trends in the debt-asset ratio tell a similar story. RPMC reported a 45% ratio in 1985; 36% in January, 1987; and 33% in March, 1987. Following the acquisition, WRL Foods had a debt-asset ratio of 34% in 1987; 36% in 1988; and 33% in 1989. However, these figures—indicating that the overall leverage of WLR Foods was about the same as the cooperative's—are misleading, because RPMC had extremely high liquidity in 1987. If $10 million of the cooperative's $11.2 million in cash had gone to debt reduction, its debt-asset ratio would have been only 13.7%. Therefore, RPMC experienced a substantial effective increase in leverage as a result of the acquisition.

Motivation for Change

Why did the cooperative's shareholders vote to convert? <u>The Equity Access Motive</u>—Clearly, it was not to gain access to additional financing. RPMC had substantial cash on hand at the time of the conversion, having earned 58.7% return on equity in the previous year. Also, WLR Foods is more highly leveraged than was RPMC; thus, the transaction resembled a leveraged buyout more than an equity infusion.

<u>The Liquidation Motive</u> — It seems likely that members of the cooperative were motivated by a desire to liquidate their equity at market value. At the time of their decision, the appraised value of the WL shares was more than three times the book value of RPMC equity. The discounted value of future cooperative membership is difficult to estimate, but was probably no greater than book value. Members of the cooperative probably anticipated a large windfall, even though it may not have been realized.

<u>The Corporate Acquisition Motive</u> — It does not appear that WL acquired RPMC at a bargain price. Instead, the price—given the information available at the time—seemed reasonable to both parties. Financial reports indicate that the cooperative contributed about 37% of the assets of WLR Foods, and that its earnings during the years just preceding the conversion were about 30% of the total income of the two firms. In return, RPMC members received about 33% of WLR Foods stock. Also, WL received a much-needed supply of poultry; members of the cooperative gained additional processing capacity.

GOLD KIST/GOLDEN POULTRY

This is a case of an agricultural cooperative—Gold Kist, Inc.—which in 1982 created a publicly-owned subsidiary. The resulting corporation, Golden Poultry Company (GP), is (like its parent organization) a producer, processor, marketer and distributor of poultry products.

Although the two firms are completely separate in some ways, they are very closely tied in others; in fact, they could be thought of as a cooperative-corporate hybrid. The cooperative owns 73% of the stock of GP, thus maintaining firm control. The two firms share a number of directors, as well as executives under a management services agreement. In addition, both sell chicken under the same brand.

After being incorporated in 1982, GP grew by acquiring operations from both Gold Kist and other sources. In 1986, it took in Carolina Poultry Products, formerly owned half by Gold Kist and half by another cooperative. GP also acquired a processed meat division from Gold Kist in 1985, and a share in a proprietary ready-to-eat food business. To finance these moves, the corporation made two limited stock offerings to officers, directors and employees in 1984 and 1986 and a public offering later in 1986.

Financial Arrangements

The net effect of GP's operations on members of the parent cooperative is complex. The two firms sell poultry products to each other and GP buys substantial amounts of feed from Gold Kist. These transactions are at approximate market prices and must be approved by a majority of GP's board members who have no interest in Gold Kist. Therefore, impacts of these sales on the cooperative probably are negligible.

However, the management services agreement gives Gold Kist an opportunity to recover some of its fixed costs and to share in GP's profits. This agreement calls for GP to pay Gold Kist for certain administrative, staff and operating functions. It also authorizes an incentive compensation of 5.8% of GP's earnings before tax if the corporation's rate of return on assets exceeds 10%; or 3.5% if the rate of return is positive but less than 10%. Gold Kist, of course, also receives cash dividends when they are paid by GP. These three types of payments totalled $2,661,000 in 1987; $1,917,000 in 1988; and $3,365,000 in 1989.

These payments are likely to find their way back to members of the cooperative through increased patronage dividends or increased book value of equity. Since Gold Kist's investment in GP is only about $6.2 million, this is an excellent rate of return on a member's invested equity.

What about financial returns to cooperative management? The incentive compensation payments from GP apparently do not go directly to Gold Kist's managers. Rather, they receive bonuses based on the performance of the cooperative itself. So to the extent that the coop's profits are increased by payments from GP, its managers benefit.

