

CPI

EQUITY/PATRONAGE

STRATEGY

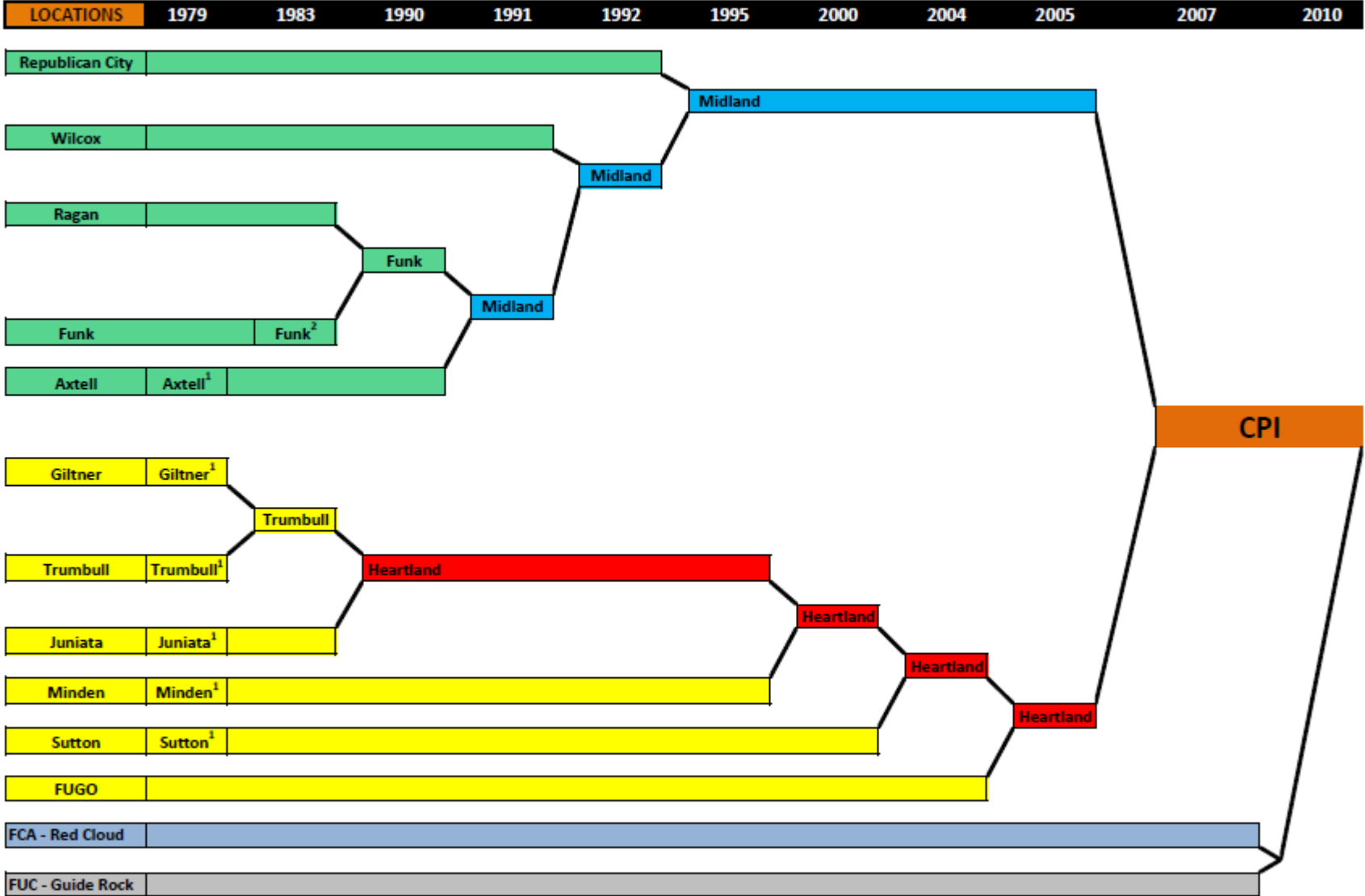
NOVEMBER 4, 2011

BOB FIFIELD-CEO

CPI HISTORY

- **When We Were Established:** CPI, Cooperative Producers, Inc. started in 1979 as grain marketing arm for 6 cooperatives. Final merger of Midland and Heartland to form new CPI in 2007. Company made up of at least 15 cooperatives that have merged with the oldest one, Juniata, dating back to 1906.
- **Who We Are:** \$700 million in sales (\$500 million grain and \$200 million farm supply) 33 full service locations; 450 full-time and 120 seasonal employees.
- **What We Are:** Grain; Crop Production; Precision Ag; Livestock Feed; Refined Fuels, LP and Lubes; C-Stores and Grocery Store; Vehicle Service; Tires; and Auto Parts
- **Locations:** 33 locations
- **Governance:** Owned by 4,200 stockholders. Governed by a 12 member Board of Directors elected by the customer-owners. Three Associate Directors are appointed for three year terms.
- **Who We Serve:** CPI has over 10,000 farm and non-farm customers. Ag customers are involved in the production of grain and livestock. Many customers are purchasers of retail fuels, LP, tires, and automotive services such as Midas. We also serve many customers through our C-stores and GW Grocery Store.

Figure 1. CPI History of Unifications: 1979-2010



Old CPI JV (at Hastings)

¹ Original six formed CPI in 1979


² Funk buys Giltner CPI share from Trumbull in 1983

CPI PATRONAGE/EQUITY RULES

- **Following the close of each fiscal year and receipt of the audit report, the President and auditor shall make recommendations to the BOD concerning the allocation of net savings of CPI among its patrons.**
- **The redemption of outstanding Members' Equity Credits by CPI is at the discretion of the BOD, depending on the financial condition of CPI and other business considerations.**

WHAT IS DRIVER?

- **\$-BALANCE SHEET
MANAGEMENT & UTILIZATION
OF CAPITAL**
- **DON'T KICK THE CAN DOWN THE
