International Food and Agribusiness Management Review
Volume 22 Issue 3, 2019; DOI: 10.22434/IFAMR2018.0087

Received: 10 August 2018 / Accepted: 4 January 2019

ConAgra foods 2015 and the limits of debt: rewriting a recipe that just didn't work

CASE STUDY

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Abstract

ConAgra Foods purchased Ralcorp, a generic brands packaged foods manufacturer, in January 2013. This purchase made ConAgra the largest private-brand packaged foods company in North America. The purchase was part of the firm's acquisition strategy, its 'recipe for growth' launched in 2012. Instead of moving ConAgra forward, the purchase almost brought ConAgra into bankruptcy. ConAgra had difficulties integrating Ralcorp and the trend for private label (vs. brand name) products declined shortly after Ralcorp's acquisition. This turn of events was made far worse because ConAgra had borrowed a large amount of debt to make the acquisition. Now, almost three years later in fall 2015 ConAgra had a new CEO, had faced reduced profitability and lower earnings per share and financial distress, and was under the pressure of an influential activist hedge fund advocating for the sale of the private brands segment. This case provides data to assess ConAgra's situation financially and strategically, and to value the potential divestiture of the private brand business segment.

Keywords: agribusiness finance, debt level, business strategy, mergers and acquisitions
JEL code: G34, G32, M1, M2, Q13

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A teaching note has been prepared for this case study. Interested instructors at educational institutions may request the teaching note by contacting the author or IFAMA.

1. Introduction

ConAgra was on a roll – business had been doing well and the future looked bright for the food packaging giant. The firm had launched its 'recipe for growth' strategy in 2012. The 'recipe' included aggressive acquisitions, highlighted by ConAgra's purchase of Ralcorp, a private brand packaged foods manufacturer, in January 2013.[1] This acquisition brought ConAgra the title of North America's largest private-brand packaged food manufacturer. Now, almost three years later by the end of fall 2015 ConAgra realized that its recipe was much less successful than it had hoped for. ConAgra had faced problems since the acquisition was made, including reduced profitability and lower earnings per share. ConAgra also borrowed heavily to fund the acquisition, leading to an extraordinarily high increase in the firm's debt. ConAgra was becoming financially distressed. How severe was its distress? How could the firm return to its more profitable and financially stable days?

2. Industry analysis

Major competitors of ConAgra included leading agribusinesses such as Kellogg, General Mills, and Mondelez International. Growth in the packaged food industry in North America over the next 5 years was predicted to be very low, about 1% to 2%. Global growth was expected to be somewhat higher at about 2.5% (Everett, 2013; Turk, 2015). Overall, analysts were pessimistic about prospects for the packaged foods industry. The industry was mature, with few possibilities for major growth. Analysts' consensus was that the industry growth would come from two sources: either by international expansion or by increasing participation in the rapidly growing organic, healthy segment of the market. Certainly, in the first case, more growth was potentially available in international markets such as China and Latin America. ConAgra, however, had limited international operations, with international sales providing under 7% of revenues.

A more secular change to the industry was coming from the increasing popularity of the organic and health foods segments, which included organic food, low-calorie snacks, gluten-free and GMO-free food. Higher revenue growth was coming from this segment. For example, General Mill's organic brand, 'Annie's' grew 25% from 2013 to 2015. U.S. sales of organic foods grew 11% in 2014 and 2015, with expected revenues of $43.3 billion in 2015 (OTA, 2016). Among gluten-free products, 2014 sales were $973 million and were expected to increase 140% to $2.3 billion by 2019 (Yucel, 2015). In a consumer survey, 55% of respondents in the US believed that organic food was healthier than conventionally grown food and were willing to pay the organic food premium price to achieve health benefits (Brantsaeter *et al.* 2017; STATISTA, 2016). The health food trend was particularly strong among millennials, people born in the early 1980s to early 2000s (OTA, 2016). A Mintel (2016) report noted that 47% of older millennials and 35% of younger millennials said they did not trust large food manufacturers, compared to 18% of non-millennials. Millennials comprised 25% of the US population in 2015. Another important trend developing in the food industry was the millennials increasing acceptance towards private brands. 75% of millennials thought private brands were a good alternative to national brands and provided good value for the cost, especially in the case of organic and gluten-free foods (Mintel, 2016). An example of this winning combination was Wal-Mart's partnership with Wild Oats to introduce low-priced, organic foods sold in its stores.

In general, larger national brands were losing ground while private labels and smaller brands were gaining share. According to a Rabo Securities (2017) report, the market share of the top 10 packaged food companies was diminishing by about 1% a year. The trend toward healthier foods – organic, less processed, easily identifiable ingredients – was assisted by social media. Consumers could easily share preferences and provide advice. Social media also allowed smaller brands to differentiate themselves to large numbers of consumers more easily. Branded foods on the other hand, were trying to fend off the competition by investing on promoting customer loyalty to a particular branded, category leader product. They were also attracting

[1] Private label or brand, referred to products sold in a grocery store under the store's own brand. Often stores offered their own brand of a particular, popular product next to the brand name version (e.g. national brand) of that product, with the private brand product selling for less than the national brand.

millennials attention by placing greater focus on appealing, eco-friendly packaging, for their branded products (Rabo Securities, 2017).