Impacts: Corporation and Cooperative

After two initial years of losses, financial performance of the subsidiary has been excellent since 1984, except during the poultry industry slump of 1988. Earnings per share were 72 cents in 1984, 65 in 1985, 78 in 1986, 90 in 1987, 14 in 1988 and $1.20 in 1989. In addition, working capital is more than adequate and financial leverage is low. Price of GP's stock rebounded from a low of $3 and high of $8 in 1988, to a low of $5.40 and a high of $12.75 in 1989.

An important question is the effect of GP's existence on the cooperative's financial structure. Clearly, the corporation is a mechanism by which the cooperative has financed considerable growth with external funds. (Since 1984, a total of $13,327,000 has been raised by GP stock issues.) To obtain that much financing internally, the cooperative would have had to substantially increase its debt and reduce payments to members. Meanwhile, since it still has 73% ownership of GP, Gold Kist maintains firm control.

Motivation for Change

If Gold Kist and GP are viewed as a single entity, it is obvious that equity access was the reason behind the formation of the corporation as a subsidiary of the cooperative. Furthermore, additional capital expansion could take place in the same way, since GP currently has a debt-asset ratio of only 25% and additional stock may be sold without compromising the cooperative's control.

It is equally obvious that the decision to form GP had nothing to do with any desire of cooperative members to liquidate their equity at market rather than book value. In fact, the existence of GP has created a problem for cooperative members who are thinking about liquidating their shares at book value. This is because GP's current market value, over $77 million, is far greater than the $6.2 million that the cooperative originally invested in it. Hence, more than $70 million of value has been created that members of the cooperative are not entitled to recover when they liquidate their membership.

The GP case has no elements of a corporate buyout, since it only involves the creation of a publicly-held subsidiary.

LAND O'LAKES/COUNTRY LAKE FOODS

In 1987, Country Lake Foods (CLF) was formed as a corporation by Land O'Lakes (LOL), a Minnesota cooperative. Three LOL businesses were combined to form the corporation: Norris Creameries, Lakeside Dairy Company and the fresh milk and ice cream portions of LOL's Dakota Division.

CLF was originally financed by exchanging 3,000,000 of its shares for approximately $9.1 million from LOL. An additional 1,430,000 shares were sold to the public in 1988. LOL currently owns 67% of the outstanding shares, thus maintaining control of the corporation.

CLF is closely tied to LOL in several ways. CLF sells some of its products directly under the "Land O'Lakes" brand and some are marketed by LOL. Three of the corporation's five directors are LOL executives; CLF executives are former LOL employees or employees of firms acquired by LOL.

Financial Arrangements

CLF buys raw milk and finished products from LOL and LOL buys finished products from CLF. An ice cream brokerage agreement with the cooperative produces revenues for CLF. In addition, CLF purchases management services from LOL.

According to the prospectus, CLF's purchases from and sales to LOL are at open market prices. (In 1989, they totalled $64.8 million and $9.7 million, respectively.) Thus, these transactions would seem to provide no significant benefit to members of the cooperative. Management fees received by LOL in 1989 ($268,000) were almost offset by brokerage fees paid to CLF ($213,000). Therefore, no significant current benefit to members of the cooperative from the operations of CLF can be identified.

However, there is a potential payoff. Seven months after receiving its initial $9.1 million from the cooperative, CLF transferred $8.9 million in cash to LOL in payment of a note. Members of the cooperative, therefore, have received 98% of their investment back and still retain 70% of the shares of CLF. In the future, cash dividends from CLF could find their way to LOL members in the form of patronage dividends.

In general, the existence of CLF apparently does not produce any significant benefit to LOL management. (However, three top LOL managers who are directors of CLF voted themselves eligible for a CLF stock option plan at $10 per share. While the value of these options is unknown, it is probably neither trivial nor extremely large.)

Impacts — Corporation and Cooperative

The public stock offering produced about $12.8 million in cash for CLF. About 70% of it went directly to LOL to pay the note. This reduced CLF's debt-asset ratio from about 70% to about 40%; the firm has high liquidity. The equity infusion from the parent cooperative resulted in almost no new income-producing assets and CLF's profits were about the same in 1989 as they were two years before. However, since the public offering increased the number of shares, the earnings per share declined proportionately. During 1988 and 1989, the stock price hovered around the initial offering price of $10.

