



Perspectives on Cooperative Finance

Cooperative Strategy,
Structure and Finance

Farmer Cooperatives Conference

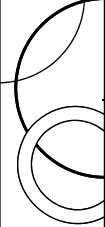
November 19, 2008
St. Paul, Minnesota



Equity and Capital Management Strategies: Doug Derscheid, CEO of CVA

- CVA equity management and income distribution in 2006
- CVA objectives
- CVA decision process
- CVA solution or strategies
 - for 2006 environment
 - for 2008 environment

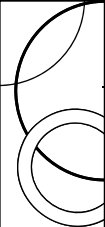
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CVA Equity Management Issues

- Series of mergers: I I into I
- Many current equity classes each with a unique redemption program
 - needed to simplify and make transition to a better program
 - 29 old classes were already grouped into 14 aggregate classes and each aggregate class had its own redemption program
- One or more equity classes were created for each absorbed co-op which led to the 29 separate classes over time


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CVA Equity Management Issues

- Each absorbed co-op had a unique situation at pre-merger time with respect to:
 - Financial and equity structure
 - Profitability history and potential
 - Redemption programs
- Various pre-merger equity management agreements were made with each absorbed co-op requiring minimum fixed obligations and implying additional flexible redemption possibilities depending on redemption program and budget


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CVA Income Distribution Issues

- CVA and its predecessors had used many alternative income distribution strategies
- CVA board priorities
 - more cash to patrons
 - less tax obligations by patrons
 - quicker equity redemptions
 - newer, larger facilities


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CVA Income Distribution Issues

- CVA wanted the best choice going forward with respect to amount of patronage income to distribute as:
 - qualified patronage refund (dividend)
 - cash percentage
 - retained (deferred) amount that would have to be redeemed later
 - nonqualified patronage refund that CVA pays income taxes on and redeems later
 - unallocated retained earnings (savings)


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CVA Income Distribution Issues

- Should different sources of income such as local earnings and regional patronage, be distributed differently?
- Equity redemption problems CVA was currently experiencing may have been due to poor income distribution choices in the past
- Two big questions:
 - What was sustainable and best for CVA?
 - What was best for members?

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CVA Objectives


In general, develop a comprehensive income distribution and equity management program that is

1. Fair and equitable to members
2. Structured and disciplined so as to protect the co-op by protecting the balance sheet and providing flexibility each year based on the likely variation in income and growth
3. Based on sound co-op financial principles supported by our bankers and financial advisors
4. Simple to understand and manage

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	CVA Objectives
	<p>Specifically, achieve these goals:</p> <ol style="list-style-type: none">1. Reduce and simplify equity classes2. Move to preferred redemption method, revolving fund, while reducing use of age of patron, in equitable way3. Implement a balance sheet management philosophy4. Determine a simple and fair way to divide the total redemption budget between all equity classes5. Evaluate alternative income distribution policies

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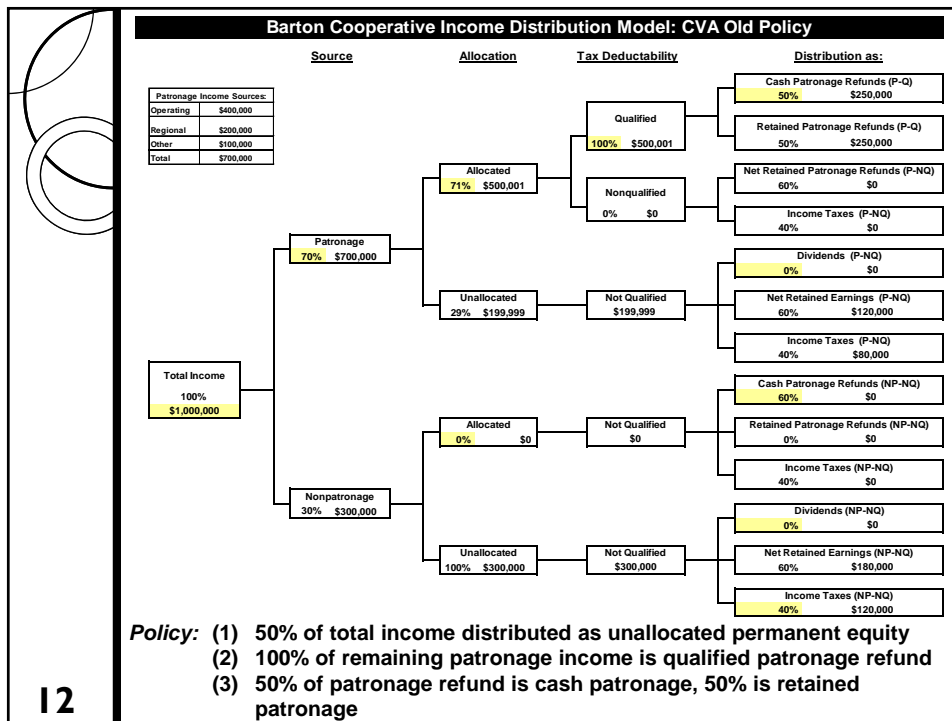
	CVA Decision Process
	<ul style="list-style-type: none">• Education on co-op finance for management team and board with participation and input from banker and auditor• Comprehensive evaluation of financial alternatives presented<ul style="list-style-type: none">– First to special equity management committee– Second to board of directors• Selection of an income distribution and equity management program by board that achieved our objectives