These changes in perception and consumer appetite required companies to move from the typical acquisition strategy of: (a) cost-cutting to offset low revenue growth prospects, including divesting unprofitable lines (e.g. Kraft's spinning off its snack foods in 2012, creating Mondelez International); (b) investing in order to create a stronger product category (e.g. Tyson Foods' acquisition of Hillshire Farms in 2014) or; (c) diversifying their revenue streams (ConAgra's acquisition of Ralcorp in 2013). However, Ralcorp's acquisition by ConAgra's management wasn't the typical acquisition to diversify revenue. Lured by high revenue prospects and hopeful expectations of realizing cost synergies; ConAgra effectively bet its future growth on the private brand business, a risky move considering that ConAgra's management did not have real expertise in the private brand business. For the acquisition to prove fruitful, ConAgra needed to integrate Ralcorp into its own operations without incurring in any costs but rather achieving substantial cost savings. ConAgra also had to be able to successfully compete in the private brand business marketplace, which was very different to their branded business marketplace.

3. ConAgra Foods

ConAgra Foods was headquartered in Omaha, Nebraska, and had 32,900 employees, mostly in the US. ConAgra started as a Midwest flour milling company, initially incorporated in 1919. The firm expanded its food business through acquisitions of packaged food brands, while also divesting fresh vegetable, poultry, pork, beef, and cheese operations. Table 1 contains ConAgra's selected financial data three years before and three years after the acquisition of Ralcorp. ConAgra's fiscal year ends in May. The last column of Table 1 has last-twelve-months (LTM) flow financial items as of November 31, 2015.

ConAgra unveiled its 'recipe for growth' in 2012, the firm's strategic roadmap for its operations. The firm had five areas of focus for its business: core, international, private brands, people and citizenship. Acquiring Ralcorp Holdings, Inc., a private brand food manufacturer, was considered to be an important step in the 'recipe for growth'. In recent years, ConAgra's operating foundation, guided by its 'recipe for growth', had centered and continued to include (ConAgra, 2014):

- 'Growing our branded and private branded portfolios through innovation;
- creating a more consumer-focused company, becoming a strategic partner and influencer for the private and private branded need of our customers;
- making food that resonates with consumers; establishing or further developing qualities that differentiate us from other food companies and capabilities that are critical to our success; and expanding our presence in desired geographies or market segments;
- achieving cost savings targets throughout our supply chain and creating a seamless technical organization to drive productivity, total delivery cost, and customized solutions;
- implementing cost-reducing initiatives throughout the selling, general, and administrative functions.'

4. ConAgra organization

After the Ralcorp acquisition in 2013, for financial reporting purposes, ConAgra divided into three divisions: consumer foods, commercial foods and private brands.

4.1 Consumer foods

This segment included branded foods sold in grocery and convenience stores. Food products included full meals, entrees, condiments, sides, snacks, and desserts, with foods that were frozen, refrigerated and shelf-stable temperature. Major brands included: Alexia®, ACT II®, Banquet®, Blue Bonnet®, Chef Boyardee®, DAVID®, Egg Beaters®, Healthy Choice®, Hebrew National®, Hunt's®, Marie Callender's®, Odom's Tennessee Pride®, Orville Redenbacher's®, PAM®, Peter Pan®, Reddi-wip®, Slim Jim®, Snack Pack®,

Table 1. ConAgra (CAG) selected financial data restated as of November 2015 (in millions USD, unless stated otherwise).[1,2] Sources: Standard & Poor's Capital IQ and Center for Research in Security Prices (CRSP) at the University of Chicago.