Since LOL's investment in the new corporation was almost entirely repaid within seven months, it could be said that the cooperative is back where it began and that CLF has had no net impact of any size on LOL to date. If the two firms are viewed as a single entity, it appears that the creation of CLF has brought about a substantial infusion of equity.

Motivation for Change

None of the three hypothetical reasons for converting a cooperative—equity access, liquidation and corporate buyout—appears, on the surface, to apply to this case. However, the equity access explanation fits best, even though LOL does not show any additional equity on its books so far. When the two firms are viewed as one, considerable new equity clearly has been obtained. Also, LOL now holds 3 million shares of CLF with a market value of more than $30 million. This increases the market value of LOL's equity, even if its accounting statements don't show it.

As in the Gold Kist/Golden Poultry case, a liquidation problem has been created because members of the cooperative now have an additional $30 million of equity with no mechanism available to distribute it.

DETERRING COOPERATIVE CONVERSIONS

The evidence indicates that the partial conversions of Gold Kist and Land O' Lakes are best explained by the equity access motive. The cases of American Rice and Rockingham Poultry have elements of both the liquidation and corporate buy-out motives. Clearly, all three possible reasons for conversion must be considered in evaluating the situations of other successful agricultural cooperatives.

Just as clearly, potential defenses against conversion may at times be considered appropriate. Certain institutional mechanisms are available.

Mitigation of the equity access motive

Growing, successful cooperatives face a genuine problem of equity access and formation of publicly-held subsidiaries may be a rational and legitimate response. There are alternatives:

- One possibility might be to negotiate loans for which interest payments are a share of the coop's profits rather than a fixed amount. This would provide capital that would function very much like equity, since it would not bankrupt the cooperative if there were several years of poor performance. Such equity-sharing loan agreements are not uncommon elsewhere in the business world.

- Another way to raise capital without the risks of conventional debt financing might be to issue non-voting stock to the public (much like the publicly-held Ford Motor Company stock). This could maintain the cooperative principle of control by those who use the services and still provide the financial benefits of outside equity funding. Cooperatives might prefer to set up such a true cooperative-corporate hybrid rather than form a publicly-held subsidiary and attempt to maintain the fiction that they are separate entities. However, legislation might be required to allow cooperatives to sell stock to the public in some states.

- A third alternative is something similar to the Irish public limited company. Under this arrangement, the cooperative would (1) transfer all of its processing and distribution functions to a corporation, (2) retain a controlling portion of the shares and (3) sell the remainder of the shares to the public. The role of the cooperative is thus reduced to raw product acquisition from farmers. This form of reorganization, of course, does not really prevent cooperative conversion, but it does solve the equity access problem.

Mitigation of the liquidation motive

When a cooperative's assets have appreciated (or have been over-depreciated) the liquidation value of its equity will exceed book value. If it is earning a good, stable income its market value as a going concern will exceed both liquidation and book value. In these cases, a motive will exist for either liquidating the cooperative or converting it to a publicly-held corporation.

A method of mitigating this problem is to change the process by which a cooperative accepts new members and liquidates the positions of retiring members. Most cooperative memberships are not transferable; the board regulates the acceptance of new members and places a value on the shares of retiring members. This creates arbitrary valuations that have the effect of distorting members' incentives. The alternative would be to allow either free transfer of membership rights, or transfer subject to board approval.

- One possibility would be an "open outcry" market, in which all exchanges of membership shares would take place at an announced time and place. This would create a competitive market for shares. Membership could be closed; or, if the cooperative decided to expand capacity, it could sell additional shares at this market. If board approval of membership rights is a concern, potential bidders could be approved or disapproved before the auction.

- Another alternative is to allow a private broker to set up a market for membership rights. This would create a bid-asked spread that would reduce the value of shares, but if the broker was a cooperative employee the spread could be controlled. Also, approval of new members could be made part of the transfer process.

Mitigation of the corporate acquisition motive

Since the reasons for corporate acquisition seem to be associated with the equity liquidation motive, it is possible that a market for membership shares would largely solve this problem. Without such a market, the corporate bid must only exceed the book value of equity for rational members to approve a sale. (In other words, the current structure of successful cooperatives makes them easy prey for corporations.) If the corporation had to bid more than the market value in order to get members to approve a sale, corporate takeovers of cooperatives would only occur when the combined value of the two firms exceeded their individual values separately.

