

# IMPACTS OF THE CONVERSION OF DIAMOND WALNUT GROWERS

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## OVERVIEW

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- Background
- History of Diamond Walnut
- Motivation for Conversion
- The Conversion
- Potential Impacts on Former Co-op Members
- Q & A

## BACKGROUND



- Walnuts rank #18 among California's ag products in value
- Diamond Walnut ranked #39 among US ag co-ops in revenue in 2004 (\$360 million)
- 1,800 members delivered 46% of state's walnut crop (5 year average)

## DIAMOND WALNUT'S HISTORY



- Formed in 1912 as federation of local packing exchanges
- Local exchanges consolidated
- Became Diamond Walnut Growers in 1956 and built processing facility to expand shelled nut production
- Began marketing other nuts in late 1990s
- Launched Emerald snack nuts in 2004
- Announced potential conversion/IPO in March, 2005

# MOTIVATIONS FOR CONVERSION



- Competing with other branded snack nut companies
  - Planters (Kraft Foods subsidiary)
  - Fisher and regional brands
- Competing in healthy snack category
  - USDA Dietary Guidelines—Omega 3s
- Ability to issue stock for acquisitions of other firms



## Members' Choices With Conversion

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- Deliver crop & hold stock OR
- Don't deliver crop but hold stock OR
- Deliver crop but don't hold stock OR
- Don't deliver crop & don't hold stock

## THE CONVERSION

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- Approved by 80%+ of votes cast on July 1, 2005
- IPO price of \$17/share
- Raised \$88.3 million in net proceeds from stock sale
- Over 95% of co-op members' acreage committed to Diamond Foods

## Impact On Members

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- Assessed within context of the co-op principles

## User-Financed

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- As co-op
  - \$15.2 million in retained earnings from nonpatronage earnings
  - Converted from 5-year revolving fund program in 1998
  - \$38.5 million working capital retains
    - Held ~33% of crop payment for 15 months
  - Members "invested" \$48.6 million in past 5 years for brand development, charged as expenses

## User-Financed

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- Members voted on conversion w/o assurance of IPO price
- Estimated at \$15/share
- IPO could be as low as \$5/share w/o having to make new filing

## User-Financed

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- Opened at \$17/share
- After IPO
  - 15.6 million shares now outstanding
  - Members received 8.1 million shares valued at \$137.0 million, plus \$17.3 million in cash

## User-Financed Positive Impacts of IPO

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- Liquidity of common stock
  - Former members' shares tradable on NASDAQ after 360 day holding period
- Potential for stock dividends & appreciation—plan for \$.03/share for Q1
- Has traded between \$15.92 and \$23.15 over 3 months
- Calavo's stock values have ranged from \$7-\$13 since 2002
- GoldKist stock has traded between \$10.15 to \$23.95 since September, 2004

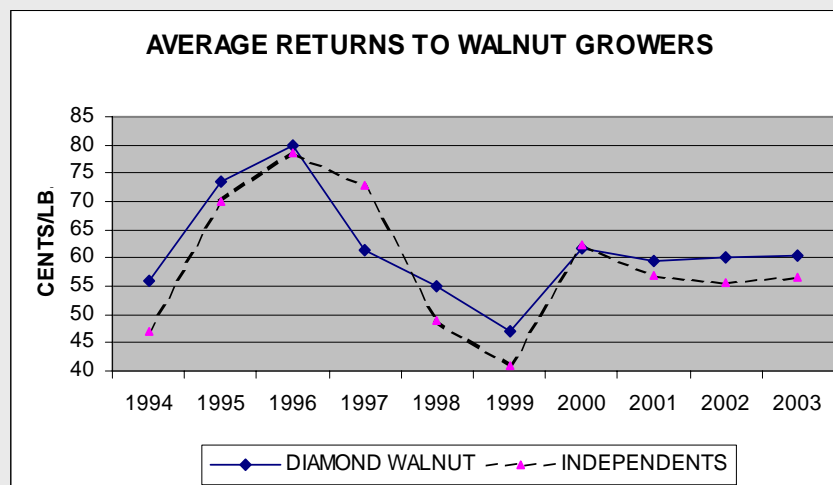
## User-Financed Negative Impacts of IPO

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- Now subject to Sarbanes-Oxley Act
- Costly reporting requirements for smaller companies
  - In Price Waterhouse survey, 58% of smaller companies (with revenues under \$1 billion) perceived compliance with Sarbanes Oxley as costly, compared to 38% of larger companies
  - Calavo's accounting fees have increased by \$1.0 million on net earnings of \$5.0 million

## User Benefit

- As members, producers averaged \$.578/lb--\$.034/lb premium over prices paid by independents over past 5 years



## User Benefit

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- After IPO
  - Existing member marketing agreements ended
  - Option to extend agreements by 3, 5 or 10 years, but required to deliver entire crop to Diamond Foods

## User-Benefit Negative Impacts of IPO

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- Marketing agreement creates monopsony with no price protection or guarantee to pay market prices
  - "...mission will shift from delivering annual net proceeds to members to maximizing long-term shareholder value"
  - "Payments under the new Walnut Purchase Agreement could be less than payments members are historically accustomed to receiving under the existing Marketing Agreement...(after harvest), will determine a purchase price based on market conditions, quality, variety and other relevant factors."

## User-Benefit

### Negative Impacts of IPO

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- Diamond has been sourcing other nuts overseas
- China is world's largest walnut producer

## User-Control

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- Diamond Walnut board was composed of 13 grower members
- Member voting proportionate to deliveries over previous 2 years
- After IPO, 9 member board with 5 outside directors, 3 producer directors + CEO
- Grower Executive Council with the 10 members of co-op board who did not become members of Diamond Foods board

## User-Control Positive Impacts of IPO

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- As a co-op marketing branded packaged products, Diamond Walnut may have suffered from principal-agent problem
- New board has 5 outside directors with considerable financial management and marketing expertise, and extensive experience in packaged foods and dietary products industries

## User-Control Negative Impacts of IPO

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- Growers now hold 51% of 15.5 million outstanding shares
- Equity Incentive Plan provides options for 1.9 million shares for future issuance to directors, management and other employees
- Largest shareholder is CEO with 253,333 shares and options for 478,000+ shares

## The Future For Former Diamond Walnut Members

- Walnut prices
- Success of Emerald Nuts and new healthy snack products
- Stock price performance
- Dividends

## Future Research Issues

- Winners & losers among co-op membership in the long-term
- Financial performance of Diamond Foods
- Walnut commodity market structure
- Marketing strategy
- ???

