

FCStone Group, Inc. Conversion Overview¹

Company Overview and History

Organizational history. FCStone Group (FCS) is now a publicly held corporation. It converted from a co-op in a two-stage process. First, it converted from a co-op to a private or closely held ordinary corporation (C-Corp) effective September 1, 2004 based on a membership vote taken on March 1, 2005. This vote explicitly terminated patronage rights as of September 1, 2004 (beginning of the 2005 fiscal year) in the plan of conversion even though the vote was taken six months after the beginning of the co-op's 2005 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 March 16, 2007 with an initial public offering (IPO). In October 2006 FCS filed for an initial public offering (IPO) of common stock. The next stockholder vote was December 5, 2006 approving the IPO and a change from an Iowa corporation to a Delaware corporation. Of the votes cast, 97 percent favored the IPO. The prospectus for the IPO was filed on March 16, 2007 and the IPO resulted in net proceeds of new equity of \$129.7 million.

Demand for the new stock was strong and continues to be strong. On March 16 the stock opened at \$24 and closed at \$32. A total of 5.865 million shares were sold and the net receipts were \$129.7 million. This new equity was added to the existing equity of \$72.1 million. The pre-IPO existing equity consisted primarily of the "original" shares converted from co-op equity with a cost basis of \$10.00, additional "appraised" shares with a cost basis of zero, additional "subscription" shares purchased at \$10 per share by existing stockholders in a supplemental subscription offering during April through June of 2005 and Employee Stock Ownership Plan (ESOP) shares purchased in August 2005 by employees using a portion of their 401(k) assets.

FCS traces its cooperative origins back to Agri Industries, an Iowa based grain marketing 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 into a subsidiary in 1978 known as Farmers Commodities Corporation (FCC). In 1978 net revenue, equivalent to gross income, was \$500,000. FCC was spun off into a separate regional cooperative company in 1986. By then net revenues had grown to \$8 million. In 2000 FCC acquired the company, Saul Stone, an execution services company with presence on all the domestic commodity exchanges, giving FCC the ability to clear all U.S. exchange-traded commodity futures and options contracts. Net revenue had grown to \$42 million. They changed their name to FCStone Group, Inc. but still maintained their cooperative status until the vote to convert to an ordinary corporation on March 1, 2005.

¹ Prepared by David Barton and Michael Boland, Professors, Arthur Capper Cooperative Center, Department of Agricultural Economics, Kansas State University for the Farmer Cooperatives Conference session on "Business Structure Choices" held November 5, 2007 and the NCERA-194 session on Restructuring of Cooperatives Roundtable held November 6, 2007 in St. Paul, MN. The primary sources of information are SEC filings and company documents. Appreciation is expressed to ACCC staff members, Chuck Mickelsen and Kristina Martin, for assistance in gathering and preparing this information and to FCStone CEO, Paul (Pete) Anderson, for reviewing this document for accuracy.

Present business. FCS has evolved from a business providing commodity exchange execution services to a diversified company focused on integrated risk management. Their IPO prospectus described themselves 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 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. They are:

(1) Commodity and Risk Management Services (CRM). This is the foundation of the company and provides the largest portion of net income. It is served by about 117 risk management consultants who assist customers mitigate their exposure to commodity price risk and maximize the amount and certainty of their operating profits.

(2) Clearing and Execution Services (CES). This supports the risk management consulting service by providing lower-margin clearing and execution services to risk management customers. In addition a wide array of other customers are served including commercial accounts, professional traders, managed futures funds, introducing brokers and retail customers.

(3) Financial Services (FS). This segment offers financing services that help customers finance physical grain inventories and other commodity inventories.

(4) Grain Merchandising (GM). This segment uses a separate company, FGDI, to function as a dealer in and manager of physical grain and fertilizer. The role of FGDI is to link merchandisers of grain products through their network of industry contacts, serving as an intermediary to facilitate the purchase and sale of grain. On June 1, 2007 FCS reduced its ownership in FGDI from 70 percent to 25 percent. The remaining 75 percent is owned by Agrex, a subsidiary of Mitsubishi.

Operations and financial performance history. FCS has been growing at a very rapid rate in the two most profitable segments, CRM and CES. Several key metrics are reported in Table 1. Net income before taxes for the CRM segment increased from \$7.9 million in 2004 to \$21.9 million in 2006. The nine month income for 2007 is already at \$26.6 million. The CES segment has seen similar improvements, with net income before taxes increasing from \$3.4 million in 2004 to \$11.0 million in 2006. The nine month income in 2007 is already at \$10.8 million.

Measuring size by total revenues or sales is misleading because they are driven heavily by the Grain Merchandising business segment's buying and selling of commodities such as grain and fertilizer, a high volume, low margin business with volatile prices. Total revenues in 2004 were \$1.6 billion and they declined to \$1.3 billion in 2006.

A better measure of activity is net revenues, which is revenues or sales net of the cost of commodities sold. These increased from \$105.1 million in 2004 to \$181.9 million in 2006. The nine month net revenue in 2007 is already \$181.8 million.

