Dairyland COULD FARMERS HAVE SAVED THEIR COOP? WITH THE RIGHT TOOL, YES!

IF YOU VISITED YOUR doctor for an annual checkup and were told "...Well, you have a foot on the left and one on the right... Each side has a hand. Ears and eyes balance. Nothing is too large or too small. You must be in good health..." you would quickly find yourself a new doctor! Yet isn't this pretty close to what happens when we approve the annual financial statements of our co-op?

Even at the governance level, it is often hard for directors to detect financial mismanagement. Senior managers acting to maximize individual performance bonuses can mask financial risk and economic vulnerability, making income statements and balance sheets "hard to figure". Staff comes to the meeting armed with bafflegab, and board politics often constrain the ability of Directors to mount an effective challenge.

To measure human health, your doctor uses a stethoscope, a blood pressure cuff and a thermometer. The equivalent tool for farmers who want a better measure of the financial health of their co-operative is OCFAID analysis.

Dairyland is a case in point – a co-op that might have been saved had this analysis been shared with members. Recent columns have recapped the history of Dairyland, a century old Fraser Valley farmer co-operative that demutualized and was sold to Saputo in 2001. As one Alberta delegate to th3 2001 AGM observed: "No-one knew what was going on... Delegates were not kept up to date by the Board; there was no transparency. Basically... Saputo stole it for 50 cents on the dollar..."

Had OFCAID analysis been used in the boardroom and featured on the cover of the annual reports, the changing fiscal health of this co-operative would have been fully transparent to both directors and delegates SOME FOUR YEARS BEFORE the co-op collapsed. This would have done two things: a) it would have provided irrefutable evidence of the deteriorating fiscal health of the co-op that management would have been powerless to refute, and b) it would have provided this information in time for farmers to take action to save their co-op before demutualization.

OCFAID methodology was developed by Professor Alan Robb, Saint Mary's University, Halifax and the University of Canterbury, New Zealand. It considers both PROFITABILITY AND LIQUIDITY and is based on the Tom Lee dictum: "The ultimate bottom line in business is not profit, it is the ability to earn a profit on a transaction and turn it into cash and do this repeatedly..." (Lee is a well known financial author and Director of Accounting and Auditing Research, Institute of Chartered Accountants of Scotland. More information on OCFAID analysis can be found at www.alanrobb.coop).

OCFAID stands for Operating Cash Flow After Interest and Distribution (mainly dividends). It is plotted graphically against Retained Earnings, both on a cumulative basis. A major change in governance, management or operations triggers a new cumulative graph.

Importantly, an OCFAID graph very usefully exhibits 5 CLEAR SCENARIOS which serve to give immediate transparency to the financial state of the organization. When both operating cash flow after interest and distribution and retained earnings are both rising, it's a STAR. When the OCFAID is rising but the RE is falling, it's a CASH COW. The reverse is a PROBLEM CHILD. When both are falling, it's a DOG. A TURNAROUND (usually under a receiver or a change manager) is when both are neutral as the nature of the entity is reconfigured.

After gathering a complete set of Dairyland/Dairyworld financials from 1980-2001, I sent them to Alan Robb for analysis. The results are very interesting...

The opening OCFAID analysis (1980-1981) depicts a healthy co-op. Both retained earnings and OCFAID are steadily rising.

In 1982, the Fraser Valley Milk Producers Co-operative (FVMPC) merged with Shushwap-Okanagan Dairy Industries Co-op Association (SODICA) to form Fraser Valley Milk Producers Co-operative Association. This structural change necessitates a recast of the OCFAID analysis, which

[The writer is an award-winning agrologist based on Bowen Island wendy@theholmteam.ca]

from 1982 to 1991 shows a "very good trend after an initially poor year of amalgamation…." (Robb.)

In 1985, David Coe was appointed CEO. According to a Director on the board at the time, Coe had an expansionist vision and two main weaknesses: "he was not enough adverse to debt and was soft on clients - really scared of losing an account; if we managed to save 1¢ on a litre of milk, he would give 2¢ away to keep a client…"

Two strong Board chairs kept Coe in check until a merger in 1992 changed everything.

The '92 merger brought together Fraser Valley Milk Producers Co-op Association, Northern Alberta Dairy Producers (NUMAID) and Central Alberta Dairy Pool (ALPHA) to form DAIRYWORLD FOODS.