In the absence of a market for membership, it is possible that a "poison pill" (a provision that makes a takeover unprofitable) could be incorporated into cooperative bylaws. There are various ways to do this, but it is not clear that the membership would benefit unless the objective of maintaining the cooperative structure outweighs all economic motives.

APPENDIX
Financial Statements and Related Data

American Rice, Inc.

WLR Foods

Golden Poultry Company, Inc.

Country Lake Foods, Inc.

EXHIBIT #1
AMERICAN RICE, INC.
BALANCE SHEETS
(Thousands of Dollars)

ASSETS	March 31 1989	April 30 1988
CURRENT ASSETS:		
Cash	363	24,672
Accounts Receivable	16,769	13,053
Inventories	49,728	62,168
Prepaid expenses	600	1,027
Total current assets	67,460	100,920
INVESTMENTS AND OTHER ASSETS:		
Trademarks	4,229	4,333
Investments and other assets	2,089	2,626
Total investments and other assets	6,318	6,959
PROPERTY, PLANT AND EQUIPMENT:		
Buildings and improvements	22,810	22,839
Machinery and equipment	38,121	36,045
Transportation equipment	822	808
Furniture and fixtures	1,814	1,775
	63,567	61,467
Less accumulated depreciation	18,733	15,671
	44,834	45,796
Houston facility	13,359	13,312
Total property, plant and equipment	58,193	59,108
Total assets	$131,971	$166,987

LIABILITIES AND STOCKHOLDERS' EQUITY	March 31 1989	April 30 1988
CURRENT LIABILITIES:		
Notes payable	35,500	53,650
Accounts payable and accrued expenses	19,900	40,849
Current portion of long-term debt	4,800	—
Total current liabilities	60,200	94,499
LONG-TERM DEBT, less current portion	47,500	48,300
STOCKHOLDERS' EQUITY:		
Convertible preferred stock, $1.00 par value; 20,000,000 shares authorized; 3,888,889 shares issued and outstanding	3,889	3,889
Common stock, $1.00 par value; 50,000,000 shares authorized; 12,222,222 shares issued and outstanding in 1989	12,222	12,223
Paid-in capital	8,076	8,076
Retained earnings	84	—
Total stockholders' equity	24,271	24,188
Total liabilities and stockholders' equity	$131,971	$166,987

EXHIBIT #2
AMERICAN RICE, INC.
STATEMENT OF EARNINGS

PERIOD FROM APRIL 30, 1988
(DATE OPERATIONS COMMENCED) TO MARCH 31, 1989
(Thousands of Dollars Except Per Share)

NET SALES	$180,163
OPERATING COSTS AND EXPENSES:	
Cost of products sold and operating expenses	148,989
Selling, general and administrative	21,218
Depreciation and amortization	3,500
	$173,107
EARNINGS BEFORE INTEREST AND INCOME TAXES	6,456
INTEREST EXPENSE	6,372
EARNINGS BEFORE INCOME TAX	84
INCOME TAX EXPENSE	—
EARNINGS	$84
EARNINGS PER COMMON AND COMMON EQUIVALENT SHARE	$.01

EXHIBIT #3
AMERICAN RICE, INC.
STATEMENT OF STOCKHOLDERS' EQUITY

PERIOD FROM APRIL 30, 1988
(DATE OPERATIONS COMMENCED) TO MARCH 31, 1989
(Thousands of Dollars)

	Total Stockholders' Equity	Preferred Stock	Common Stock	Paid-in Capital	Retained Earnings
Balance, April 30, 1988	$24,188	$3,889	$12,223	$8,076	—
Common stock retired	(1)	—	(1)	—	—
Earnings	84	—	—	—	84
BALANCE, MARCH 31, 1989	$24,271	$3,889	$12,222	$8,076	$ 84

EXHIBIT #4
AMERICAN RICE, INC.
STATEMENT OF CASH FLOWS

PERIOD FROM APRIL 30, 1988
(DATE OPERATIONS COMMENCED) TO MARCH 31, 1989
(Thousands of Dollars)

