Gold Kist
Conversion Overview

Company Overview and History

Organizational history. Gold Kist ceased to exist as a separate independent company in December 2006 when they were taken over by Pilgrim’s Pride in an acquisition using a stock exchange buyout plan approved by the boards of both companies. The Gold Kist board recommended that its stockholders tender their shares to Pilgrim’s Pride for the agreed upon price of $21 per share prior to the offer deadline of December 26, 2006. Prior to the mutual agreement, Pilgrim’s Pride had initiated a hostile takeover or tender offer of $20 per share and by the end of November claimed to have secured two-thirds of the Gold Kist shares. The remaining outstanding shares were tendered in December and Gold Kist became a wholly-owned subsidiary of Pilgrim’s Pride in January 2007.

About two years prior to the takeover by Pilgrim’s Pride Gold Kist converted from a cooperative to a “for profit” public corporation. There was a conversion and initial public offering (IPO) on October 12, 2004, following a member vote in which 96 percent of the votes cast favored the conversion.

Following the conversion and IPO, Gold Kist stock was listed on NASDAQ and traded under the symbol GKIS. There were 13.6 million shares issued to the public for $11.00 per share and 36.4 million shares distributed to cooperative member-owners. Then in December 2006, Pilgrim’s Pride bought Gold Kist for $21.00 per share. Pilgrim’s Pride had made several offers to buy Gold Kist, both before it converted from a co-op and after.

The purchase price of $21.00 was 191 percent of the $11.00 share price at conversion and 162 percent of the market price of $12.93, the last close on August 18, 2006 prior to Pilgrim’s public announcement on of an unsolicited offer to buy Gold Kist for $20 per share. Gold Kist, the third largest poultry producer, and Pilgrim’s Pride, the second largest, combined to form the largest poultry producer in the United States with about a 25 percent market share, surpassing Tyson Foods’ 21 percent market share.

The company that became the Gold Kist Cooperative was formed in 1933 in Carrolton, Georgia as a cotton marketing cooperative. The cooperative became a diversified regional cooperative operating in the southeastern United States. The makeup of the cooperative was retail, pecan, peanut, metal fabrication, marketing, and farm supply businesses, as well as a vertically integrated poultry division. In 1972 the name of the cooperative was changed from the Cotton

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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 former Gold Kist board chairman, Dan Smalley, for reviewing this document for accuracy.
Producers Association to Gold Kist. Later on, in 1998, a decision was made to focus on the poultry business, which led Gold Kist to sell many non poultry businesses.

The voting membership in Gold Kist dropped from 31,000 to 2,300 as a result of the focus on poultry. Just prior to conversion in October 2004 they had about 15,000 equity holders who were no longer active members. Active members in Gold Kist consisted of poultry and pork producers who had contracts to deliver chickens or hogs to Gold Kist within the previous three years. Each active member had one vote and elected 11 cooperative directors by district.

**Business just prior to conversion.** Gold Kist was the third largest broiler producer in the United States and was producing about 9 percent of the broilers in the U.S. annually. They operated hatcheries, feed mills, processing plants and distribution warehouses in Georgia, Alabama, Florida, North Carolina and South Carolina.

The poultry business is dominated by approximately 40 large vertically integrated poultry producers geographically concentrated in the southeastern region of the country. Vertical integrators control most aspects of poultry production. Most vertically integrated poultry firms are privately owned. The largest are Perdue Farms, Wayne Farms and Mountaire Farms. However, Tyson Foods, Pilgrim’s Pride, Sanderson Farms and Cagle’s are all publicly held. Gold Kist was the only large vertically integrated poultry cooperative. Since their acquisition by Pilgrim’s Pride, more industry consolidation is expected.

Gold Kist provided chicks and feed to contract growers. The contract grower, in turn, provided the facilities, water, power and labor to grow the birds for the 6 to 8 week period it takes to produce a four pound broiler. The contract growers were the member-owners of the Gold Kist cooperative.

Gold Kist marketed its products to customers in retail, institutional, export and restaurant markets, giving them over 3,000 customers. The largest customer accounted for about 11 percent of Gold Kist sales and the ten largest customers accounted for 33 percent of Gold Kist sales. Gold Kist marketed whole chickens, cut-up chickens, segregated chicken parts and further processed products packaged in ice-pack, chill-pack or fresh. They marketed the products under Gold Kist, Young n Tender, Medallion and various store brands. Value added, further processed products accounted for 18 percent of Gold Kist sales.