ROAD**



2011-2012 CoBank Loans

EQUITY CATEGORIES

- **Series A-Members' Equity Credits allocated to patrons starting with fiscal year end November 30, 2000**
- **Series B-Members' Equity Credits allocated to patrons of Heartland Co-op-Hastings ending with fiscal year end November 30, 1999**
- **Series C- Members' Equity Credits allocated to patrons of Farmers Cooperative Grain and Supply Company-Minden ending with fiscal year end March 31, 2000**
- **Series D-Members' Equity Credits allocated to patrons of Sutton Cooperative Grain Company- Sutton ending with fiscal year end January 31, 2004**

EQUITY CATEGORIES

- **Series E-Members' Equity Credits allocated to patrons of Farmers Union Cooperative Gas and Oil Company-Juniata ending with fiscal year end January 31, 2005. Members' Equity Credits allocated to patrons of Farmers Cooperative Association-Red Cloud ending with fiscal year end March 30, 2010. Members' Equity Credits allocated to Patrons of Farmers Union Cooperative-Guide Rock ending with fiscal year end June 14, 2010.**
- **Series F-Members' Equity Credits allocated to patrons of Midland Co-op-Funk ending with fiscal year end February 28, 2007.**

EQUITY REVOLVEMENT PLAN

- **DIFFERENT FOR EACH CATEGORY**
 1. **85% Redeemed at age 65 in five equal annual installments**
 2. **85% Redeemed at age 70**
 3. **100% Redeemed at age 68**
 4. **100% Redeemed only at death**
 5. **In all cases impaired equity will be paid or cancelled only when its status can be determined**

EQUITY REVOLVEMENT PLAN

- **Management and the BOD did not want to continue to just kick the can down the road.**
- **Engaged Dr. Barton to work with CPI on revising the Equity Revolvment Plan**
- **Developed a long term strategy**
- **However, we have not implemented the plan because of covenants within our syndicated loan package**
- **With continued improvements in the financial success of CPI, we will be able to initiate the process in the near future**

