

AMERICAN BANKRUPTCY INSTITUTE JOURNAL

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Inside the Turnaround of Pilgrim's Pride

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The turnaround of an \$8 billion debt-laden company that hemorrhaged \$1 billion in cash the year prior and then entered into bankruptcy protection is no easy task and took the teamwork and cooperation of financial and restructuring advisors, lawyers, the judge and others. With an operational turnaround and a major investor in place, the company emerged from bankruptcy in December 2009. The company cash-flowed, on an EBITDA basis, \$216 million for the year. Creditors, holding debt valued at pennies on the dollar, were made whole by recovering total value with interest. Equity investors with near-worthless stock recovered 36 percent of their initial value and saw their stock price stabilize at the \$8 level.

Sell It or Smell It



William K. Snyder

Pilgrim's Pride, a 63-year-old company founded by Lonnie "Bo" Pilgrim in northeast Texas, was the nation's largest poultry producer. Of \$8.4 billion in sales, 93 percent of Pilgrim's Pride's customers were in the United States. Of that, 65 percent went to the food service industry, 22 percent to retail and the rest to exporters. About 7 percent of the company's sales were in its Mexico operations and the rest exported.

The company's \$1.3 billion acquisition of chief rival Gold Kist in 2007 increased its debt burden from 4.1 to 10.3, based on the ratio of total debt to cash flow. In the meantime, a perfect

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storm brewed. In 2007, the government had required a higher use of ethanol in fuels, which led to higher corn and soybean meal prices, which are key chicken feed ingredients. Natural gas and oil prices also rose. The recession led to decreased sales for restaurants, which further depressed demand for chicken.

The industry, and Pilgrim's Pride in particular, responded to lower prices by producing more chicken in order to maintain revenues. A common saying around the company was "Sell it or smell it." The company thought it would always find a buyer for its chicken,

filing. The first order of business from the financial and restructuring advisors was to determine whether the company could be turned around or quickly sold.

The decision-making process included evaluating the forces that were affecting the company, determining whether it was to be a tactical or strategic turnaround, evaluating the effects of bankruptcy, resources, stakeholder appetite for the turnaround and legal options. Pilgrim's Pride was not so far into in a death spiral that a turnaround could not be effected, but the time and protections that a conventional bankruptcy would offer were needed. This would not be the quickie bankruptcy so commonly seen these days. With the right players in their roles, the financial and restructuring advisors decided Pilgrim's Pride could be turned around.

The first step prior to bankruptcy was to assess the company's cash flow and prepare a 13-week cash flow forecast.

Feature

whether or not it was at or below cost. It was a philosophy that had served the company well in times of the 10 percent growth it had experienced in the past, but not in an environment in which chicken prices were falling.

Hit by higher feed commodity prices and an oversupply of chicken, and staggering under debt accumulated with acquisitions, the company lost nearly \$1 billion in 2008. Despite attempts at streamlining operations that included 4,500 layoffs, management had no choice but to enter bankruptcy on Dec. 1, 2008.

Prebankruptcy Filing

Pilgrim's Pride hired financial and restructuring advisors in November 2008, one month before the bankruptcy

The cash flow process was revised—taking into consideration suggestions from creditors—for better control of cash by assigning responsibility for operational costs to individuals within the organization.

On the financial side, it was clear that there was no buyer yet ready to pump equity into the company. Although fixed-asset lenders were unable to provide any more loans, the company's investment banker, Lazard, was able to negotiate a debtor-in-possession (DIP) loan from the working-capital lenders.

At any one time, Pilgrim's Pride was feeding 200 million chickens in 139 facilities at a cost of \$42 million per week. Prior to the filing, the financial and restructuring advisors set up a series of conference calls with critical vendors.

¹ CRG Partners LLC served as the financial and restructuring advisors to Pilgrim's Pride during its bankruptcy filing.

Vendor support was vital as feed inventories are kept very low. Its 200 million chickens could not survive more than a week without feed. In addition, more than 5,000 chicken farmers earned their sole source of income from Pilgrim's Pride and required feed and supplies to continue raising chickens.

The total §503(b)(9) claim estimate—based on goods delivered and not paid for 20 days before filing—was initially between \$70 million and \$80 million. The vendor communication about the company's progress and answers to key questions allowed Pilgrim's Pride to pay grain suppliers, farmers and critical vendors, conduct other business normally and, most importantly, keep its most important trade credit agreements in place. Out of \$100 million in prepetition obligations that were paid during the bankruptcy, \$43 million was paid to critical vendors and in return, those vendors extended credit on new or better terms totaling \$200 million. Without this credit, the company would have had to borrow more from its DIP loan and made the situation much worse.

Bankruptcy Filing

On Dec. 1, 2008, Pilgrim's Pride and six subsidiaries filed voluntary chapter 11 petitions. The chapter 11 cases were jointly administered under a single case heading and number² before Hon. D. Michael Lynn of the U.S. Bankruptcy Court for the Northern District of Texas. The court authorized the hiring of general bankruptcy counsel, an investment banker, corporate counsel, financial and restructuring advisors, a claims agent and several counsel.

