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# Birds Eye Foods, Inc.

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## **Birds Eye Foods, Inc.**

Birds Eye Foods, Inc., formerly known as Agrilink Foods Inc., had been a wholly-owned subsidiary of Pro-Fac Cooperative Inc., the Rochester, New York-based, 500-member grower cooperative until June 2002 when Vestar Capital Partners acquired a majority position and transformed Pro-Fac into a minority shareholder. The acquisition infused cash into the largest frozen vegetable processor in the United States, causing its Chairman, President and Chief Executive Officer of Birds Eye, Dennis M. Mullen, to note that the company has the opportunity to strengthen its competitive position.<sup>1</sup> He also noted that “With the new equity capital and materially lower debt, we are well positioned for significant future growth. This transaction is good for Agrilink and good for Pro-Fac, which will continue to be our main supplier of raw product.”<sup>2</sup>

The principal rationale for the Vestar investment was “. . . deleveraging our balance sheet with these investment proceeds will strengthen the company’s position in the highly competitive food industry.”<sup>3</sup> The rationale was to access resources to become a national branded food company with increased promotion, advertising, and research and development. The transformation of majority ownership at Birds Eye did not change top management in the company or significantly alter the traditional relationship between the company and Pro-Fac Cooperative members who supply fruits and vegetables to the company for processing. Despite these continuities in management and relationships, it is still important to assess the benefits and challenges as well as the strategic implications of the conversion for Birds Eye Foods.

### **Birds Eye Foods: Overview**

Birds Eye Foods (“Birds Eye”) has four primary product lines encompassing vegetables, fruits, snacks, and canned meals. Its canned meals are products of its fruit and vegetable operations, thus making it a player in three principal industries — fruits, vegetables and the snack foods market. An industry overview is available from the authors.

### **Birds Eye Foods’ History**

The Grange League Federation, a farm supply cooperative in New York, helped facilitate the merger of two small privately-owned processors, Curtice Brothers Company of Rochester and the Burns-Alton Corporation of Alton, to form Curtice-Burns, Inc. in the late 1950s. Simultaneously, the Grange League also helped facilitate the formation of a producer cooperative, Pro-Fac Cooperative who would own the vegetable processing facilities and supply vegetables to the newly-formed processing company. Hence, the company’s name became Pro-Fac.

Curtice-Burns paid rent equal to the amortization of the leased assets and any other facility ownership costs (taxes, utilities, financing charge, etc.) were incurred by Pro-Fac. In addition, Curtice-Burns paid or received an adjustment based upon its earnings or losses on all products determined by a formula reflecting the respective adjusted equity investments of the two companies. This relationship between Curtice-Burns and Pro-Fac transformed vegetable processing in New York State and developed a business that continues to have significant impact on producers.

Curtice-Burns' operations began on April 1, 1961 and involved the processing of raw vegetables into canned and frozen products for sale into the retail and institutional markets. Through acquisitions, Curtice-Burns expanded and diversified its operations, transforming it into a major player in the U.S. food industry. It went public on the American Stock Exchange in 1973 and the Grange League Federation and its successor, Agway, Inc. maintained controlling interest. A restructuring at Agway in the 1990s led to the sale of Curtice-Burns to Pro-Fac in November 1994 for \$170 million or \$19 per share, making it the first cooperative to take a publicly traded company private. The acquisition also allowed Pro-Fac to become the first producer cooperative to be listed on a major stock exchange, the NASDAQ.<sup>4</sup>

### **Portfolio Restructuring**

The acquisition of Curtice-Burns by Pro-Fac led to a change in the company's name to Agrilink Foods, Inc. ("Agrilink") in 1997 and a consolidation and streamlining of its operations. Agrilink was structured into three operating units: Curtice Burns Foods, Nalley Fine Foods and Snack Foods Group. The Curtice-Burns unit comprised Comstock Michigan Fruit, Southern Frozen Foods and Brooks Foods. The acquisition of Dean Foods' frozen and canned vegetable business with its Birds Eye, Freshlike and Veg-All brands, in 1998 for \$400 million led to the creation of a fourth unit, Agrilink Foods' Vegetable Company, and the significant expansion of the company's branded business. The company also acquired some smaller companies, such as J.A. Hopay Distributing Co., Inc. of Pittsburgh, PA which distributed snack products for Snyder of Berlin and Erin's Gourmet Popcorn, a Seattle-based, ready-to-eat popcorn manufacturer which it merged with its Auburn, WA snack company, Tim's Cascade Chips. It also formed a new sauerkraut company, Great Lakes Kraut Company, through a joint venture with Flanagan Brothers, Inc. of Bear Creek, WI by contributing its sauerkraut production assets.