The poultry business is cyclical, and while the demand for poultry is seasonal and price sensitive, the long term sales trend is up. The basis of competition in this industry is on price, service and quality. An oversupply of broilers results in falling prices. Americans are eating more chicken but the inflation adjusted price of chicken has decreased. Production and processing efficiency enable firms to be profitable. The export market accounts for about 15 percent of US broiler sales.

**Operations and financial performance.** Gold Kist maintained a steady increase in sales from 1996 to 2004, the year of conversion, in spite of re-positioning its asset portfolio by exiting most of the non-poultry businesses. Sales increased from $1.4 billion in 1996 to $2.3 billion in 2004. However, net income was very volatile as seen in Table 1. Losses were experienced in three of
the nine years, 1996-2004. Return on equity varied from a low of minus 44 percent in 1998 to a high of 39 percent in 2004. Equity to assets was also volatile in response to the variability in net income.

Sales held fairly constant following conversion, at $2.3 billion in 2005 and $2.1 billion in 2006. Net income in 2005 was a record $112.3 million but dropped to a loss of $17.7 million in 2006. Pilgrim’s Pride and other large poultry businesses also suffered losses in 2006. The Gold Kist share price stayed above the issue price of $11.00 in 2005 and 2006, averaging $17.90 and $15.07, respectively. See Table 1 for financial performance information.

A large and volatile factor of production is the cost of feed. Gold Kist, not contract growers, assumes the price risk of feed because they supply the feed to contract growers. Chickens are fed a mixture of milled corn and soybeans. A convenient way to think about the price of chicken and the cost of feed is the broiler-feed ratio. This ratio is the number of pounds of feed that can be bought for the price of a pound of broiler. The broiler feed ratio is a good proxy for profitability in the poultry industry.

**Pre-conversion situation.** Gold Kist started making the transition from a diversified cooperative to a poultry company in 1998. They sold their farm supply businesses to the Southern States Cooperative and subsequently bought $98 million of Southern States preferred stock to help them finance the purchase. Gold Kist itself was highly leveraged with an equity to asset ratio of 22 percent in 1998. During the transition time between 1999 and 2003, sales growth averaged 1 percent per year.²

The confluence of a several factors combined to financially weaken Gold Kist in 2003. There was a recession that cut poultry demand. Russia, a significant export market, embargoed U.S. poultry imports to retaliate for steel import quotas in the United States. The embargo was replaced by Russian import quotas on U.S. poultry imports at 70 percent of 2002 levels. The oversupply of poultry resulted in falling domestic prices. International competition from Brazil became a factor in export markets. The investment in Southern States Cooperative preferred stock became non-performing when Southern States failed to pay dividends. Corn and soybean meal prices increased 25 percent and 18 percent, respectively, in 2003. Gross Margins fell from 9.2 percent of sales in 2002 to 2.3 percent in 2003. Net Income in 2003 was a negative $51.4 million. Cash flow from operations was a negative $15.3 million. The equity to assets ratio fell to 24.1 percent. Gold Kist considered selling the business during the period, but didn’t have an acceptable proposal. Pilgrim’s Pride was not disclosed as a potential buyer until 2004.

As a provision in loan covenants, Gold Kist was limited to paying 10 percent of patronage earnings in cash. Gold Kist also allotted 20 percent of patronage earnings to retained earnings. Since 1987 patronage refunds had been distributed in non-qualified form. This meant Gold Kist paid the income tax on non-qualified retained patronage income in the year the income was earned. When non-qualified patronage refunds were redeemed, the recipient of the redemption had taxable income and paid the income tax and Gold Kist got a deduction from taxable income.

In theory, Gold Kist intended to redeem retained patronage refunds on a 20 year revolving fund cycle. In practice, redemptions were only for estates and other special redemptions. The cooperative had an insurance policy to cover estate redemptions for the 700 patron-owners with more than $100,000 of notified or allocated equity. Cash returns to members were low and member dissatisfaction was high during 1998-2003.