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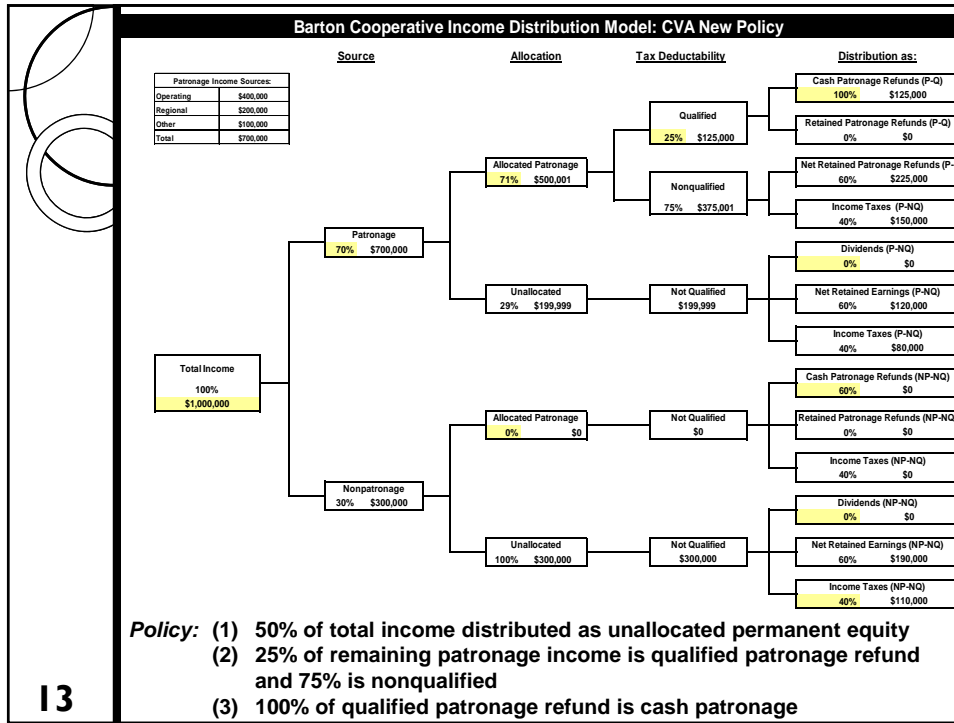
CVA Income Distribution Policy: Old and New

- Distribute 50% of total income to unallocated retained earnings equity to build permanent equity from current 45% to projected level of 50% by 2015 (10 years)
- Implement new nonqualified distribution by dividing remaining patronage income between qualified and nonqualified as follows:
 - 25% to qualified, paid as 100% CPR
 - 75% to nonqualified (taxable to CVA in year of distribution)
 - Justification: patrons only pay income taxes on cash received
- See slide 12 (old) and 13 (new) for examples