The governance of Agrilink and its owner, Pro-Fac, was also centralized when Pro-Fac began doing business as Agrilink Foods and the boards of directors of the two firms held joint meetings. The growth strategy adopted by the company and cost of the acquisition resulted in a significantly higher debt load and the need to find ways to minimize the debt became a major strategic effort. Other costs had also arisen with maintaining a national brand name. These including research that was needed to develop innovative products. There were over 500 producers in Pro-Fac and they had already reached their equity investment capacity.

The financial burden led to the shedding of some non-core or poorly performing assets. For example, in 1999 Agrilink sold its Cambria, WI processing facility to Del Monte and its Midwest private label canned vegetable business to Seneca Foods. In 2000, it sold its pickle business based in Tacoma, WA to Dean Pickle and Specialty Products Company, a subsidiary of Dean Foods, and its applesauce business to Knouse Foods in 2002. The sale of the applesauce business led to the closure of its Red Creek, NY facility. In March 2003, the company exited the sauerkraut business by transferring its assets in the joint venture with Flanagan Brothers to the Bear Creek, WI company and then in June 2003, it sold its Veg-All canned vegetables business to Allen Canning Co. of Siloam Springs, AR. The company also embarked on closing some of its plants to enhance its financial performance.

### **Relationship with Vestar and Renaming to Birds Eye**

The management and board looked at various alternatives to reduce its debt. These included an IPO, sale of the company, finding a strategic investor, working with a synergistic partner through an LLC, private equity infusion, or just “tough it out.” The latter alternative would have put the members’ remaining equity at stake as well as its ability to retain key management talent. Ultimately, Agrilink reached an agreement with Vestar Capital Partners in August 2002 for Vestar to acquire 56 percent of Agrilink Foods for \$178 million. Pro-Fac retained 41 percent of Agrilink’s ownership, transforming itself from a controlling position to a minority owner. The remaining equity owned by Birds Eye management. A number of agreements were reached as part of the Vestar transaction: (1) Pro-Fac has a 10-year supply agreement with Agrilink, ensuring the continuous access to a processing facility for its members; (2) Agrilink pays \$10 million annually to Pro-Fac until 2007 in pursuant of the termination of the previous Marketing and Facilitation Agreement between them; and (3) Pro-Fac has access to a \$1 million line of credit each year until 2007 from Agrilink. The Birds Eye board of directors included four from Vestar, two producers from Pro-Fac, CEO of Birds Eye who also served as Chairman, and three outside directors.

The change in the ownership structure changed little in management at Birds Eye. Dennis Mullen remained at the helm of the company as Chief Executive, President and Chairman of the Board, positions he held prior to the Vestar Capital Partners deal that changed the ownership arrangement at Birds Eye. With the exception of a couple of executives, all officers had been with Pro-Fac for many years. Mr. Stephen Wright, Executive Vice President, for example, had been with the company for more than 28 years, rising through various positions including can manufacturing, production planning, inventory, logistics, purchasing and agriculture. Likewise, Lois Warlick-Jarvie, VP, Human Resources was an 18-year veteran at the company. Bernhard Frega had been Executive Vice President - Sales and Marketing of the processor company since 1999 and had 25 years experience with Agrilink Foods, including serving as vice president for private label and consumer products for the Comstock Michigan Fruit Division and executive vice president and COO of the Curtice Burns business unit from 1995 to 1999.

In January 2003, Agrilink changed its name to Birds Eye Foods, Inc. to reflect its strongest brand, the Birds Eye frozen vegetables. “Birds Eye is a brand that’s instantly recognizable and carries with it an image of high quality and consumer trust. Birds Eye’s founder, Clarence Birdseye, is credited with starting the frozen food industry, and today, as the nation’s largest processor of frozen vegetables, it makes perfect sense for us to carry this prestigious name,” Dennis M. Mullen, Agrilink Foods chairman, president and CEO explained the rationale for the name change.<sup>5</sup> Thus, with name changes, product changes and ownership changes, Birds Eye was positioning and entrenching itself as the major competitor in the frozen vegetable marketplace as well as a successful competitor in the fruit and snack foods categories.