Net income for the total company increased from \$3.6 million in 1998 to \$6.4 million in 2004, the last year as a co-op. Patronage income averaged about 42 percent of net income (after taxes and before pension adjustment), Cash patronage refunds averaged about 70 percent in the three years prior to conversion. Since converting to an ordinary corporation, net income has increased to \$6.6 million in 2005, to \$15.3 million in 2006, and after nine months in 2007 it is at \$21.3 million.

Pre-conversion situation. FCS grew rapidly prior to conversion due to its success in applying its risk management service and commodity exchange service business model to an expanded set of customers and commodities beyond agriculture and its cooperative members. The core of the business model is referred to as the Integrated Risk Management Program or IRMP.

This growth created a need for access to capital to finance this growth, primarily to finance the regulatory capital required by CFTC. 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 the equity redemption of retained patronage refunds. Another potential opportunity was the construction of a method to improve the rewards to employees and management, including the board of directors, for high performance through direct ownership.

Conversion Rationale and Proposal Overview

Stated reasons for conversion. We identified eight reasons based on 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 [equity class 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 and were giving up 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 told the following 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 June 29, 2005. Out of 553 member-stockholders, 56 exercised this right and purchased 174,372 shares of stock for \$1.7 million out of the maximum that could be purchased of 2.15 million shares for \$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 September 27th 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 plan of reorganization was approved by the members at a meeting held on March 1, 2005 and the reorganization became effective September 1, 2004.

IPO proposal description. FCStone received stockholder approval on December 5, 2006 to convert from a private to a public corporation with an initial public offering (IPO) and to change the charter from an Iowa corporation to a Delaware corporation. FCS then issued a prospectus for an IPO to occur March 16, 2007. The proposal had the following components and results:

1. *Issued 5.865 million shares at an initial offer price of \$24.00 which resulted in additional net proceeds of \$129.67 million and total outstanding shares of 18.2 million.*
2. *Use of proceeds included:*
 - a. *Redeem 2.159 million shares or 15% of existing common stock prior to the offering at a price of about \$22.32 for a total cost of about \$48.210 million.*
 - b. *Use the balance to reduce debt and build assets as needed.*
3. *Notice was made that cash dividends could be paid in the future on stock, although it was expected they would be less than past dividends paid.*
4. *Notice was made that a 3 for 1 stock split was being implemented for prior stock holders as a stock dividend. That split occurred as of February 26, 2007.*

Post Conversion and IPO Overview

Company performance. FCStone has continued to perform at a very high level since the conversion and IPO. Net revenues and net income have 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 has ranged from 13.2 percent in 2005 to 26.3 percent in 2007 (first 9 months).

Total book value of equity increased from \$39.8 million in 2004 to \$49.7 million in 2005, following conversion. Equity continued to increase in 2006 to \$58.9 million. After the IPO total equity increased to \$162.2 million on May 31, 2007. The market capitalization on October 19, 2007 was \$991.4 million based on 27.4 million shares currently trading at about \$36.15 per share.

A 3 for 1 stock split was made in February 2007, prior to the IPO, and a 3 for 2 stock split was made in September 2007, after the IPO. The stock price has increased significantly since the IPO

and has recently ranged from around \$30 to \$40 per share, closing at \$37 in mid-October. This compares to a post-split adjusted initial price the first day that ranged from \$18 to \$23. See Figure 1 for a history of prices.

There were eight reasons listed above for the conversion. All eight have been achieved.

Access to equity capital has been increased through sales of stock, supplementing the previous primary source, net income. There have been several sales of stock including the subscription rights offering to member-stockholders in 2005, the ESOP sales in 2005 and since, the IPO in March 2007. This strengthened the balance sheet by reducing debt and increasing the equity to asset ratio from 5.6 percent in 2006 to 10.8 percent in 2007. 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 and then going public increased the liquidity of cooperative member allocated and unallocated equity and captured the market value of that equity. The conversion distributed the pre-conversion appraised value of the ownership to stockholders as shares at a rate of \$10 per share. The two public stock offerings allowed members to sell part or all of their original, appraised and purchased subscription stock for a substantial gain.

Non-patronage type 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 still control FCS through a significant ownership of voting shares amounting to about 45 percent. More importantly, the current board of directors is comprised primarily of local co-op managers and they have substantial influence on future nominees to the board, suggesting they may continue to have higher influence than the proportional share of voting shares owned by local co-ops. An ESOP was formed, an equity incentive program was implemented and stock option awards were made to the leadership team of executives and directors. This aligns the interests of the leaders and employees with the interests of stockholders.

Member benefits. The ultimate test of a conversion is the benefits it actually provided compared to the benefits that would have been achieved if the co-op business form had 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 nonpatronage sources to shares of stock owned.

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

A second key metric is the impact on their investment in FCS and the income received. Since the co-op members continued to be the biggest block of owners of the company measures of interest

are (1) the cash dividends received per share (roughly equivalent 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.