Under the terms of the merger, regulations requiring members' approval for new capital loans were dropped. Also dropped was a revolving check-off loan (1% from milk cheques) that provided the co-op with low cost equity from its members (patient capital, the loans earned modest interest and were repaid in 15 years). Paying out the loan drew down $7-12 million in capital from the co-op. And, lastly, the strong and experienced BC Chair (Peter Freisen) was replaced by a less experienced Alberta Chair. These changes gave their expansionist CEO a clear road.

In 1993, Dairyworld merged with processing co-op Dufferin Employment Co-op (MANCO, +3000 employees).

OCFAID analysis for the period 1992-95 continues to show "…a healthy trajectory, even better than the previous period." (Robb.)

But storm clouds were gathering...At the 1993 AGM, Director and former Vice Chair John Van Dongen publicly resigned, telling delegates that he had many concerns for which he could not get board support. In his remarks, he recommended to members case studies of US co-op failures at the hands of overly aggressive CEO's.

In 1996, Dairyworld Foods merged with Dairy Producers Co-op Ltd (DPCL) Saskatchewan to form Agrifoods International. At the time, the co-op had 2,100 shippers and gross sales of $1.13 billion.

OCFAID analysis for 1996 and 1997 is again positive: " a successful merger for the members…" (Robb.)

In 1997, the co-op's ice cream division was sold to Nestle. Sometime that year, Cliff Denny stepped down as Chief Financial Officer. A board member at the time suggests he was pushed.

Problems came to a rolling boil in 1998, when accelerated steps to position the co-op as a national supplier included expansion to Eastern Canada through purchase of processing plants in Ontario, Baxter Dairies in the Maritime, McCain Refrigerated Foods, a joint interest in Pascobel cheese and a partnership agreement with Nurtinor and Agrodor.

Merger talks with Agropur were also initiated at this time; they failed on two issues: governance (Agropur wanted 14/10 board split; Agrifoods wanted 12/12) and management (each co-op wanted their own CEO to take the helm).

The 1998 acquisitions paid heavily for intangibles: goodwill represented 50% ($43.8m of the $84.2m) of the net assets acquired from McCains and 79% ($22.5m of the $28.5m) of the net assets of other acquisitions. All acquisitions were dependent on borrowed finance. And a rapid depreciation of this good will tanked profitability, leaving no surplus for distribution to members.

As a result of the 1998 acquisitions, long-term debt rose by 68% ($73 million), and current liabilities rose 55% ($75 million). The cash paid for intangibles caused a sharp drop in operating cash flows and OCFAID analysis became seriously negative.

Had members been presented with 1998 OCFAID analysis, it would have been obvious to all that the co-operative was in serious financial trouble and alarmingly vulnerable.

Instead, waving a balance sheet showing assets of $513 million and sales of $1.2 billion, Coe told delegates how "immensely proud" he was of this "substantial increase in sales and net earnings" that positioned them for a bright future. The budget was approved by the Delegates.

By 1999, the ratio of external debt to members' equity was almost three to one (2.9:1), double the debt to equity level in 1982 (1.5:1). Similarly, the ratio of intangibles to members' equity and members loans had risen to a whopping 66.4 percent, up from only 0.6 percent in 1997 and a mere 3.3 percent in 1982.

At the 1999 AGM, delegates were told of a $6 million loss (25% of member equity) from Ontario processing operations. When members criticized the board for operating outside their mandate ("to process members milk"), the CEO is said to have justified Ontario acquisitions as a "pre-emptive strike" to "stop processors from coming West".

At the January 2001 AGM, with financial statements reporting sales of $1.5 billion, 120 shocked delegates were told the Royal Bank had called their loans, Saputo was offering 50¢ on the dollar, and the Board recommended acceptance.

Between a rock and a hard place, 110 farmers voted to sell the co-op's assets and brand to Saputo. The co-op Agrifoods International retained the raw milk transport business. Reportedly, senior staff got healthy termination bonuses.

When private sector firms fail, no one questions capitalism… But when co-ops fail, some are quick to suspect the model. In fact, 60 percent of new co-operatives survive and thrive; a much higher rate than for private sector firms. ◉

This is the last in a three part series. The Dairyland story (May 2011) and Taking the pulse of your cooperative (Nov 2012) are posted at wendy-holm.com