In the 2004 fiscal year, the last full year for Gold Kist as a cooperative, the financial situation at Gold Kist improved significantly. Sales increased by 21 percent to 2.26 billion dollars, gross margin percent improved to 19 percent and net income was a record 111 million dollars. The equity to assets ratio improved to 32.1 percent.

**Conversion Rationale and Proposal Overview**

**Stated reasons for conversion.** Gold Kist was under financial pressure in 2004 and lenders were putting pressure on the company. They borrowed $200 million in March of 2004 at 10.25 percent interest rate, a relatively high rate, with the principal due in 2014. As a result of conversations with potential lenders, Gold Kist made the preliminary proposal to convert to a ‘for profit’ corporation described in a June 1, 2004 SEC filing. The stated reasons for conversion were:

1. Provide more financing alternatives.
2. Reduce the cost of debt.
3. Reduce the amount of debt.
4. Provide the ability to add independent directors to the board of directors.
5. Enable immediate redemption of retained patronage refunds.
6. Provide the ability to use stock in acquisitions.
7. Provide the ability to use stock as compensation for employees and management.

**Conversion proposal description.** The initial plan filed June 1, 2004 was not feasible and was replaced by the restated and revised plan, dated July 22, 2004. The initial plan, as shown to members and filed with the SEC, proposed selling 36 percent of the company (18 million shares at $15.00 per share) to the public to raise about $270 million in cash. The revised and restated plan proposed selling 24 percent of the company (12 million shares at $11.00 per share) to the public to raise $132 million in cash. The conversion process in both plans had four provisions.

1. Equity holders with less than $10,000 of equity will have their equity redeemed for cash before the conversion. The implemented plan of conversion redeemed about $15 million to this group.
2. Members with more than $10,000 of nonqualified equity can request that all or part of their book value of equity be redeemed for cash before the conversion. The implemented plan of conversion redeemed about $90 million to this group.
3. Members with equity that is not redeemed will have their equity converted to stock in the new Gold Kist. The implemented plan of conversion created about $344.4 million in new stock for this group.
4. If the value of the member’s share of Gold Kist Inc. exceeds the value of the notified or allocated equity, the excess value will be distributed as cash or stock to active
members. This premium is called “member equity”. The excess value member equity will be distributed in amounts proportional to each active member’s gross volume of business with Gold Kist (not contribution to profitability) over the last 5 years. Gross volume was measured by business volume payments to contract growers and volume of business (sales to or purchases from) with other members including retail dealer operations and peanut growers. Contract grower payments included payments to broiler producers, such as 5 cents per pound, and payments to hatching egg producers, such as 40 cents per dozen. The implemented plan of conversion distributed an additional $66 million (6 million shares) to this group.

Half of the stock issued to members was to be locked up for six months, the other half was to be locked up twelve months. The revised and restated plan was approved by 96 percent of the members.

At the time of the conversion there was $360.0 million of notified or allocated equity held by members. There was also $42.3 million of unallocated losses. Therefore, the net equity of Gold Kist was $317.7 million. The value of the shares issued to members was $344.4 million, before the excess value distribution. The excess value of the member equity was $66 million and was divided among the remaining stockholders, amounting to a premium of 19.2 percent. This gave members a total of $410.4 million, or 72.8 percent of the ownership after the IPO and redemptions.

Members requested that $105.0 million of notified equity be redeemed for cash. The revised and restated proposal budgeted only $88.0 million to redeem equity so requests exceeded the redemption budget by $17 million. In the actual conversion, the underwriters exercised an oversubscription option to purchase 1.6 million shares for $11.00 per share, so an additional $17.6 million in cash needed to redeem equity for cash became available and was applied.

In the IPO, 27.2 percent of Gold Kist was sold to the public for $149.6 million in cash. A total of $194.8 million was spent to repay debt, redeem equity and pay the underwriting expenses. The extra cash needed beyond the IPO proceeds, amounting to $45.2 million, came from the Gold Kist cash reserves on the balance sheet.

Prior to the conversion, Gold Kist announced plans to create 4 million additional shares for a Long-Term Incentive plan. The shares in the plan were to be used to reward management and employees. In October 2004 shares were allotted to the incentive plan with a market value of $7.5 million.