	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	Nov. 2015
Revenue	12,014.9	12,386.1	13,331.1	13,469.3	15,843.6	15,832.4	15,819.5
Cost of goods sold	-8,954.4	-9,482.6	-10,532.1	-10,087.7	-12,331.7	-12,491.7	-12,288.6
Selling, gen. & adm. exp.[3]	-1,926.4	-1,570.7	-1,931.7	-1,908.5	-1,938.9	-1,799.0	-1,825.1
Operating income -EBIT	1,134.1	1,332.8	867.3	1,473.1	1,573.0	1,541.7	1,705.8
Net interest expenses	-160.4	-177.5	-204.0	-276.2	-379.4	-331.9	-330.5
Income tax expense	-292.3	-421.6	-191.7	-361.9	-220.1	-234.0	-257.1
Net income	613.5	817.6	467.9	773.9	303.1	-252.6	-1,744.1
Diluted EPS	1.37	1.87	1.12	1.85	0.70	-0.60	-4.06
Diluted shares outstanding	447.1	434.3	418.3	417.6	427.5	426.1	429.8
Dividends per share ($/unit)	0.8	0.9	1.0	1.0	1.0	1.0	1.0
EBITDA	1,458.2	1,693.7	1,238.2	1,891.7	2,150.3	2,105.7	2,258.0
Stock price	23.8	25.4	25.2	33.7	32.3	38.6	40.9
Cash and ST investments	953.2	972.4	103.0	183.9	150.4	183.1	95.9
Receivables	849.6	849.4	924.8	1,279.4	1,058.4	972.9	894.4
Inventory	1,597.9	1,803.4	1,869.6	2,340.9	2,077.0	2,201.2	1,975.6
Other current assets	559.4	274.1	321.4	575.6	945.0	310.5	946.6
Total current assets	3,960.1	3,899.3	3,218.8	4,379.8	4,230.8	3,667.7	3,912.5
Net property, plant & equipment	2,602.4	2,670.1	2,741.9	3,757.6	3,636.0	3,608.1	2,645.9
Total assets	11,738.0	11,408.7	11,441.9	20,405.3	19,319.5	17,542.2	15,994.6
Accounts payable	919.1	1,083.7	1,190.3	1,498.1	1,349.3	1,358.3	1,195.5
Accrued expenses	810.6	470.6	718.7	1,034.9	885.2	908.6	925.2
Short-term borrowings	0.6		40.0	185.0	141.8	7.9	195.0
Current portion of long-term debt	260.2	375.3	192.0	622.4	84.1	1,008.0	1,309.8
Other current liabilities	45.7	196.0	84.2	60.9	182.0	27.4	328.1
Total current liabilities	2,036.2	2,125.6	2,225.2	3,401.3	2,642.4	3,310.2	3,953.6
Long-term debt	3,226.4	2,870.3	2,858.6	8,886.9	8,720.5	6,888.9	6,400.4
Total liabilities	6,809.1	6,732.0	6,905.9	15,042.3	13,964.3	12,932.2	12,446.2
Common stock	2,839.7	2,839.7	2,839.7	2,839.7	2,839.7	2,839.7	2,839.7
Retained earnings	4,417.1	4,690.3	4,765.1	5,129.5	5,010.6	4,331.1	3,115.3
Total equity	4,928.9	4,676.7	4,536.0	5,363.0	5,355.2	4,610.0	3,548.4
Total liabilities and equity	11,738.0	11,408.7	11,441.9	20,405.3	19,319.5	17,542.2	15,994.6
Cash from operations	1,472.7	1,352.3	1,052.0	1,412.2	1,568.6	1,480.6	1,380.9
Capital expenditures	-482.3	-466.2	-335.7	-422.6	-592.3	-471.9	-491.0
Cash acquisitions	-103.5	-131.1	-635.2	-5,018.8	-39.9	-95.7	-20.3
Cash from investing	-355.3	88.9	-1,064.3	-5,465.8	-531.5	-41.6	-511.2
Total debt issued	0.0	0.0	40.0	6,362.7	0.0	550.0	-205.7
Total debt repaid	15.8	294.3	363.6	2,074.0	612.4	1,645.2	411.3
Cash from financing	-404.5	-1,432.1	-849.6	4,240.2	-1,025.1	-1,403.0	-852.9

[1] FY stands for fiscal year. ConAgra's fiscal year ends in May. The last column provides last-twelve-months financial data as of November 31, 2015. Data in USD millions, except per share items.

[2] EPS: earnings per share, EBIT: earnings before interest and taxes, EBITDA: earnings before interest, taxes, depreciation and amortization.

[3] gen. & adm. exp.: general and administrative expenses.

Swiss Miss®, Van Camp's®, and Wesson® (ConAgra, 2017). The Alexia brand provided ConAgra's foray into frozen meals using natural foods. However, the brand was the subject of a class action false advertising lawsuit for allegedly labeling its products 'all natural' when chemicals were present.

4.2 Commercial foods

Commercial Foods included food and ingredients sold primarily to commercial, foodservice, food manufacturing, and industrial customers. The segment's primary food items were frozen potato and sweet potato items and a variety of vegetable, spice and frozen bakery goods which are sold under brands such as Lamb Weston® and Spicetec Flavors & Seasonings®.

4.3 Private brands

Private brands included private branded and customized food items sold in various retail channels, primarily in North America. Products included hot and ready-to-eat cereal, snacks, condiments, bars and coordinated categories, pasta and retail bakery goods. A significant portion of 2014 and 2015 results came from the newly acquired Ralcorp businesses. ConAgra's largest customer was Walmart, which accounted for 18% of the firm's total revenues in 2015.

5. The Ralcorp acquisition

In January 2013, ConAgra completed its $5.07 billion purchase of Ralcorp, making ConAgra North America's largest manufacturer of cereals, crackers, and other packaged foods sold under private labels. 'Clearly, consumer dynamics have changed since the recession and we expect growth in private-label food to continue to outpace growth in branded food,' commented by then ConAgra CEO Gary Rodkin (The Economist, 2012). When Ralcorp's cash was subtracted from the purchase price, the net price was $4.75 billion in cash paid to Ralcorp shareholders. ConAgra assumed some liabilities of Ralcorp, making the size of the acquisition worth more than $6 billion. The acquisition was funded mainly with debt. Estimations using discounted cash flow, multiples and comparable transaction analysis showed that ConAgra paid a fair price for Ralcorp (White *et al.*, 2018).

The acquisition of Ralcorp seemed to make sense at the time. In particular, ConAgra anticipated revenue enhancement and cost savings synergies through the acquisition. For example, ConAgra expected to sell Ralcorp products to its private brand customers. This would give ConAgra's sales force a wider range of products to sell. ConAgra primarily sold branded products; the Ralcorp acquisition would increase its diversity of products, with existing brand names, along with more private label products, which sold better in recessionary times. Cost savings could be achieved through reducing redundant employees and departments, economies of scale (for example, negotiate better prices with suppliers) and economies of scope (sharing manufacturing facilities).