CASH FLOWS FROM OPERATING ACTIVITIES:	
Earnings	$ 84
Adjustments to reconcile net income to net cash provided (used) by operating activities:	
Depreciation and amortization	3,500
(Gain) loss on sale of equipment	33
(Increase) decrease in accounts receivable	(3,716)
(Increase) decrease in inventories	12,440
Increase (decrease) in accounts payable and accrued expenses	20,949)
Other changes in assets and liabilities	371
Net cash provided (used) by operating activities	(8,237)
CASH FLOWS FROM INVESTING ACTIVITIES:	
Property, plant and equipment additions	(2,459)
Proceeds from sale of equipment	53
Decrease in long-term investment	485
Net cash provided (used) in investing activities	(1,921)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Increase (decrease) in notes payable	(18,150)
Debt proceeds	4,000
Retirement of common stock	(1)
Net cash provided (used) by financing activities	(14,151)
NET INCREASE (DECREASE) IN CASH	(24,309)
CASH:	
Beginning of period	24,672
End of period	$ 363

EXHIBIT #5
SUCCESSOR AMERICAN RICE INC.
PRO FORMA STATEMENT OF EARNINGS

Year Ended June 30, 1987
(Unaudited)
(Thousands of Dollars)

	Predecessor ARI (Historical)	Comet American Marketing (Historical)	Eliminations and Reclassifications(B)	Other Pro Forma Adjustments		Successor ARI (Pro Forma)
				Amount	Note	
Revenues	$175,700	$57,828	$(20,628)	$ (51,535)	C	$
				(4,309)	D	157,056
	175,700	57,828	(20,628)	(55,844)		157,056
Operating Costs and Expenses:						
Purchases	—	29,949	(20,628)	56,098	E	
				9,079	F	74,498
Processing, warehousing and shipping expenses	36,447	10,092	114	4,492	D	
				(3,798)	E	
				5,689	F	53,036
Selling, general and administrative	5,773	13,281	—	481	D	
				707	F	20,242
Estimated expenses applicable to period-end inventory	9,871	—	—	(9,871)	D	—
Costs and expenses applicable to nonpatron operations	15,639	—	—	(15,639)	F	—
	67,730	53,322	(20,514)	47,238		147,776
Interest	2,715	—	—	31	D	
				164	F	
				450	G	3,360
	2,715	—	—	645		3,360
Earnings (Loss) from Investment in Marketing Joint Venture	2,139	—	(2,139)	—		—
Proceeds/Earnings Before Federal Income Taxes	107,394	4,506	(2,253)	(103,727)		5,920
Federal Income Tax Expense	67	—	—	723	H	790
Net Proceeds/Net Earnings	$107,327	$ 4,506	$ (2,253)	$(104,450)		$ 5,130
Net Earnings Per Common and Common Equivalent Share	N/A					$ .32

See Notes to Pro Forma Statements of Earnings.

AMERICAN RICE, INC.
Notes to Pro Forma Statements of Earnings

A. General

The Pro Forma Statements of Earnings set forth the historical net proceeds of Predecessor ARI distributed to the patrons, the historical net earnings of CAM and the adjustments necessary to reflect net earnings of Successor ARI under the proposed Reorganization as if it had occurred at the beginning of each period presented.

B. Acquisition of CAM

Under the ERLY Agreement, Successor ARI will exchange 3,888,889 shares of the Preferred Stock for Comet's 50% interest in CAM. As this exchange will make CAM wholly owned by ARI, the Pro Forma Statements of Earnings adjust the historical financial statements, which accounted for Predecessor ARI's original 50% interest in CAM using the equity method, to consolidate 100% of the results of CAM, after elimination entries.

C. Reversal of Federal Farm Program Benefits

As a result of federal legislation, a marketing loan benefit program administered by the Commodity Credit Corporation, an agency of the U.S. Department of Agriculture, was initiated in April 1986. Predecessor ARI recognized such benefits as revenues and subsequently allocated the net proceeds to the producers. As the producers will directly receive such amounts under the Reorganization, an adjustment is made in the Pro Forma Statement of Earnings to reverse revenues recognized as a result of this program.

D. Change in Accounting Policy for Sales Accruals

As an agricultural cooperative, Predecessor ARI recognized the estimated sales values of year-end inventory and related expenses to properly allocate total crop year production and the related net proceeds to patrons. The Pro Forma Statement of Earnings adjusts the historical financial statements to recognize sales and expenses related to year-end inventory in the period actually realized.