Within 18 days of the filing, a new CEO was appointed, although the court did not approve his appointment until February 2009. Regardless, he began work early and he later brought in other top managers. With the vendor agreements and payments, financing and new management in place, it was time to get to work on operations, the balance sheet and the mountain of legal issues the company faced.

Legal Challenges

Pilgrim's Pride and its subsidiaries had 13,000 executory contracts—anything from leases to employment contracts, maintenance or vendor agreements—to amend or otherwise handle. In addition, the company faced

327 personal injury and workers' compensation claims, ranging from people choking on chicken bones to truck driving accidents. There were 762 grower claims and another 131 claims—including two class actions—filed for assertions that Pilgrim's Pride violated federal "donning and doffing" workplace regulations on when workers could change their uniforms. In addition to the other legal issues, there were 117 miscellaneous lawsuits for such things as litigation claims (*i.e.*, breach of contract, wrongful termination, copyright or patent infringement, personal property damage) and 27 labor contracts to be renegotiated.

Pilgrim's Pride could emerge from bankruptcy in two ways. The first option was a stand-alone plan with claims held by the general unsecured creditors converted to equity and subsequently controlling the reorganized company. The second option was to strike a deal with JBS SA of Brazil, the largest beef producer in the world, through selling a controlling stake in the company.

In all, 6,799 claims totaling \$2.4 billion were scheduled by the company, and 6,427 claims representing \$4.12 billion were filed by creditors. Of those, 2,450 claims totaling \$27 million were initially deemed as allowed claims, while 5,500 claims representing more than \$1 billion were objected to by the company. The claims-adjudication process continued even after emergence.

In March 2009, the financial and restructuring advisors advised the debtor to file a stand-alone plan by the end of the summer. The company was generating \$50 million per month in cash flow from operations, and the stock price started to rise. It was clear that if the company did not start early on a process to deal with the massive number of legal issues, it would not exit bankruptcy with any shareholder equity or be in the

position to attract an investor. If all of the claims were dumped into a separate liquidating trust, as is done in most cases, the holdback for contingent claims would leave nothing for the equity-holders.

In addition to the normal review of vendor claims by the company, the adjudication process took on five elements: (1) an estimation motion was filed for the donning and doffing claims; (2) an ADR process was established for the personal-injury claims; (3) 35 adjusters were brought in to negotiate settlements with other various claims; (4) a team was organized to deal with the collective-bargaining agreements; and (5) a vigorous settlement process was established for the grower and rejection claims.

To deal with the 327 personal injury claims representing \$156.5 million, Judge Lynn ordered alternative dispute centers in Dallas, Atlanta and Richmond, Va., to be set up in April 2009, and required that all claimants enter the process. Both sides got two chances to present their positions, and if that did not come to settlement, a court-appointed arbitrator made the decision. Eventually, 108 claims, representing \$15 million, were settled for \$900,000. Of those remaining unresolved, there are 219 claims totaling \$141.6 million. Settling a large portion of the bodily-injury cases was key in this case. Pilgrim's Pride might have ended up trying cases in front of hundreds of sympathetic local judges who might make big awards.

Grower Claims

The company idled certain facilities in May 2009 and eliminated shifts at others. Growers who supplied those plants had contracts with Pilgrim's Pride, typically lasting up to a year. The 762 grower claims totaling at least \$180 million (hundreds of claims were "unliquidated") were a major concern and involved some of the stickiest negotiations.

The situation with the growers was sensitive. Not only were politics involved with cutting back production in small communities, the culture of a company was being changed. Judge Lynn was also sensitive to the fact that about 400 growers were just idled. Bankruptcy law allowed the rejection of any of the grower contracts outright, but a settlement was attempted, covering the contract rejection damage claims for a mutually agreed-upon amount using an outside mediator.

² In re Pilgrim's Pride Corp., et al., Case No. 08-45664 (DML).

The company settled 630 of the contract rejection portion of the grower claims for \$5.7 million, with the rest of the claims representing \$108 million still in process. The donning and doffing claims totaled \$56 million, although the court approved an estimation procedure and these were settled for \$13 million. While 22 claims in the miscellaneous tort category were settled, 95 claims representing \$80 million remained unresolved.

The company also rejected two leases for real property, 22 service agreements and 44 vehicle and equipment leases that were not needed due to plant closings. The company saved \$8 million on an annual basis through the lease-rejection process. In order to maintain open dialogue during the bankruptcy process, frequent calls with all lessors were conducted, which assisted in the rejection process, maintaining current lease terms and negotiating better terms from certain existing leases.