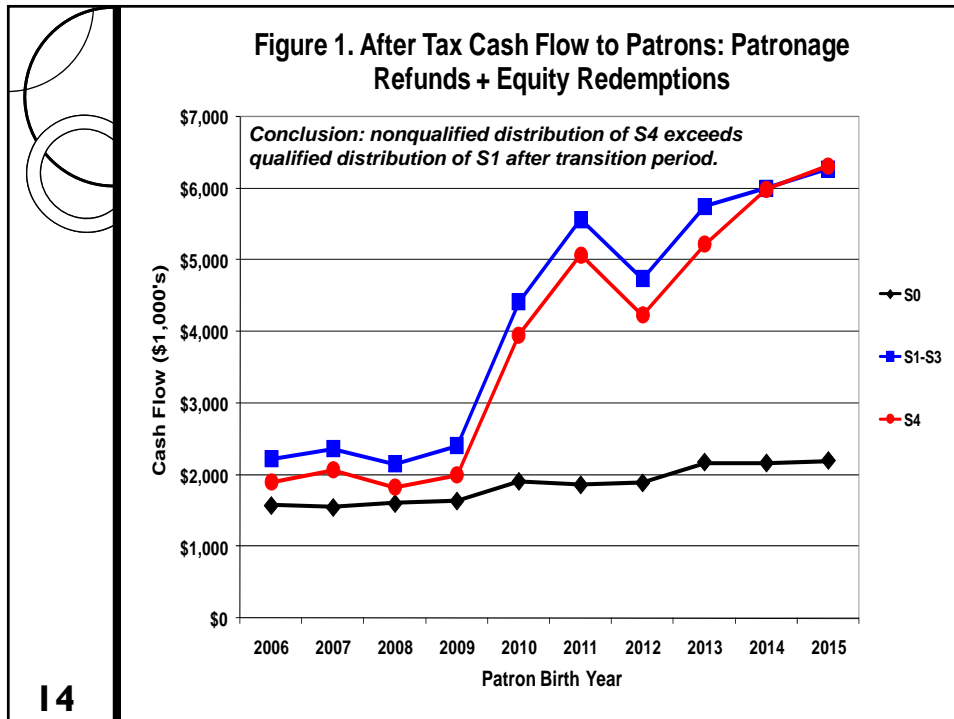
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CVA Equity Management Policy: New

- Implemented balance sheet management to achieve
 - Liquidity or working capital target dollars
 - Solvency or total equity to assets percentage (or equivalent solvency measure)
- Determined total redemption budget (residual use of available working capital or excess equity)
- Determined redemption program for each simplified equity class
 - 15 classes including new non-qualified class
 - See slide 18 (Table 1)

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CVA Equity Management Policy: New

- Determined priority each equity class group (5 groups) had in using available redemption budget (see slides 18 & 19/Tables 1 & 2 examples)
 - Estate settlements (SP) had first priority regardless of class or group
 - Group 2 had second priority as fixed redemptions based on fixed age of patron or percentage pool rules
 - Group 3 had third priority using a combination of an existing fixed age of patron redemption and a new flexible revolving fund redemption. The residual flexible budget assigned to each class in Group 3 was based on its pro rata share of total equity

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CVA Equity Management Policy: New

- Determined priority each equity class group (5 groups) had in using available redemption budget (see slides 18 & 19)/Tables 1 & 2 examples)
 - Group 4 had fourth priority. The “CVAQ” class 13 uses only a revolving fund, the preferred redemption method, and has no redemption budget (except estate settlements) until any Group 3 flexible class is redeemed to zero balance. Flexible class “percentage splits” are then assigned to “CVAQ.” “CVANQ class 14 gets no redemptions (except estate settlements) until CVAQ class 13 is redeemed to zero. The baseline projection said that would occur in the tenth year (2015).
 - Group 5 had no priority since its equity is “frozen” with no redemptions.

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Table 1. CVA Mergers: Equity Class Structure and Redemption Program: 2007 Sample Solution

Equity Class					Redemption Method Priorities				
Co-op	Group	Class	Type	Q or Non-Q	SP -	PP %	AP/O age	RF length	Beginning 2007 Amount
Z/CVA	1	1	Voting	Q	Y				\$72,370
Z/CVA	1	2	Non-voting	Q	Y				\$114,030
A/SCR	2	3	Fixed	Q	Y		87		\$171,328
B/HOO	2	4	Fixed	Q	Y		87 & 71		\$261,700
C/FRE	2	5	Fixed	Q	Y		72		\$217,720
D/NOR	2	6	Fixed	Q	Y	2.5%	?		\$2,765,172
E/CVC	3	7	Flexible	Q	Y		74	34	\$8,166,503
F/CFC	3	8	Flexible	Q	Y		65	13	\$433,270
G/TRIQ	3	9	Flexible	Q	Y		80	29	\$5,398,005
H/TRNQ	3	10	Flexible	NQ	Y		80	30	\$180,391
I/AGL	3	11	Flexible	Q	Y		71	28	\$4,248,564
J/HUM	3	12	Flexible	Q	Y		65	18	\$2,264,423
Z/CVAQ	4	13	Flex-Hold	Q	Y			XX	\$2,882,238
Z/CVNQ	4	14	Flex-Hold	NQ	Y			YY	\$7,851,546
Z/FRO	5	15	Frozen	Q	N				\$161,494
TOTAL									\$35,188,753