PATRONAGE ALLOCATION HISTORY

- **FISCAL YEARS 2007 & 2008-50/50/50-50% to retained savings and the remaining 50% was split 50% cash and 50% deferred patronage**
- **FISCAL YEAR 2009-20% to retained savings and the patronage was split 30% cash and 70% deferred patronage**

IRS CODE SECTION 199

- What affect does it have on local Cooperative-CPI
 - **Significantly increases available deductions to CPI**
- What affect does it have for farmer
 - **Law is clear that the cooperative is the one entitled to the 199 computation and can choose to use it themselves or can pass the deduction on to patron**
- Why this is a good year to use it with non-qualified patronage for producer
 - **Combining the Section 199 deduction with non-qualified reduces normal income tax**

2010 ALLOCATION OF PROFITS

- **FISCAL YEAR 2010-Loan covenant allows us to pay out up to 30% of the bottom line as cash-utilized the Section 199 and Non-Qualified allocation-Board, CEO, and CFO worked with our auditors, CBIZ/MHM, and Teree Castanias**
- **Retained savings of approximately 40% of bottom line. Patronage allocation of remaining 60% split 50% cash and 50% Non-Qualified**

2010 ALLOCATION CONT.

- **NON-QUALIFIED ALLOCATION**

- ❖ **The Cooperative is responsible for the tax at this time**
- ❖ **At a future date when, the Non-qualified is allocated and redeemed, the patron then has the tax responsibility and the Cooperative has a tax benefit**

- **SECTION 199**

- ❖ **Since the law is clear that the Cooperative is entitled to 199 computation, it was clear to us to use it for the maximum tax advantage to CPI**

PATRON CASH FLOW PROJECTIONS

- **Compare allocation of 30% cash/70% deferred to a 50% cash/50% non-qualified**
- **Assumptions**
 - **\$5,000 of total patronage in both cases**
 - **Patron is in a 30% tax rate bracket**
- **This is only an example that we are trying to keep simple. Actual numbers will depend on each individual patron's situation.**

30% CASH/70% DEFERRED

TOTAL PATRONAGE		\$ 5,000.00
CASH PORTION	30%	\$ 1,500.00
DEFERRED MEMBERS' EQUITY CREDIT	70%	\$ 3,500.00
TAX RATE	30%	
TOTAL INCOME TAXES		\$ 1,500.00
CASH FLOW		\$ -

50% CASH/50% NON-QUALIFIED

TOTAL PATRONAGE		\$ 5,000.00
CASH PORTION	50%	\$ 2,500.00
NON-QUALIFIED ALLOCATION	50%	\$ 2,500.00
TAX RATE	30%	
TOTAL INCOME TAXES		\$ 750.00
CASH FLOW		\$ 1,750.00

2010 ALLOCATION BENEFITS

- **CPI**

- **Helps strengthen CPI balance sheet while maintaining the covenants of our syndicated loan agreement**
- **Maximum utilization of the Section 199**

- **PATRON**

- **Simple for patron and patron tax preparer**
- **More positive cash flow for the producer when he is actively engaged in farming**

2010 ALLOCATION BENEFITS IN THE FUTURE

- **CPI**

- Will provide for a positive tax benefit
- Will minimize the impact to the balance sheet at that time-will pay out cash but have tax benefit that will minimize cash flow impact

- **PATRON**

- Will receive at a time that patron should have a lower tax rate
- Will still allow the patron to have a positive cash flow at payout time

FISCAL YEAR 2011

- **Fiscal year ended on June 30, 2011**
- **Auditors presented Audit to the BOD at the September 21, 2011 board meeting to meet loan covenant**
- **CEO and CFO discussed with auditor and Teree what was the best for CPI and recommended to BOD similar program as last year, which they approved**
- **Retained savings of approximately 40% of bottom line. Patronage allocation of remaining 60% split 50% cash and 50% Non-Qualified**

FUTURE

- **What will happen to 199'S or other Tax Law or Accounting Law changes**
- **Covenant changes in our syndicated loan package**
- **Profitability of CPI**
- **Patronage and Equity management is dynamic and will be reviewed yearly at CPI**

THANK YOU