Finally, Pilgrim's Pride used the bankruptcy to renegotiate the majority of the 27 labor collective-bargaining agreements. Local unions were reached out to and told what was requested, which was mainly making the various agreements consistent in how they dealt with overtime, and how holidays were paid, and putting everyone on a global health plan instead of providing multiple options. Although this process bogged down procedures at first and took most of the bankruptcy to solve, eventually the United Food and Commercial Workers' top leadership met with the Pilgrim's Pride executives and settled. Other unions followed suit. The company would save an estimated \$23.4 million per year on labor and administration costs.

Operational Changes

Analysis of the operational problems within Pilgrim's Pride showed the following:

- a patriarchal company culture intensely focused on producing as much low-cost product as possible, forcing increased commoditization of major product lines;
- excess capacity across all product lines with escalating raw material costs and declining product prices, and a supply chain that was virtually unhinged from market demand;
- several assets that were of minimal value to the core business; and
- inflexible supply lines, with growers too dependent upon Pilgrim's Pride.

To deliver the cash necessary for an exit from bankruptcy, the company needed to reorganize its entire supply structure and reduce production. With the many pressures, including senior political interventions concerned about plant closures in their states, it would require the full use of the Bankruptcy Code. Operational restructuring plans were communicated aggressively to all stakeholders—creditors, equity-holders, customers, employees and the court.

A two-phase plan was developed. Phase I focused on implementing lean manufacturing systems. Phase II reduced Pilgrim's Pride's production capacity, making it a more market-driven company, and changed the product mix to higher-margin prepared chicken lines with less commoditized unprepared parts.

In addition to the plant closures prior to the filing, the company closed five more plants during the spring of 2009, and two more plants later that year. The lean implementation programs were coordinated with the initial phase of plant closures, and Pilgrim's Pride was able to demonstrate sustainable cost savings at several operating facilities. Procedural changes included the following:

- demand planning from customer forecasts;
- production and inventory planning, scheduling and optimization;
- equipment utilization optimization, as well as logistical and maintenance planning;
- procurement scheduling with resolution of vendor issues; and
- portfolio profit margin review and optimization.

Using §363, the company sold noncore assets, including a processing complex and excess land for \$72 million, a rail service and a distribution center. The total of the asset sales brought \$86.8 million. The plant closures added \$135 million to cash flow and removed 800 million pounds of unprofitable (commodity) chicken off the market. Commodity prices improved modestly during the bankruptcy, but raw material hedging was delayed until exit.

Financial Issues and Exit

After the Gold Kist acquisition, total debt on Pilgrim's Pride's books was \$1.8 billion. During the bankruptcy, Pilgrim's Pride generated \$390 million in cash, which was used to pay down \$140 million in DIP financing with

\$250 million accumulating in the cash collateral account by the emergence effective date.

Pilgrim's Pride could emerge from bankruptcy in two ways. The first option was a stand-alone plan with claims held by the general unsecured creditors converted to equity and subsequently controlling the reorganized company. The second option was to strike a deal with JBS SA of Brazil, the largest beef producer in the world, through selling a controlling stake in the company. The cash from the infusion would be used to pay all general unsecured creditors in full. Both options required a recapitalization of the existing senior secured debt.

Because of the company's improving fundamentals and the clarity around the contingent claims, JBS was ready to do the deal. For \$800 million, JBS would receive 64 percent of Pilgrim's Pride, which valued the existing shareholder stake at \$450 million. It represented 36 percent of the company's previous value, and the stock subsequently relisted on the New York Stock Exchange.

The company's debt still had to be refinanced. The company received at least eight proposals to provide the exit financing, and chose CoBank to underwrite a \$1.75 billion single-lien credit facility that, due to its large size, would require many of the prepetition lenders to roll their existing commitments.

However, if the prepetition lenders chose not to roll their commitments, one possible alternative was a "cramdown" facility, which would provide the lenders with less collateral, as they could be reinstated with a bifurcated credit facility and a different collateral package. Ultimately, CoBank, with the help of RaboBank as co-lead arranger, filled all commitments and completed a successful close, which was instrumental to the company's emergence from bankruptcy.

Pilgrim's Pride emerged from bankruptcy on Dec. 28, 2009, 13 months after filing. During its bankruptcy, the company's cash position went from a negative cash balance with approximately \$140 million in DIP financing to approximately \$250 million in cash with the DIP credit facility completely paid down. Company stock, once trading as low as 12 cents, traded above \$8 per share upon exit. Debt that had traded as low as 7 cents on the dollar was made whole.

Lessons Learned

The key elements of the Pilgrim's Pride turnaround included:

- *Getting everyone on the same page.* Transparency and collaboration helped get all constituencies on the same page to exit quickly.
- *Establishing legal teams.* Legal counsel was critical in setting up processes to adjudicate claims quickly so that the known claim pool was established for valuation purposes. The full extent of the Bankruptcy Code was used to manage both legal and operating issues.
- *Positioning on the forward curves.* When dealing with a company that is highly susceptible to commodity prices, it is vital that the exit is planned with the best possible knowledge and positioning on the forward curves.
- *Swift execution by management.* Having a management team that is dedicated to doing the right thing and making immediate changes was a cornerstone of the turnaround. ■

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