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Table 2: Allocation Distribution Program by Equity Class 2007										Budget		\$1,000,000	
Equity Class Group	New Class	New Class Code	In Class		Out of Class		Type	By Class		Total		Funds Retention: APD & RP	
			\$	%	\$	%		\$	%	\$	%	\$	%
MEMBER VOTING 11	1	1	\$72,330.00				None						
11 MEMBER VOTING					\$20,000.00								
32 AGLAND MEMBER VOTING					\$14,700.00								
62 TRI VALLEY MEMBER VOTING					\$11,580.00								
71 NORTHEAST MEMBER VOTING					\$11,700.00								
51 HUMPHREY COMMON					\$4,250.00								
SEPT PARTICIPATION 12	1	2	\$114,030.00				None						
12 SEPT PARTICIPATION					\$17,500.00								
33 AGLAND C OF P					\$24,180.00								
41 HUMPHREY C OF P					\$12,210.00								
63 TRI VALLEY C OF P					\$13,810.00								
72 NORTHEAST C OF P					\$46,240.00								
MEMBER & PARTICIPATION EQUITY			\$186,460.00		\$186,460.00								
SCHMIDT DEFERRED 28	3	3	\$171,327.68	0.48%			Fixed	\$25,583.54	100%	100%			
28 SCHMIDT DEFERRED					\$171,327.68								
HOOPER DEFERRED 30	3	4	\$261,700.46	0.74%			Fixed	\$30,308.81	100%	100%			
30 HOOPER DEFERRED					\$261,700.46								
REIMONT DEFERRED 30	3	5	\$217,719.51	0.62%			Fixed	\$40,166.38	100%	100%			
30 REIMONT DEFERRED					\$217,719.51								
NORTHEAST DEFERRED AND STOCK CREDITS 74 73	2	6	\$2,765,171.88	7.80%			Fixed	\$68,125.31	2.0%	all years			
74 NORTHEAST STOCK CREDITS					\$2,020.00								
74 NORTHEAST DEFERRED					\$2,763,151.88								
DEFERRED EQUITY			\$1,418,818.53		\$1,418,818.53			\$140,397.54					
DIC FOR DIC DEFERRED EQUITY 16 8 6 7	3	7	\$2,168,959.22	6.33%			Flex	\$29,913.92	39.20%		\$68,944.91	100%	\$29,913.92
16 DIC DEFERRED EQUITY					\$3,778,821.54								
8 DEFERRED DIC EQUITY					\$2,014,104.09								
7 DEFERRED DIC EQUITY					\$7,620.81								
6 DEFERRED DIC EQUITY					\$2,054,548.81								
DIC LONG TERM DEFERRED EQUITY 10	3	8	\$433,269.34	1.28%			Flex	\$16,684.22	2.00%		\$886.77	100%	\$16,797.44
10 DIC LONG TERM DEFERRED EQUITY					\$433,269.34								
TR VALLEY FC TO PLUS AND DEFERRED AND ST 66 61 64	3	9	\$3,388,204.56	15.42%			Flex	\$216,895.24	28.00%		\$108,944.54	100%	\$108,944.54
66 TR VALLEY FC TO PLUS					\$15,222.40								
61 TR VALLEY DEFERRED					\$5,244,782.01								
64 TR VALLEY STOCK CREDITS					\$2.00								
TR VALLEY UNQUALIFIED PAT 45	3	10	\$190,339.62	0.55%			Flex	\$8,342.12	1.00%		\$8,351.21	100%	\$241.00
45 TR VALLEY UNQUALIFIED PAT					\$190,339.62								
AGLAND DEFERRED 31	3	11	\$4,248,363.38	12.58%			Flex	\$171,013.53	20.50%		\$168,889.34	100%	\$4,123.62
31 AGLAND DEFERRED					\$4,248,363.38								
HUMPHREY MEMBER EQUITY AND STOCK CREDIT 47 50	3	12	\$2,254,422.56	6.48%			Flex	\$91,763.37	11.00%		\$88,793.64	100%	\$4,978.73
47 HUMPHREY MEMBER EQUITY					\$2,254,422.56								
50 HUMPHREY STOCK CREDIT					\$45.10								
DEFERRED EQUITY			\$1,887,182.65		\$1,887,182.65			\$84,212.48			\$472,032.32		\$242,178.88
DIV DEFERRED 9	4	13	\$2,682,258.40	8.24%			None						
9 DIV DEFERRED					\$2,682,258.40								
DIV NON QUALIFIED 18	4	14	\$7,851,548.00	22.47%			None						
18 DIV NON QUALIFIED					\$3,167,414.00								
18 DIV NON QUALIFIED 2007 Underbnd					\$4,684,134.00								
NON QUALIFIED EQUITY			\$10,733,806.40		\$10,733,806.40								
PROZEN EQUITIES 13	5	15	\$191,494.40	0.48%			None						
13 PROZEN EQUITIES					\$191,494.40								
DEFERRED PROZEN EQUITY			\$191,494.40		\$191,494.40								
TOTAL MEMBER EQUITY CREDITS			\$51,512,383.12	100.00%	\$51,512,383.12	100.00%							
TOTAL MEMBER & PARTICIPATION EQUITY			\$186,460.00		\$186,460.00								
TOTAL ALLOCATED EQUITY			\$51,698,793.12		\$51,698,793.12								