### **Birds Eye’s Market Segments**

Birds Eye operated in four major market segments: vegetables, fruits, canned meals and snack foods. The vegetable segment consisted of canned and frozen vegetables, chili beans, and various other products as well as value-added items such as frozen vegetable blends, Southern-specialty products (such as black-eyed peas, okra, and Southern squash), frozen meal starters with pasta or potatoes and sauce, complete frozen meals in a bag, and frozen soups. The branded products within the vegetable segment included Birds Eye, Birds Eye Voila!, Birds Eye Simply Grillin’,

Birds Eye Hearty Spoonfuls, Freshlike, Veg-All, McKenzies, and Brooks Chili Beans. The vegetable segment accounted for 72 percent of total net sales of the company in 2002.

The fruit segment consisted of canned and frozen fruits including fruit fillings and toppings with its Comstock and Wilderness brands being the major marketing vehicles. Birdseye was a major supplier of branded and private label fruit fillings to retailers and food service institutions and this product segment accounted for 11 percent of its total net sales in 2002. The snack foods segment consisted of several varieties of potato chips including regular and kettle fried, as well as popcorn, cheese curls, snack mixes, and other corn-based snack items. Birds Eye snack foods were primarily marketed in the Pacific Northwest, Midwest and Mid-Atlantic states under the following brands: Tim's Cascade Chips, Snyder of Berlin, Husman, La Restaurante, Erin's, Beehive, Pops-Rite, Super Pop, and Flavor Destinations. The snack foods segment contributed 9 percent to total net sales in 2002. The canned meal and other products segment included canned meat products such as chilies, stews, soups, and various other ready-to-eat prepared meals as well as its salad dressing business, which were marketed primarily in the Pacific Northwest under the Birds Eye's Nalley and Bernstein's brands. This segment contributed about 8 percent of total net sales in 2002.

Birds Eye had 33 production facilities and warehouses, for a total of more than 6 million square feet, as of June 2003 in 13 states and Mexico. However, the facilities were concentrated in only four states, with New York, Pennsylvania, Wisconsin and Michigan accounting for about 55 percent of the number of plants and 61 percent of facility square footage. The distribution of facilities by their use was as follows: frozen product plants and warehouses (61 percent), canning plants and warehouses (30 percent) and snack food manufacturing plants and distribution centers (9 percent).

Birds Eye continued to reorganize and restructure, selling non-performing assets and exiting low return businesses. For example, the company announced in February 2003 that it would close six frozen vegetable processing plants in Green Bay, WI, Oxnard, CA, Barker, NY, Bridgeville, DE, Uvalde, TX and Montezuma, GA over the next several months. Dennis Mullen explained that, in line with the company's drive towards efficiency, the production from these facilities would be consolidated at plants in Darien, WI, Oakfield, NY and Watsonville, CA.

## **Competitors in Fruit and Vegetable Processing**

Birds Eye Foods marketed its products through brokers and distributors to retail, food service and institutional customers. Its vegetables, fruits, and canned meals were primarily sold through food brokers who sold to retail chains and various institutional organizations while its snack food products were primarily marketed through distributors selling directly to retail outlets in the Midwest, Mid-Atlantic and Pacific Northwest. The company was confronted by some major competitors in these markets — Kraft Foods, Del Monte Foods, General Mills/Pillsbury, Nestlé's, PepsiCo and ConAgra. In addition to these major national brand competitors, Birds Eye was also confronted in its regional markets, especially in its snack foods business, by small but strong local brands.

Kraft was the leading food company in the U.S. with major brands covering the full spectrum of the food marketplace. Its acquisition of Nabisco in 2000 brought it directly into the fruit and vegetable industry while gaining significant access into the snack food operations.<sup>6</sup> Del Monte

Foods, the largest manufacturer and distributor of branded canned fruit and vegetables in the U.S. had annual sales of about \$1.3 billion. The company had been reorganizing itself with acquisitions and new products. Its flagship canned products (corn, green beans, peas, peaches, pears, and pineapples), marketed under its principal brand, Del Monte, were in direct competition with Birds Eye frozen vegetable business. In the snack food business, Frito Lay North America, a division of PepsiCo, was also the world's leading marketer of salted snacks.<sup>7</sup> The snack food market was also segmented, creating significant competition in the small regional markets in which Birds Eye operates.