However, ConAgra's integration of its Ralcorp acquisition did not go well. In addition to decreases in Consumer Foods volumes, unrelated to the Ralcorp acquisition, ConAgra noted 'challenges' to the private brands segment profitability, beginning soon after the Ralcorp acquisition. According to ConAgra's 2014 10K report:

> 'We anticipate fiscal 2015 to be a year of stabilization and recovery. We plan to benefit from stronger underlying operations, generate sizeable productivity and administrative savings and continue to realize substantial synergies from the Ralcorp transaction.' (ConAgra, 2014)

In fact, in 2014, the private brands division went from a $125.4 million operating profit in 2013 to a $373.4 million loss the following year and a $1,457 million loss in 2015. Table 2 provides revenue, operating profits, EBITDA (earnings before interest, taxes, depreciation and amortization), and total assets for each of

ConAgra's three business segments. In addition to impairment charges, the decrease in 2015 profits was driven by lower net sales and higher commodity costs, in particular for wheat and tree nuts. Decreased profitability occurred in spite of ConAgra's efforts to improve operations through increasing the firm's responsiveness to customers and commercialization of new products, improving order fill rates and on-time deliveries, and better commodity cost management. Profits in Consumer Foods were down from $984.4 million in 2013 to $892 million in 2014, but up to $1,070 in 2015 (Table 2). Profits in the commercial foods decreased from $585.5 million in 2013 to $537.3 million in 2014 and $568.5 in 2015.

Diluted loss per share 2015 for the corporation was $0.60, the sum of a loss of $1.46 per share from continuing operations and earnings of $0.86 per share from discontinued operations. Discontinued operations included the sale of a snack foods business, Medallion Foods, the assets of Lightlife, and write-offs of flour milling as part of the formation of Ardent Mills. In comparison, diluted earnings per share in fiscal 2014 were $0.70 ($0.37 per diluted share from continuing operations and $0.33 per share from discontinued operations). Earnings per share were $1.85 in 2013 (Table 1).

Integrating Ralcorp with ConAgra's existing business had been challenging. In 2014, ConAgra announced its supply chain and administrative efficiency plan (SCAE). This included steps to optimize the entire organization's supply chain network and to improve selling, general, and administrative (SG&A) expenses efficiency. The 2014 10K notes:

> 'The successful design and implementation of the SCAE Plan presents significant organizational design and infrastructure challenges and, in many cases, will require successful negotiations with third parties, including labor organizations, suppliers, business partners, and other stakeholders. In addition, the SCAE Plan may not advance our business strategy as expected […] If we are unable to realize the anticipated savings of the SCAE Plan, our ability to fund other initiatives may be adversely affected.' (ConAgra, 2014)

Table 2. ConAgra selected financial data by segments (in millions USD). Source: business segments module of Standard & Poor's Capital IQ (restated financial statements October 2015).

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Revenues	12,386.1	13,331.1	13,469.3	15,843.6	15,832.4
Consumer foods	8,002.0	6,945.8	7,551.4	7,315.7	7,304.4
Commercial foods	4,384.1	5,747.0	4,109.7	4,332.2	4,463.2
Private brands	0.0	638.3	1,808.2	4,195.7	4,064.8
Operating profit before tax	1,635.9	1,589.1	1,695.3	1,056.3	181.5
Consumer foods	1,126.4	878.2	984.4	892.0	1,069.7
Commercial foods	509.5	615.7	585.5	537.7	568.5
Private brands	0.0	95.2	125.4	-373.4	-1,456.7
EBITDA	1,903.8	1,876.4	2,042.7	1,553.4	698.0
Consumer foods	1,306.7	1,050.3	1,167.5	1,074.2	1,270.6
Commercial foods	597.1	712.4	669.9	637.8	682.0
Private brands	0.0	113.7	205.3	-158.6	-1,254.6
Assets	11,408.7	11,441.9	20,349.8	19,319.5	17,542.2
Consumer foods	7,277.3	7,205.4	7,845.5	7,666.1	7,568.5
Commercial foods	2,466.8	2,801.0	2,972.4	3,127.4	3,991.1
Private brands	0.0	544.7	7,676.5	6,912.4	5,144.7
Corporate	1,664.6	890.8	1,855.4	1,613.6	837.9

In fiscal 2015 goodwill impairment charges[2] were $1.59 billion with $83.7 million in fiscal 2014 and $28.4 million in fiscal 2013. SG&A expenses totaled $3.47 billion for fiscal 2015, an increase of $700.9 million compared to fiscal 2014's $2.77 billion. ConAgra attributed some of the increase to the SG&A from Ralcorp's businesses along with intangible asset impairments, integration expenses, higher stock compensation and incentive compensation expenses. ConAgra also engaged in research and development concerning product improvement and quality control and development of new products. R&D expense were $90.4 million, $101.8 million, and $91.1 million in fiscal 2015, 2014, and 2013, respectively (Data source: financial statements data from Standard & Poor's Capital IQ).

While ConAgra hoped to stem the red ink by 2016, perhaps ConAgra's attempt to juggle both private and national brands was too much for the firm to handle. The 2015 10K noted that it was difficult to compare 2015 with prior years because of extraordinary charges mostly related to the private brands segment (ConAgra, 2015a).[3]

6. Acquisitions[4]

ConAgra continued to make acquisitions in the years following the Ralcorp purchase, although not on such a large scale or focused mainly on their private brands division. For example, in May 2015 ConAgra bought Blake's All Natural Foods, a family-owned company specializing in all natural and organic frozen meals, for $20.7 million in cash, for the Consumer Foods segment. In July 2014, ConAgra acquired TaiMei Potato Industry Limited, a Chinese potato processor, for $92.2 million, (or $74.9 million net of cash acquired). The firm made frozen potato products and became part of the Commercial Foods segment. In September 2013, ConAgra bought frozen dessert production assets from Harlan Bakeries for $39.9 million in cash. These assets produced frozen fruit pies, cream pies, pastry shells, and loaf cakes and became part of the Consumer Foods segment. In April 2014 ConAgra sold Medallion Foods, a snack food business, for $32.0 million in cash, part of the private brands segment. In September 2013, assets of Lightlife (health foods, specifically plant protein foods), part of the Consumer Foods segment, were sold for $54.7 million.