Total Distribution Budget Summary		
	\$	%
Total Allocations	186,460.00	100.00%
Funds Retention	854,212.48	33.42%
Total	1,000,000.00	100.00%
Funds Retention	\$472,032.32	46.84%
APD	168,889.34	41.61%
RP	303,143.00	71.57%
Total	854,212.48	100.00%

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General Observations and Recommendations

- Equity management strategies in mergers should be based on sound cooperative finance principles and strategies
- Income distribution as non-qualified retained patronage refunds should be considered as a new innovative policy
- Income distribution of patronage income to unallocated retained earnings should be used with caution (temptation to sell co-op; cash flow reduction to patrons)

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General Observations and Recommendations

- Redemption programs should give preference to:
 - Balance sheet management to determine the total redemption budget
 - Proportionality of investment to determine the preferred redemption methods: RF or BC
- Merger equity management should give preference to:
 - Being simple, but fair and equitable, if possible
 - Pre-merger instead of post-merger agreements
 - Transition to preferred programs using balance sheet management, a total redemption budget and revolving fund redemption method
 - Using more complex multiple equity pools only if necessary to achieve fairness (“win-win”)

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Questions and Discussion

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Redemption Budget: \$1,000,000															
Equity Class Groups	New Group	New Class Code	Equity			Type	Fixed Redemptions: APO & PP			Flexible Redemptions: APO and RF					
			by Group	by New Class	%		\$	by Class	Birth Year	Total	Split %	APO	RF		
MEMBER VOTING 11	1	1	\$72,370.00			None									
11 MEMBER VOTING				\$29,500.00											
32 AGLAND MEMBER VOTING				\$14,760.00											
62 TRI-VALLEY MEMBER VOTING				\$11,580.00											
71 NORTHEAST MEMBER VOTING				\$11,700.00											
51 HUMPHREY-COMMON				\$4,830.00											
CERT PARTICIPATION 12	1	2	\$114,030.00			None									
12 CERT PARTICIPATION				\$17,690.00											
33 AGLAND C OF P				\$24,180.00											
41 HUMPHREY-C OF P				\$12,210.00											
63 TRI-VALLEY C OF P				\$13,810.00											
72 NORTHEAST C OF P				\$46,240.00											
SUBTOTAL MEMBER & PARTICIPATION EQUITY			\$186,400.00												
SCRIBNER DEFERRED 28	2	3	\$171,327.68		0.489%	Fixed	\$25,583.04	1920 and 1921							
28 SCRIBNER DEFERRED				\$171,327.68		0.489%									
HOOPER DEFERRED 29	2	4	\$261,700.46		0.748%	Fixed	\$30,908.81	1920 and 1936							
29 HOOPER DEFERRED				\$261,700.46		0.748%									
FREMONT DEFERRED 30	2	5	\$217,719.51		0.622%	Fixed	\$40,165.39	1925 and 1926							
30 FREMONT DEFERRED				\$217,719.51		0.622%									