Post Conversion and IPO Overview

**Company Performance.** In the first year of operation as a public corporation, 2005, Gold Kist had a record sales and profit year. Sales were $2.30 billion and net income was $112 million. The equity to assets ratio improved from 34 percent, just prior to the IPO, to 49 percent. Additionally, the redemption of non-qualified equity prior to the stock conversion of about $106 million was expected to eventually create an income tax refund of $24 million for Gold Kist.
In the 2006 fiscal year, sales went down 7.7 percent to $2.13 billion and net income was a negative $17.7 million. The fear of avian flu cut demand and decreased prices.

The financial performance of the company appeared to be similar before and after the conversion although there were only two years of post-conversion history. The company still had the same management, assets, inputs, contract growers, products, markets and competitors. However, the company was different in two ways:

1. The investor relations with the company were different. Investors gained substantial liquidity and weren’t captive investors with the expectation that retained patronage refunds would be redeemed at the discretion of Gold Kist. Investors, including former Gold Kist members, took on the risks and rewards of ownership when they bought or held the stock. Also, Gold Kist Inc. stated that it did not intend to pay dividends on stock. Co-op members who held the stock did not get dividends in lieu of patronage refunds. They did get increased liquidity and the related possibility of stock appreciation (and depreciation).

2. The financial condition of the company improved. Some of the proceeds of the IPO ($77.2 million) were used to repay debt. The interest expense of the debt was high, so interest expense went down as well. The financial performance in 2004 and 2005 helped strengthen the balance sheet.

There were seven reasons listed for the conversion and IPO. Of the stated reasons for conversion, most were accomplished to some extent. The amount and cost of debt was reduced. Independent directors were elected to the new board. Members that wanted their notified (allocated) equity redeemed got cash. There was a stock incentive plan for management and employees. The ability to use stock for acquisitions was created, but it also created the ability to be acquired in a hostile takeover, which is what happened.

**Member benefits.** Members that wanted to participate in the future of Gold Kist as stockholders could do so. Members who wanted to cash out and receive the appraised value of their ownership interests were also able to do so. The post-conversion price of Gold Kist stock saw ups and downs but members were free to sell after the lockup periods usually for a price higher than the issue price. Former Gold Kist members that held their stock until the Pilgrim’s Pride buyout were rewarded with a premium.

It is difficult to estimate the tax and net cash flow impacts on all the former Gold Kist members and then compare them to what they would have been, had Gold Kist not converted and not been acquired. It was anticipated that pre-conversion redemptions would be taxed as redemptions, the notified equity for stock swap would be treated as an exchange of like value, and the members’ equity premium would be treated as a capital gain or a dividend.

Certainly those co-op owners who were no longer contract grower patrons and eligible to receive patronage refunds gained in the conversion. They were able to convert an very illiquid asset, their equity investment in Gold Kist, into cash much sooner than would have been possible, otherwise.
It is likely that virtually all cooperative members and stockholders had a positive cash flow from the conversion and one that was bigger than they could expect from the traditional Gold Kist income distributions and equity management program. So they appear to have gained, at least in the short-run, in terms of their financial relationship with the co-op as patrons and owners.

Their customer role as a contract grower may change for better or worse depending on their future contracts with Pilgrim’s Pride. Their role as members, with voting control of the company, was changed in the conversion and the takeover. Voting power was significantly reduced, especially for active patron-members, with the conversion. The board of directors of Gold Kist, as an independent public cooperation, continued to be controlled by traditional producer members. After the takeover the voting power of traditional members in Pilgrim’s Pride was substantially less than in Gold Kist and no producer-members became directors on the Pilgrim’s Pride board.

<table>
<thead>
<tr>
<th>Year</th>
<th>Sales</th>
<th>Gross Margins</th>
<th>Net Income</th>
<th>Cash Patronage Refunds Declared/Dividends</th>
<th>Equity Redemptions Paid</th>
<th>Pre-Conversion Redemptions</th>
<th>Total Assets</th>
<th>Total Equity</th>
<th>Equity to Assets</th>
<th>Return on Equity</th>
<th>Shares Outstanding</th>
<th>Return per share</th>
<th>Cash return per share</th>
<th>Market Capitalization</th>
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<td>66,826,833</td>
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**Notes:**
1. Transition Quarter Ended October 2, 2004
2. 50,000,000 shares outstanding at the time of conversion on October 12, 2004.
3. Annual simple average of weekly prices
4. Only the first three quarters of Pilgrim's Pride FY are reported.