E. Purchases

Historically, Predecessor ARI obtained rice from patrons who were compensated through an allocation of net proceeds. After the Reorganization, it is anticipated members will be given the opportunity to sell all their rice to Successor ARI under varying pricing scenarios as set forth under "Actions to Be Taken by Predecessor ARI in Connection with the Reorganization — Disposition of Growers' Agreements". It is anticipated that substantially all of the existing members of Predecessor ARI will enter into such agreements, but there can be no assurance that this will be the case. To the extent the operation of Successor ARI requires more rice than the amount of rice provided under the new agreements, Successor ARI will be required to purchase additional rough rice in the open market. A product cost is imputed (based upon average prices in the United States) in the Pro Forma Statement of Earnings using the lower of first-in, first-out method or market as such method approximates costs which would have been incurred for the periods presented.

F. Reclassification of Nonpatron Operations

The Pro Forma Statement of Earnings reclassifies amounts previously allocated to nonpatron operations to other categories as the differentiation between patron and nonpatron would no longer exist after the Reorganization.

G. Interest Expense

The Pro Forma Statements of Earnings adjust historical interest expense for the effects of the Reorganization including: a) the anticipated debt restructuring (including the anticipated interest rate

increase in the senior notes) as set forth in Note D to the Pro Forma Balance Sheet, b) the use of proceeds from the offering and c) the change in the timing of product purchases of Successor ARI as discussed below.

The Growers' Agreements of Predecessor ARI require the cooperative to purchase producer rice earlier than would be normal under open market conditions. It is anticipated in connection with the proposed Reorganization substantially all of the existing members of Predecessor ARI will enter into new producer agreements with Successor ARI which provide for purchases under open market conditions. Therefore, the Pro Forma Statement of Earnings anticipates reductions in seasonal interest expenses to reflect the effect of the new producer agreements.

H. Federal Income Taxes

Under the Reorganization, Successor ARI will be subject to corporate federal income taxes. The tax for 1987 is computed at statutory rates less applicable tax credits.

EXHIBIT #6
WLR FOODS, INC.

Five Year Financial Summary

Dollars in thousands, except per share data Fiscal year ended:	July 1 1989	July 2 1988	June 27 1987	June 28 1986	June 29 1985
OPERATIONS					
Net sales	$454,519	$371,436	$378,139	$365,256	$304,980
Cost of sales	384,142	329,583	322,237	306,575	269,338
Gross profit	70,377	41,853	55,902	58,681	35,642
Selling, general and administrative expenses	41,839	35,147	31,718	27,762	19,609
Other expense (income)	1,808	803	(430)	267	1,494
Earnings before income taxes, minority interest and extraordinary items	26,730	5,903	24,614	30,652	14,539
Income tax expense	10,520	3,237	9,809	7,951	5,406
Minority interest	(206)	60	257	250	161
Extraordinary items	—	—	—	—	(197)
Earnings before cumulative effect of change in accounting	16,416	2,606	14,548	22,451	9,169
Cumulative effect on prior years of change in accounting	—	1,112	—	—	—
Net earnings	$ 16,416	$ 3,718	$ 14,548	$ 22,451	$ 9,169
PER COMMON SHARE					
Earnings before extraordinary items and cumulative effect of change in accounting	$ 2.48	$ 0.39	$ 2.20	$ 3.41	$ 1.33
Extraordinary items	—	—	—	—	0.03
Cumulative effect on prior years of change in accounting	—	0.17	—	—	—
Net earnings	2.48	0.56	2.20	3.41	1.36
Dividends declared	0.40	0.47	0.43	0.37	0.22
Book value	13.32	11.24	10.86	9.47	6.74
Year end stock price	26.75	12.67	n/a	n/a	n/a
Average common shares outstanding (in thousands)	6,607	6,607	6,607	6,591	6,752
FINANCIAL POSITION AT END OF YEAR					
Working capital	$ 42,329	$ 34,367	$ 31,944	$ 37,902	$ 23,640
Property, plant and equipment, net	52,251	46,411	45,876	34,257	28,663
Total assets	132,147	115,343	108,975	99,824	76,238
Long-term debt	3,850	4,532	4,955	8,628	7,643
Shareholders' equity	88,033	74,271	71,777	62,578	44,240
ANALYTICAL INFORMATION					
Current ratio	2.18	2.05	2.11	2.46	2.06
Long-term debt/shareholders' equity	4.37%	6.10%	6.90%	13.79%	17.28%
Return on equity	22.10%	5.18%	23.25%	50.75%	24.63%

All per share data has been adjusted for the 3-for-2 stock split effected in the form of a 50% stock dividend declared on March 28, 1989.