In May 2014, ConAgra, Cargill, and CHS, Inc. formed Ardent Mills. ConAgra's contribution was $49 million cash and the assets of ConAgra Mills, which gave ConAgra 44% ownership of Ardent Mills. ConAgra received $391.4 million from Ardent Mills as a return on capital. This was a one-time gain of $625.6 million in income from discontinued operations. As part of the formation of Ardent Mills, ConAgra sold three flour milling facilities to Miller Milling Company LLC for $163.0 million. The proceeds were used to repay debt.

7. Capital structure changes

Following the Ralcorp acquisition, ConAgra massively increased its debt to equity ratio, its credit rating decreased significantly, and it became one of the worst performing stocks in the food manufacturing sector on the S&P 500, particularly from mid-2013 through the end of 2014 (Figure 1 plots annualized stock returns of ConAgra and the S&P 500 index). Stock price data is provided in Table 3. ConAgra said an important goal was to have a prudent capital structure that maintained flexibility enough to continue desired growth. Short-term debt was used to finance ongoing operations, including seasonal working capital and a combination of equity and long-term debt to finance base working capital needs and non-current assets (ConAgra, 2014).

Purchasing Ralcorp meant acquiring new debt totaling around $6.7 billion. In 2013, ConAgra issued senior notes for $3.975 billion, issued additional senior unsecured notes of $716 million in exchange for senior

[2] Goodwill impairment refers to lowering the value of the acquired assets on the balance sheet, with a corresponding lowering of equity to make the balance sheet balance.

[3] Extraordinary charges include: $1.59 billion in impairment of goodwill, other intangibles and fixed assets in the private brands segment, plus $5.1 million of impairment in consumer foods and commercial foods, $85.5 million restructuring charges, $24.6 million in early buyback of debt (paying off term loan facility and repurchase of senior notes), $16.3 million Ralcorp integration charges, $6.9 million charge from writing off actuarial losses in ConAgra's pension liability.

[4] Data related to acquisitions starting July 2014 are from ConAgra (2015a) and data related to acquisitions before this date are from ConAgra (2014).

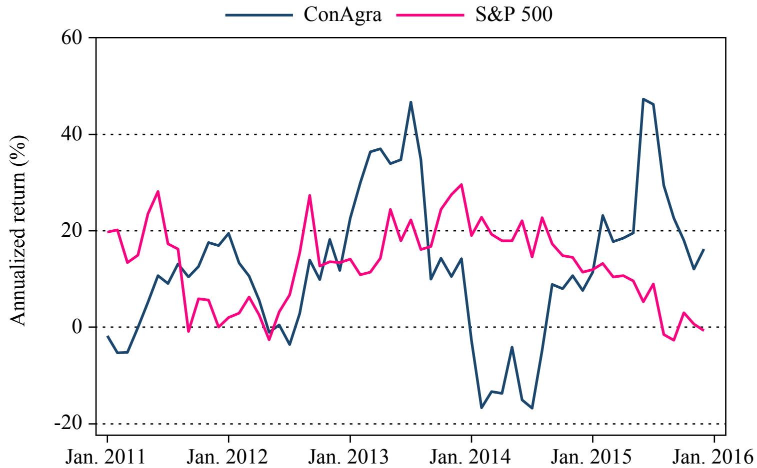

Figure 1. ConAgra and S&P 500 annual stock returns. Source: prices from the center for research in security prices (CRSP).

Table 3. ConAgra stock prices (USD). Source: Center for Research in Security Prices (CRSP).

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2010	22.74	24.46	25.07	24.47	24.18	23.32	23.48	21.59	21.94	22.49	21.48	22.58
2011	22.33	23.16	23.75	24.45	25.43	25.81	25.61	24.42	24.22	25.33	25.26	26.40
2012	26.67	26.25	26.26	25.82	25.15	25.93	24.69	25.11	27.59	27.84	29.86	29.50
2013	32.69	34.11	35.81	35.37	33.69	34.93	36.21	33.82	30.34	31.81	32.99	33.70
2014	31.79	28.40	31.03	30.51	32.30	29.68	30.13	32.20	33.04	34.35	36.52	36.28
2015	35.43	34.98	36.53	36.15	38.61	43.72	44.06	41.68	40.51	40.55	40.93	42.16

notes issued by Ralcorp, assumed senior Ralcorp notes for $460.7 million and borrowed $1.5 billion under a new term loan facility. This loan, due in 2018, carried an interest rate of the London interbank offered rate (LIBOR) plus 1.75%. The $3.975 billion in debt was issued in four tranches: 1.4% senior notes for $750 million due in January 2016, 1.9% senior notes for $1 billion due in January 2018, 3.2% senior notes of $1.225 billion due in January 2023, and 4.6% senior notes for $1 billion due January 2043. The $716 million in senior notes consisted of 4.95% notes with a principal amount of $282.7 million due August 2020 and $433.3 million in 6.625% senior notes due August 2039. As a result, ConAgra's capital structure, measured by the value of total debt to equity increased from 69% to 181% from fiscal 2012 to fiscal 2013.