NORTHEAST DEFERRED AND STOCK CREDITS 74 73	2	6	\$2,765,171.86		7.900%	Fixed	\$69,125.30	2.5% all years							
73 NORTHEAST STOCK CREDITS				\$5,203.70		0.015%									
74 NORTHEAST DEFERRED				\$2,759,968.16		7.885%									
SUBTOTAL FIXED EQUITY			\$3,415,919.51				\$165,787.54			\$329,413.92	39.500%	\$98,944.51	1933	\$230,569.42	1922
CVC FCX LO CFC DEFERRED EQUITY 16 8 6 7	3	7	\$4,166,503.25		23.331%	Flex									
16 CFC DEFERRED EQUITY				\$3,778,825.54		10.796%									
8 DEFERRED CVC EQUITY				\$2,014,104.09		5.754%									
7 DEFERRED UO EQUITY				\$78,023.81		0.223%									
6 DEFERRED FCX EQUITY				\$2,295,549.81		6.558%									
CFC LONG-TERM DEFERRED EQUITY 10	3	8	\$433,269.84		1.238%	Flex				\$16,684.25	2.000%	\$886.77	1932	\$15,797.48	1994
10 LONG-TERM DEFERRED EQUITY				\$433,269.84		1.238%									
TRI-VALLEY PC 70 PLUS AND DEFERRED AND ST 66 61 64	3	9	\$5,398,004.50		15.422%	Flex				\$216,895.24	26.000%	\$109,944.54	1927	\$106,950.70	1982
66 TRI-VALLEY PC 70 PLUS				\$153,222.49		0.438%									
61 TRI-VALLEY DEFERRED				\$5,244,782.01		14.984%									
64 TRI-VALLEY STOCK CREDITS				\$0.00		0.000%									
TRI-VALLEY UNQUALIFIED PAT. 65	3	10	\$180,390.62		0.516%	Flex				\$8,342.12	1.000%	\$8,583.12	1927	\$241.00	1977
65 TRI-VALLEY UNQUALIFIED PAT.				\$180,390.62		0.516%									
AGLAND DEFERRED 31	3	11	\$4,248,563.86		12.138%	Flex				\$171,013.55	20.500%	\$166,889.94	1936	\$4,123.62	1936
31 AGLAND DEFERRED				\$4,248,563.86		12.138%									
HUMPHREY-MEMBER EQUITY AND STOCK CREDIT 47 50	3	12	\$2,264,422.90		6.469%	Flex				\$91,763.37	11.000%	\$86,783.64	1942	\$4,979.73	1984
47 HUMPHREY-MEMBER EQUITY				\$2,264,377.80		6.469%									
50 HUMPHREY-STOCK CREDIT				\$45.10		0.000%									
SUBTOTAL FLEXIBLE EQUITY			\$20,691,154.97				\$20,691,154.97			\$834,212.46	100.000%	\$472,032.52		\$562,179.95	
CVA DEFERRED 9	4	13	\$2,882,268.40		8.234%	None									
9 CVA DEFERRED				\$2,882,268.40		8.234%									
CVA NON QUALIFIED	4	14	\$7,851,546.00		22.431%	None									
14 CVA NON QUALIFIED				\$7,851,546.00		22.431%									
18 CVA NON-QUALIFIED 2007 Undistributed				\$3,167,416.00		9.049%									
18 CVA NON-QUALIFIED 2007 Undistributed				\$4,684,130.00		13.382%									
SUBTOTAL FLEX-HOLD EQUITY			\$10,733,814.40				\$10,733,814.40								
FROZEN EQUITIES 13	5	15	\$161,494.45		0.461%	None									
13 FROZEN EQUITIES				\$161,494.45		0.461%									
SUBTOTAL FROZEN EQUITY			\$161,494.45				\$161,494.45								
TOTAL MEMBERS EQUITY CREDITS			\$35,022,383.33		100.000%		\$35,022,383.33								
TOTAL MEMBER & PARTICIPATION EQUITY			\$186,400.00				\$186,400.00								
TOTAL ALLOCATED EQUITY			\$35,188,783.33				\$35,188,783.33								

Total Redemption Budget Summary	
\$	%
Fixed Redemptions	165,787.54
Flexible Redemptions	834,212.46
Total	1,000,000.00
Flexible Breakout	
APO	\$472,032.52
RF	\$362,179.95
Total	\$834,212.46