EXHIBIT #7
GOLDEN POULTRY COMPANY, INC.

SELECTED FINANCIAL DATA

The selected data presented below under the captions "Statement of Earnings Data" for each of the years in the five-year period ended July 1, 1989, and "Balance Sheet Data" as of June 30, 1985 and 1986, June 27, 1987, June 25, 1988, and July 1, 1989 are derived from the financial statements of the Company, which financial statements have been audited by Peat Marwick Main & Co., independent certified public accountants. The financial statements as of June 25, 1988 and July 1, 1989, and for each of the years in the three-year period ended July 1, 1989, and the report thereon, are included elsewhere herein. The information set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the financial statements and related notes included elsewhere herein.

	For Fiscal Year Ended				
	June 30, 1985	June 30, 1986	June 27, 1987	June 25, 1988	July 1, 1989
	(In thousands, except per share data)				
Statement of Earnings Data:					
Net sales	$102,125	$108,156	$121,618	$142,320	$194,790
Cost of sales	91,442	94,051	100,416	135,422	168,513
Gross profit	10,683	14,105	21,202	6,898	26,277
Selling, administrative and general expenses	3,231	4,542	6,440	5,074	8,376
Operating income	7,452	9,563	14,762	1,824	17,901
Other (expense) income:					
Interest expense	(258)	(251)	(136)	(508)	(214)
Interest income	121	418	1,099	705	993
Miscellaneous	402	14	47	196	69
	265	181	1,010	393	848
Earnings before taxes	7,717	9,744	15,772	2,217	18,749
Income taxes	3,726	4,727	7,375	877	7,131
Net earnings	$ 3,991	$ 5,017	$ 8,397	$ 1,340	$ 11,618
Net earnings per share	$ .52	$ .62	$ .90	$ .14	$ 1.20
Cash dividend per share	—	$ .008	$ .022	$ .032	$ .032

	As of				
	June 30, 1985	June 30, 1986	June 27, 1987	June 25, 1988	July 1, 1989
Balance Sheet Data:					
Total assets	$ 20,021	$ 32,353	$ 56,826	$ 55,616	$ 70,890
Property, plant and equipment, net	3,428	6,172	17,590	21,878	35,432
Working capital	5,626	12,791	27,092	23,450	20,609
Long-term debt	1,280	5,194	6,669	5,985	5,140
Shareholders'equity	7,891	19,211	39,014	40,045	51,353

Information herein has been adjusted to reflect a one for four stock dividend paid in May 1989.

EXHIBIT #8
COUNTRY LAKE FOODS, INC.

SUMMARY OF CONSOLIDATED FINANCIAL INFORMATION

(In thousands, except per share data)

	1989	1988	1987	1986	1985
STATEMENT OF EARNINGS DATA (Years Ended December 31):					
Net sales	$154,611	$146,545	$147,513	$140,781	$137,223
Cost of sales	122,618	115,500	117,586	112,575	110,931
Selling, general and administrative	27,015	24,537	23,525	22,634	22,184
Income from operations	4,978	6,508	6,402	5,572	4,108
Interest expense	26	280	1,167	1,438	1,850
Interest income	662	421	174	231	327
Earnings before income taxes	5,614	6,649	5,409	4,365	2,585
Provision for income taxes	2,161	2,759	1,886	1,306	178
Net earnings	3,453	3,890	3,523	3,059	2,407
Net earnings per share	.78	.98	—	—	—
Weighted average shares outstanding	4,430	3,985	—	—	—
BALANCE SHEET DATA (As of December 31):					
Current assets	$24,372	$21,905	$15,679	$15,172	$14,158
Total Assets	42,618	40,180	32,156	28,623	27,548
Notes payable	—	—	8,900	—	—
Total liabilities	13,329	14,355	22,995	24,676	25,053
Shareholders' equity	29,289	25,825	9,161	3,947	2,495

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