In 2015 ConAgra had a $1.5 billion revolving credit facility, maturing in September 2018. The credit facility primarily served as back up to ConAgra's commercial paper program. At the end of the fiscal year, the firm had no amounts outstanding in either the revolving credit facility or its commercial paper borrowings. The facility required debt not exceed 65% of ConAgra's capital base and that fixed charges coverage be greater than 1.75 to 1.0. In March 2015, ConAgra and its lenders agreed to exclude certain goodwill and other intangible asset impairments from the calculation of the fixed charge coverage ratio. At fiscal year-end, ConAgra was in compliance with these covenants.

ConAgra repaid $612 million in debt in 2014 and planned further debt repayments for 2015. ConAgra repurchased 1.4 million shares of common stock for $50.0 million in 2015, compared to 2.9 million shares repurchased for $100 million in 2014. The firm also completed its multi-year debt reduction goal of repaying $2.2 billion in debt between fiscal 2014 and 2015 (The cash from financing section of Table 1 shows cash inflows and outflows related to debt). Table 1 shows that in fiscal 2015 ConAgra generated operating cash flows of $1.48 billion and used most of this amount, $1.1 billion (net after deducting issued debt), to repay debt. During 2015, ConAgra repurchased $225.0 million of senior notes due in 2023, $200.0 million of senior notes due in 2043, $25.0 million of senior notes due in 2019, $25.0 million of senior notes due in 2018, and $25.0 million of senior notes due 2017, in each case prior to maturity in a tender offer, resulting in a net loss of $16.3 million as a cost of early retirement of debt, including a $9.5 million tender premium (ConAgra, 2015a). Debt reduction was expected to continue in the future.

ConAgra's debt reduction efforts during fiscal 2014 and 2015 were helping the firm. ConAgra's credit rating by Standard & Poor's was upgraded from BBB-, as low as a rating can be without being classified as junk, or below investment grade, to BBB shortly after the release of 2015 financials.[5] The firm stated in its 2015 annual report that it was committed to maintaining an investment grade bond rating. Analysts were also responding positively to ConAgra's debt reduction as they upgraded their recommendations from sell to buy during the second half of 2015. Figure 2 plots the percentage of total buy, sell, and hold recommendations by analysists, compiled by I/B/E/S Thomson Reuters.

Yet, despite the temporary positive reaction by the market to ConAgra's efforts by the end of 2015, ConAgra's financials were still lagging relative to competitors. A financial assessment by Standard and Poor's Capital IQ by the end of 2015 rated ConAgra at the bottom among 11 peers in the food packaged industry, as shown in Table 4. Financial metrics of all peers during the last three years are provided in Table 5 to further assess ConAgra's position relative to the industry during the Ralcorp post-acquisition period.

[5] Source: Standard & Poor's Capital IQ Credit Health Panel.

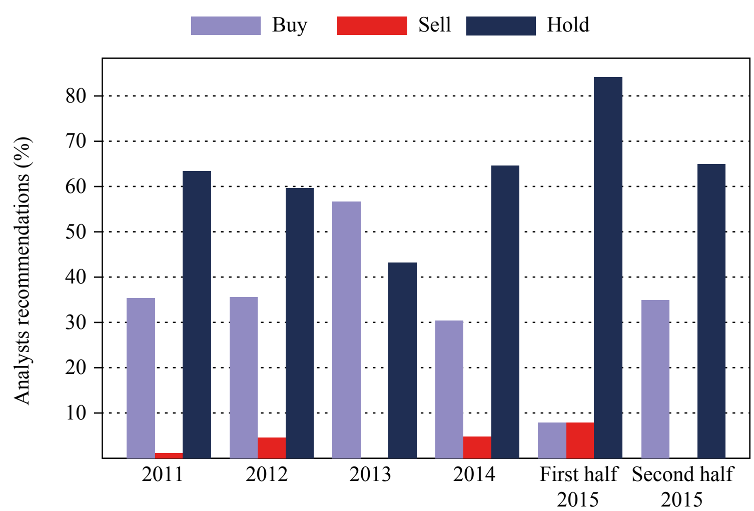

Figure 2. Percentage of recommendations by analysts over time for ConAgra equity. Source: data from I/B/E/S, Thomson Reuters.

Table 4. Results (December 2015) financial assessment from Standard & Poor's credit health panel for US selected packaged food firms.[1]

Company name	Overall	Operational	Solvency	Liquidity
The Hershey Company (NYSE:HSY)	1	1	1	4
Hormel Foods Corporation (NYSE:HRL)	1	2	1	2
Kellogg Company (NYSE:K)	2	1	3	3
The J. M. Smucker Company (NYSE:SJM)	2	3	2	3
TreeHouse Foods, Inc. (NYSE:THS)	2	4	2	1
General Mills, Inc. (NYSE:GIS)	3	3	4	2
Dean Foods Company (NYSE:DF)	3	4	3	2
Post Holdings, Inc. (NYSE:POST)	3	4	4	1
Mondelez International, Inc. (NasdaqGS:MDLZ)	4	2	3	4
Campbell Soup Company (NYSE:CPB)	4	3	4	3
ConAgra Brands, Inc. (NYSE:CAG)	4	2	2	4

[1] Credit health scores per firm based on a 1 to 4 scale – 1: in the top, 2: above average, 3: below average and 4: in the bottom.