## Financial Performance

The growth by acquisition, while it positioned the company on the path to building a strong national presence in frozen vegetables, created a highly leveraged balance sheet that limited the company's resources to finance growth initiatives (Exhibit 1).

Exhibit 1. Balance Sheet for Agrilink Foods (1998 to 2002) and Bird Eye Foods, Inc. (2003)

	1998	1999	2000	2001	2002	2003
Current Assets	\$233,492,000	\$515,515,000	\$529,502,000	\$464,172,000	\$440,939,000	\$476,583,000
Net Fixed Assets	\$194,615,000	\$367,255,000	\$348,359,000	\$305,531,000	\$288,120,000	\$195,199,000
Investments in Other Companies	\$28,961,000	\$26,372,000	\$22,978,000	\$18,678,000	\$20,385,000	\$3,038,000
Other Noncurrent Assets	\$109,640,000	\$287,337,000	\$286,427,000	\$272,970,000	\$107,802,000	\$234,563,000
Total Assets (Imputed)	\$566,708,000	\$1,196,479,000	\$1,187,266,000	\$1,061,351,000	\$857,246,000	\$909,383,000
Current Liabilities	\$139,389,000	\$278,184,000	\$269,021,000	\$220,544,000	\$141,728,000	\$159,682,000
Long-term Debt	\$69,937,000	\$702,322,000	\$679,205,000	\$631,128,000	\$623,057,000	\$459,970,000
Other noncurrent liabilities	\$55,510,000	\$40,222,000	\$41,852,000	\$29,417,000	\$28,918,000	\$76,361,000
Additional Paid-in Capital	\$9,399,000	\$10,240,000	\$10,902,000	\$11,526,000	\$188,005,000	\$201,690,000
Unrealized gain (hedging)	\$32,942,000	\$28,614,000	\$17,751,000	\$123,893,000	\$206,000	\$348,000
Minimum pension liability	\$87,580,000	\$91,599,000	\$105,700,000	\$45,000	(\$573,000)	(\$11,257,000)
Retained Earnings	\$11,448,000	\$21,658,000	\$25,490,000	\$17,851,000	(\$126,623,000)	\$20,756,000
Total Equity	\$141,369,000	\$152,111,000	\$159,843,000	\$153,315,000	\$61,015,000	\$211,537,000

A goodwill impairment charge of \$179 million (\$137.5 million net of tax) was levied in 2002 (Exhibit 2). Management explained it as emanating from a number of factors, including the recent deterioration of general economic conditions in the country, lower valuations resulting from its current market declines and the valuation reached in the deal it reached with Vestar. Earnings before interest, taxes, depreciation, and amortization (EBITDA) was a better way to analyze its performance.

Exhibit 2. Income Statement of Agrilink Foods (1998 to 2002) and Bird Eye Foods, Inc. (2003)

	1998	1999	2000	2001	2002	2003
Sales	\$719,665,000	\$1,238,946,000	\$1,268,542,000	\$1,339,211,000	\$1,010,540,000	\$878,265,000
Cost of Sales	\$524,082,000	\$877,438,000	\$882,861,000	\$956,182,000	\$795,297,000	\$672,656,000
Other Operating Revenue	\$1,893,000	\$62,521,000	\$0	\$0	\$0	\$0
Operating Expenses	\$141,739,000	\$291,395,000	\$286,562,000	\$298,283,000	\$117,447,000	\$121,608,000
Interest Expense	\$30,767,000	\$67,420,000	\$83,511,000	\$85,073,000	\$66,420,000	\$48,320,000
Income Tax Expense	\$7,840,000	\$24,746,000	\$8,497,000	\$968,000	(\$31,490,000)	\$15,103,000
Depreciation	\$22,390,000	\$41,826,000	\$46,178,000	\$46,988,000	\$37,657,000	\$38,766,000
Other Income (Loss)	\$0	(\$23,524,000)	\$9,053,000	\$1,779,000	(\$193,560,000)	\$263,000
Net Income (Imputed)	\$17,130,000	\$16,944,000	\$16,164,000	\$484,000	(\$130,694,000)	\$20,841,000

The dominant business segment at Birds Eye was vegetables, accounting for about 70 percent of total earnings before interest, taxes, depreciation and amortization over the 2000 to 2002 time period. Fruits, canned meals and snacks had average shares of total EBITDA of 14 percent, 6 percent and 7 percent respectively. Thus, the canned meal segment was about the same size as the snack food segment. The salad dressing segment (reported as “other”) had an average share of total EBITDA of 4 percent between 2000 and 2002. Beginning in 2003, Birds Eye reported its segments as branded frozen (39 percent of sales), branded dry (25 percent), and non-branded products (36 percent).

