

Profit Distribution Alternatives for a Grain and Farm Supply Cooperative

Phil Kenkel

Bill Fitzwater Cooperative Chair

AE-16016 Dec 2016

East West Central Cooperative is a diversified grain and farm supply cooperative which handles around 1.5M bushels of grain, 10,000 tons of fertilizer and 1M gallons of fuel on an annual basis. The cooperative averages around \$18M in sales, \$2M in gross margins and \$1.2M in profit before patronage giving it a Return on Assets of 10% and a Return on Equity of 22%. Around 10% of the profits are from nonmember business. The cooperative had traditionally distributed 65% cash patronage. However it had now become concerned over its level of unallocated equity which represented 62% of total equity and concluded it needed to create more allocated equity. The board had a goal to reduce the ratio of unallocated equity to total equity to 50% or lower within 5 years. The cooperative effective tax rate (after bonus depreciation and other programs) is 9.1%. A university survey reported the average farmer tax rate at 14.1%.

There CFO prepared three alternative profit distribution strategies, all of which were projected to provide roughly the same cash flow to the cooperative. The board therefore began to ponder which strategy was most compatible with their goals for the cooperative's balance sheet and would be the most beneficial to the member.

Alternative A: Maintain the current 20 year equity revolving plan, and distribute member based profits as 0% unallocated equity, 50% cash patronage and 50% qualified stock patronage

Alternative B; Reduce the revolving period to 16 years and distribute member based profits as 10% unallocated, 40% cash patronage and 50% qualified stock patronage

Alternative C: Maintain the current 20 year equity revolving period and distribute member based profits as 0% unallocated, 44% cash patronage and 56% nonqualified stock patronage

Results (Do not distribute until discussion is complete)

Alternative A: 50% Cash, 50% Qualified, 20 Year Revolve:

Year 5 ratio of Unallocated to total equity: **46%**

Projected average member IRR average for 30 years: **22.17%**

Year 1 cash flow: **\$439,878**

Alternative B: 10% Unallocated, 40% cash, 50% Qualified, 16 year Revolve

Year 5 ratio of Unallocated to total equity: **52%**

Projected average member IRR average for 30 years: **19.85%**

Year 1 cash flow: **\$455,496**

Alternative C: 0% Unallocated, 44% cash, 56% Nonqualified, 20 year Revolve

Year 5 ratio of Unallocated to total equity: **44%**

Projected average member IRR average for 30 years: **23.2%**

Year 1 cash flow: **\$439,819**