Table 5. ConAgra's competitor ratios. Average values during three years from 2013 to 2015 fiscal years.[1] Source: Peer Analysis module of Standard & Poor's Capital IQ.

	CPB	DF	GIS	HRL	K	MDLZ	POST	HSY	SJM	THS	Ind. Mean	Ind. Median
Profitability:												
Return on assets	9.7%	3.0%	7.9%	11.0%	8.2%	3.6%	2.2%	16.7%	5.8%	4.7%	7.3%	6.8%
Return on capital	14.6%	5.5%	11.1%	15.5%	11.9%	5.3%	2.7%	25.5%	7.3%	5.7%	10.5%	9.2%
Return on equity	54.7%	17.0%	21.6%	17.6%	34.6%	13.5%	-7.1%	51.9%	9.1%	6.5%	21.9%	17.3%
Margin analysis:												
Gross margin	35.9%	20.8%	35.3%	17.5%	38.4%	37.6%	31.1%	45.6%	35.2%	21.1%	31.9%	35.3%
EBITDA margin	18.8%	3.7%	19.2%	11.6%	17.6%	15.2%	14.5%	22.4%	20.6%	12.8%	15.6%	16.4%
Net income margin	8.1%	2.9%	9.2%	6.6%	7.0%	14.0%	-5.1%	9.9%	8.5%	3.5%	6.5%	7.6%
Asset turnover:												
Total asset turnover	1.0x	2.9x	0.8x	1.7x	0.9x	0.5x	0.4x	1.4x	0.6x	0.9x	1.1x	0.9x
Fixed asset turnover	3.6x	7.4x	4.6x	9.3x	3.8x	3.4x	3.6x	3.7x	4.6x	5.6x	5.0x	4.2x
Inventory turnover	5.6x	27.4x	7.5x	7.5x	6.9x	6.0x	7.1x	5.6x	3.8x	4.6x	8.2x	6.4x
Liquidity:												
Current ratio	0.7x	1.5x	0.8x	2.2x	0.7x	0.9x	3.3x	1.3x	2.1x	2.9x	1.6x	1.4x
Quick ratio	0.3x	1.0x	0.4x	1.0x	0.4x	0.5x	2.2x	0.7x	0.7x	0.9x	0.8x	0.7x
Cash conversion cycle (days)	53.9	18.0	31.3	50.1	18.7	13.8	50.5	50.0	88.4	75.3	45.0	50.0
Solvency:												
Total debt/equity	306.0%	141.6%	119.1%	8.4%	274.9%	55.9%	139.7%	166.6%	56.8%	74.3%	134.3%	129.4%
LT debt/equity	178.5%	141.4%	92.1%	6.9%	210.1%	48.6%	139.2%	121.7%	53.1%	73.8%	106.6%	106.9%
Total debt/EBITDA	2.7x	3.0x	2.5x	0.3x	3.3x	3.3x	9.6x	1.3x	3.0x	3.4x	3.2x	3.0x
Altman Z score:	2.88	4.16	3.06	7.47	2.98	1.96	0.87	6.86	2.31	2.5	3.51	2.93
Growth over prior year:												
Total revenue	4.2%	-4.0%	2.0%	4.1%	-1.5%	-5.2%	77.9%	3.6%	1.1%	14.1%	9.6%	2.8%
EBITDA	0.9%	13.8%	0.6%	12.7%	10.5%	-3.5%	50.4%	6.3%	-0.2%	10.6%	10.2%	8.4%
Net income	8.4%	412.7%	-5.4%	11.2%	6.7%	72.1%	-69.5%	-4.0%	-5.6%	9.9%	43.6%	7.6%

[1] CPB: ticker of Campbell Soup Company, DF: Dean Foods Company, GIS: General Mills Inc., HRL: Hormel Foods Corporation, K: Kellogg Company, MDLZ: Mondelez International Inc., POST: Post Holdings Inc., HSY: The Hershey Company, SJM: The J.M. Smucker Company, THS: TreeHouse Foods Inc., Ind. Mean: average of 2013-2015, and Ind. Median: median of 2013-2015.

8. A change in management

ConAgra hired Sean Connolly as CEO in April 2015. Previously, he had been president and chief executive officer and a director of The Hillshire Brands and CEO of Sara Lee North American Retail and Foodservice. He also was president of Campbell North America, the largest division of Campbell Soup Company. Connolly replaced Gary Rodkin, who became an independent director for the Simon Property Group. In ConAgra's press release at the time, Connolly said:

> 'I'm excited to begin my new role at ConAgra Foods. The company has a unique portfolio and a motivated team. I'm looking forward to transitioning with Gary, and creating a lot of value over time.' (ConAgraFoods, 2015b)

The stock market reacted positively to this announcement (Figure 1). CEO Connolly expressed concern about ConAgra's competitiveness, noting that consumer attitudes about food had changed, with a new emphasis on foods that promoted health and wellness. Jana Partners (JANA), an activist hedge fund, had a 7% share of ConAgra stock and was advocating a change in management and the sale of the private brands segment.