## **The Rationale for the Conversion**

There were three primary motives for the conversion of organizations, including cooperatives: access to equity, demand for liquidity and acquisition of assets. In the case of Birds Eye, it appeared that the fundamental reason Pro-Fac undertook the conversion (and divestment) was to increase the company’s access to equity capital because it had exhausted its source of member equity. Given its market conditions, the equity was necessary to pursue growth opportunities and also reduce its debt load. The \$178 million resulting from the conversion provided the cash infusion to address these needs. Additionally, the conversion allowed the company to restructure some of its debts with Pro-Fac to help it transition to a more competitive position in its marketplace.

As a result of the conversion, Pro-Fac lost its controlling position in Birds Eye and became instead a minority shareholder. But that loss of control was accompanied by the elimination of some of Pro-Fac’s debt load resulting from its controlling position in Birds Eye. Pro-Fac achieved a negotiated terms of engagement with Birds Eye that put it almost in its pre-1994 position, where it leased or rented its facilities to the processing company in exchange for certain arrangements. Some of these arrangements included the processing company purchasing the produce of its members and providing it with a line of credit to pay producers while produce was being processed.

The relationship between Pro-Fac and Birds Eye was guided by a Marketing and Facilitation Agreement that had been in place since 1994. A clause in that agreement required Birds Eye to share profits with Pro-Fac and for Pro-Fac to compensate Birds Eye for losses. Another clause required Birds Eye to pay Pro-Fac \$10 million per year for five years if it initiated a termination of the agreement. The conversion required a termination of the agreement to disentangle the financial performance of the companies, i.e., Pro-Fac compensated Birds Eye for losses and Birds Eye shared its profits with Pro-Fac. Since Birds Eye initiated the termination of the Marketing and Facilitation Agreement, it triggered the \$10 million per annum for five years clause but released it from the profit share and loss compensation clauses.

An Amended and Restated Marketing and Facilitation Agreement was developed between Birds Eye and Pro-Fac after Vestar Capital Partners took control of the company. It included the requirement for Pro-Fac to maintain sufficient grower membership levels to generate certain minimum crop supply in order to continue receiving the termination penalty of \$10 million per year for five years. Under the new agreement, the partners also agreed that Pro-Fac would be Birds Eye’s preferred crops supplier and Birds Eye would continue to pay Pro-Fac the Commercial Market Value (CMV) of crops supplied by Pro-Fac in installments corresponding to the dates of payment by Pro-Fac to its members for crops delivered. As with the previous

agreement, Pro-Fac's commodity committees met with Birds Eye's management to establish CMV guidelines, review calculations, and report to a joint CMV committee consisting of representatives of both parties. Thus, the conversion instituted a more arm's length relationship between the two companies, similar to what existed prior to the acquisition and conversion that occurred in 1994.

For Pro-Fac, the conversion allowed it to free itself of some of the debt ownership and control Birds Eye brought and the opportunity to increase the wealth of its members with an equity partner. For Birds Eye, the conversion provided access to new capital and the opportunity to enhance its competitive position. It also eliminated some of its debts, allowing it to deleverage its balance sheet.