Profitability as measured by return on equity and absolute net income has been higher since conversion than before. Cash patronage rates and redemption rates were relatively high while FCS was a co-op, compared to other co-ops. After conversion to a private corporation cash distribution was significant but a smaller percentage of net income for 2005 and 2006. However, this could be viewed in the context of the move toward an IPO by including 2007 cash flows paid to co-ops directly by FCS. In 2007, a substantial dividend of \$6.1 million was paid of which 90 percent could be assigned to co-op owners with the remainder being paid to the ESOP.

But much more significantly, 15 percent of co-op equity was repurchased or redeemed by FCS in the amount of \$48.2 million. This alone is several times the cash flow received while FCS operated as a co-op.

Stock price has also increased substantially compared to the cost basis, creating a substantial gain in the asset on co-op balance sheets, equity asset investment in FCS. Consider just the original and appraised stock issued at the time of conversion and ignore the additional subscription stock and other stock some co-ops acquired later. At the time of conversion in March 2005 the original and appraised stock components had a cost basis of about \$16.7 million for about 4.31 million shares, or about \$3.88 per share. After the 3 for 1 stock split on February 26, 2007, just prior to the IPO these shares increased to 12.93 million shares with a cost basis of about \$1.29 per share.

As noted above, about 15 percent of these shares as well as other shares were repurchased or redeemed by FCS for around \$22.32 per share. This is a multiple of about 17.3 over cost basis and a gain of \$21.03 per share sold.

More significantly, the remaining 85 percent of these shares can 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 on August 3, 2007 and had net proceeds of \$48.24 per share. This is a multiple of 37.4 over cost basis and a gain of \$46.95 per share.

On September 17, 2007 there was a 3 for 2 stock split, reducing the cost basis on these shares to about \$0.86 per share. Recent market prices are about \$37, a multiple of 43 times the cost and a gain of over \$36 per share sold.

A phenomenal amount of market value has been captured compared to cost or book value by the conversion of FCS and its IPO. Multiples of this magnitude is 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 equity redemptions and other cash flows to producers.

A third key metric is governance or control. The ownership still includes substantial local co-op investment. The board of directors continues to be composed of the same 10 local co-op CEOs. The CEO is the same. Two additional directors were added to the board, the FCS CEO (but not as chairman of the board) and an outside financial expert. The nomination process for new directors is likely to keep the board relatively stable and composed of local co-op CEOs, at least for the next few years.

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 ⁴
Revenue	\$332,325,857	\$346,599,349	\$399,679,645	\$452,280,625	\$658,419,467	\$858,433,993	\$1,169,276,422	\$1,623,587,172	\$1,400,098,000	\$1,294,805,000	\$1,266,015,000
Revenues, Net¹ (Gross Income)	\$27,477,783	\$29,766,335	\$33,927,376	\$41,836,208	\$56,224,527	\$65,737,281	\$76,077,837	\$105,093,000	\$126,753,000	\$181,856,000	\$181,815,000
Net Proceeds/Net Income	\$42,191	\$3,627,206	\$4,640,641	\$6,256,272	\$5,967,855	\$3,387,528	\$4,305,293	\$6,413,931	\$6,580,000	\$15,257,000	\$21,303,000
Cash Patronage/Dividends²	\$3,977,692	\$2,072,500	\$670,499	\$1,542,406	\$2,132,609	\$1,849,182	\$936,747	\$1,428,862	\$1,869,000	\$2,898,000	\$6,057,000
Equity Redemptions	\$150,750	\$205,263	\$101,533	\$271,757	\$110,976	\$419,440	\$217,221	\$1,436,544	\$613,000	\$0	\$48,486,000
Total Assets	\$92,581,414	\$100,390,807	\$115,445,584	\$234,850,728	\$271,911,019	\$399,526,490	\$504,732,608	\$603,827,125	\$805,522,000	\$1,057,207,000	\$1,507,387,000
Total Equity	\$21,447,724	\$24,202,268	\$27,201,870	\$31,069,458	\$35,068,413	\$35,172,430	\$35,826,840	\$39,828,782	\$49,672,000	\$58,895,000	\$162,231,000
Equity to Assets	23.2%	24.1%	23.6%	13.2%	12.9%	8.8%	7.1%	6.6%	6.2%	5.6%	10.8%
Return on Equity	0.2%	15.0%	17.1%	20.1%	17.0%	9.6%	12.0%	16.1%	13.2%	25.9%	26.3%
Shares Outstanding³	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	4,828,279	4,845,736	27,426,400
Return per share	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	\$1.36	\$3.15	\$0.78
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
Share Price⁵	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	\$36.15
Market Capitalization	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	\$991,464,360

¹ Revenues, net of cost of commodities sold; equal to gross income.

² Cash Patronage amounts in year paid, not earned, for 1997-2005. Cash dividends declared of \$0.60 per share on October 25, 2005 and \$0.42 per share on November 9, 2006.

³ 3 for 1 stock split on Feb. 26, 2007 and 3 for 2 stock split on Sept. 17, 2007.

⁴ Only first 9 months of 2007 included except share and market capitalization values, which are as of October 19, 2007.

⁵ As of October 19, 2007.

Figure 1. FCStone Daily Stock Price