9. Analyst opinions

Analysts were speculating about ConAgra's financial woes, and how the company might respond. The company was under new management, and analysts expected higher growth goals and more successful execution of these goals. Analysts' consensus price range for ConAgra in 2016 was $42-$49, compared to its current price of about $41 in early December 2015 (Table 3).

While new CEO Sean Connolly had not yet had time to make significant changes in the struggling company, analysts speculated that ConAgra might spin off its private brands division, which would allow the firm to focus on its more profitable segments. This possibility was supported by the fact that JANA had two board seats and a significant stake in ConAgra's equity. JANA was expected to encourage divestiture of the private brands division. (Table 6 provides comparative firm value and market multiples of private brand food firms by the end of 2015, which could be useful for valuation purposes if ConAgra were to sell its private business segment.) Analysts also expected that new management might have a better handle on ConAgra's selling, general and administrative (SG&A) expenses, currently about 10% of sales. Analysts estimated that the right moves could cut SG&A to sales by one or two percentage points. A JP Morgan analyst thought that ConAgra could increase its operating margin from 12 to 14% by 2018. ConAgra's weighted average cost of capital by the end of 2015 was estimated to be 6%.[6]

[6] As of the end of 2015, ConAgra's mix of financing was 31% debt and 69% equity, with a book value of debt = $7,904.8, and market value of equity = $17,589.7, calculated by multiplying the number of shares times stock price (Table 1). The cost of debt, approximated by dividing interest paid by total debt was 4.9%, and the marginal effective income tax rate was estimated to be 34% by financial analysts, according to data compiled by Capital IQ's Standard and Poor's. During 2015, the risk-free rate, proxied by a 10 year long term bond issued by the US government was around 2.5%, and the assumed market risk premium was 7% (Brotherson *et al.,* 2013). ConAgra's market beta, using 5 years data, was estimated at 0.68 by Capital IQ's Standard and Poor's.

Table 6. Selected Information of firms with private brands in their portfolio of products (in millions USD).[1] Data from Standard & Poor's Capital IQ.

Firm	TEV	TEV/LTM EBIT	TEV/LTM EBITDA	TEV/LTM revenue
Dean Foods Company	2,594.8	14.53	7.14	0.28
Farmer Brothers Co.	437.9	29.44	11.55	0.83
Treehouse Foods, Inc.	5,034.0	19.74	13.14	1.51
Post Holdings, Inc.	8,112.5	23.91	13.39	1.78

[1] TEV: total enterprise value, EBIT: earnings before interest and taxes, and EBITDA: earnings before interest, taxes, depreciation and amortization, and LTM: last-twelve-months.

10. ConAgra at a crossroads

By the end of fall 2015, ConAgra clearly had problems, both in its acquisitions integration, its acquisition strategy and its capital structure choices. ConAgra needed to focus on its high debt and determine ways to decrease the debt load. If the firm improved profitability, would that be sufficient in the long run, for example, if it used its cash flow to repurchase debt? Or, would this strategy take too long? Table 7 breaks down ConAgra's cash flow statement as of fiscal 2015 and Table 8 shows ConAgra's fixed payment commitments for the following years. Three years before, ConAgra paid $4.75 billion for Ralcorp's equity and assumed Ralcorp's liabilities. While it would be unlikely to recover all of that cost, what if it could recover a percentage by selling its private brand division? What sales price would be needed to bring the firm's debt load back to manageable levels?

Table 7. ConAgra cash flow statement as of fiscal 2015 (in millions USD). Source: Standard & Poor's Capital IQ (restated financial statements 30 November 2015).

	FY[1] 2015
Net income	-252.6
Depreciation & amortization	564.0
(Gain) loss from sale of assets	14.3
(Gain) loss on sale of investments	0.0
Asset write-down & restructuring costs	1,643.6
(Income) loss on equity investments	-30.8
Stock-based compensation	68.3
Net cash from discontinued operations	6.9
Other operating activities	-362.6
Change in accounts receivable	93.8
Change in inventories	-119.8
Change in accounts payable	-15.9
Change in deferred taxes	-102.0
Change in other net operating assets	-26.6
Cash from operations	1,480.6
Capital expenditures	-471.9
Sale of property, plant, and equipment	20.6
Cash acquisitions	-95.7
Divestitures	0.0
Sale (Purchase) of intangible assets	0.0
Invest. in marketable & equity securities	391.4
Net (Inc.) Dec. in loans originated / sold	0.0
Other investing activities	114.0
Cash from investing	-41.6
Short term debt issued	0.0
Long-term debt issued	550.0
Short term debt repaid	-150.0
Long term debt repaid	-1,495.2
Issuance of common stock	153.8
Repurchase of common stock	-50.0
Common dividends paid	-425.2
Other financing activities	13.6
Cash from financing	-1,403.0

[1] FY: fiscal year. ConAgra's fiscal year ends in May.

Table 8. ConAgra outstanding debt as of the end of FY 2015 and long-term debt maturities (in millions USD). Source: Standard & Poor's Capital IQ.

	FY[1] 2015
Total debt outstanding	7,904.8
Fixed payment schedule:	
LT[2] debt due in 1 year	1,009.0
LT debt due in 2 years	568.4
LT debt due in 3 years	1,706.3
LT debt due in 4 years	479.7
LT debt due in 5 years	4.0
LT debt due next 5 years	3,767.4
LT debt due, after 5 years	4,129.5

[1] FY: fiscal year. ConAgra's fiscal year ends in May.

[2] LT: long term.

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