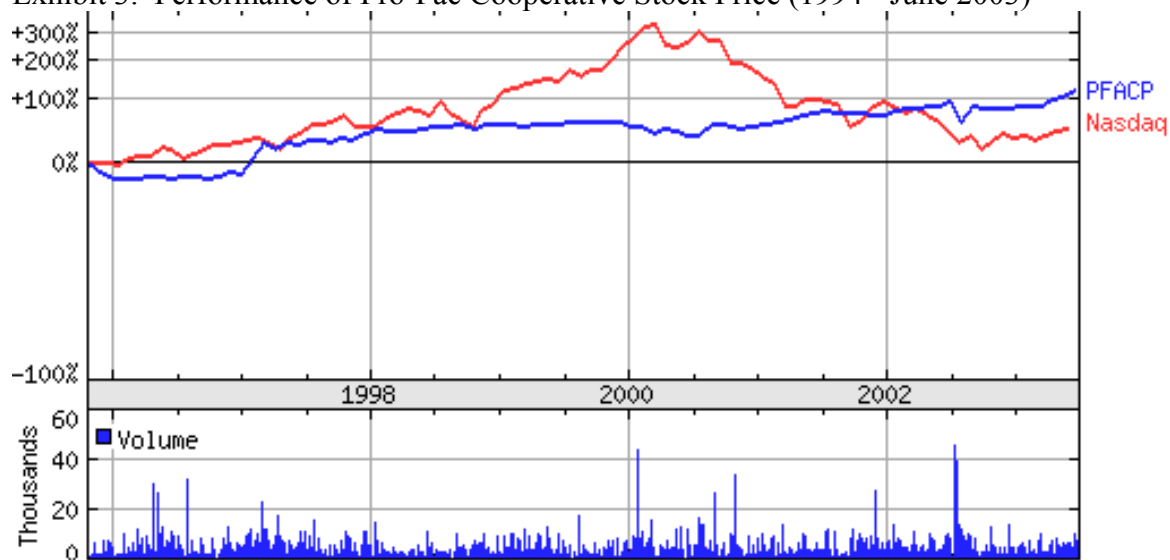
### **Conclusions: Same Mandate, New Resources**

The Grange League Federation, which later became Agway Inc. organized the formation of Curtice Burns Foods and the organization of Pro-Fac Cooperative in the late 1950s. The producer cooperative owned the buildings and processing facilities and Curtice-Burns leased them for its operations. Agway took Curtice Burns public in 1973, listing it on the American Stock Exchange, with the view of increasing its access to equity capital. This marked the first conversion of the company. Then, in 1994, when Agway decided to sell Curtice Burns, Pro-Fac purchased it and converted it to a privately held company, wholly owned by Pro-Fac Cooperative, Inc., changing its name to Agrilink, and later to Birds Eye Foods.

Pro-Fac became the first agricultural cooperative to be listed on the NASDAQ, trading under the ticker symbol PFACP. While the company's stock maintained a fairly close performance with the NASDAQ until the late 1990s, it has outperformed it since the beginning of 2002 (Exhibit 3). Unfortunately, the low volume of activity of Pro-Fac's stock meant that it was ineffective as an equity-generating vehicle, causing the company to maintain its dependence on debt for financing its growth and other activities. The inability to obtain more member equity or to generate significant cash flows from earnings to support the needed research and development and other factors associated with supporting a national brand resulted in Vestar Capital Holdings infusing \$178 million into Birds Eye. The difference between the current conversion compared to the previous ones was that Vestar was not a cooperative. So, for the first time in its history, a non-cooperative oriented investor held the majority and controlling interest in the company.

Mr. Mullen knew the history of the company and had excellent knowledge of its needs and requirements for success. Because very few changes were made in management, it may be assumed that Mr. Mullen had the right team to execute a successful competitive strategy. But most importantly, he had the resources to achieve the objectives that were hampered as a result of high debt and low availability of capital.

Exhibit 3. Performance of Pro-Fac Cooperative Stock Price (1994 - June 2003)



Source: <http://finance.yahoo.com/>, accessed on June 23, 2003.

## Endnotes

1. PR Newswire. "Agrilink Foods to Receive \$175 Million Equity Investment From Vestar Capital Partners; Vestar to Become Majority Shareholder in Producer of Birds Eye," June 21, 2002.
2. PR Newswire. "Agrilink Announces Completion of Vestar Equity Investment; Investment Firm Becomes Majority Shareholder of Birds Eye Frozen Foods Producer," August 19, 2002.
3. PR Newswire. "Agrilink Foods Enters Letter of Intent with Vestar," March 12, 2002.
4. Only Pro-Fac's Class A cumulative preferred stock is available on the NASDAQ.
5. PR Newswire. "Agrilink Foods Announces Name Change to Birds Eye Foods," January 29, 2003.
6. Kraft Foods' information obtained from <http://www.kraft.com/newsroom/05042003.html>, accessed on June 23, 2003.
7. Data Accessed from [http://www.pepsico.com/investors/annual-reports/2002/annual\\_desc.shtml](http://www.pepsico.com/investors/annual-reports/2002/annual_desc.shtml), accessed on June 23, 2003.

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