Post Petition Liquidation/Takeover

http://www.gurufocus.com/news/176677/how-do-i-get-4-per-share-for-cagaq

http://www.kccllc.net/documents/8819200/8819200120510000000000008.pdf

CAGLE'S INC -CL A(CAGAQ) - $1.50 on Apr 13, 2012 by YCOMBINATOR

			2011	2012
Price:	$1.50	EarningsPerShare:	$0.00	$0.00
Shares Outstanding (in M):	5	P/E:	0.0x	0.0x
Market Cap (in $M):	7	P/FCF:	0.0x	0.0x
Net Debt (in $M):	74	EBIT (in $M):	$0	$0
TEV (in $M):	81	TEV/EBIT:	0.0x	0.0x

Cagle’s is a bankrupt chicken producer based primarily in Georgia. On March 23, the company filed a 363 motion to sell substantially all of its assets to JCG Foods LLC (an affiliate of Koch Foods) for ~$72mm, subject to an auction process to solicit higher and better bids. Koch’s stalking horse bid takes Cagle’s into solvency. Debtors’ counsel made a statement at the April 4 court hearing to approve the bid procedures that the company expects there will be equity value.

There are only 4.6mm shares outstanding and the founding family/insiders own 65% of the equity. **Given the insider ownership, I think the Debtors will work hard to maximize the equity recovery.** The chance of a robust auction appears high. The Debtors spent months negotiating an asset purchase agreement (“APA”) with Continental Grains/Bachoco (“C/B”) and if C/B comes to bid in an auction, both C/B and Koch have substantial firepower to improve their bids.

A survey of 363 auctions conducted over the past year shows that winning bids average a 40% improvement over the stalking horse bid. Transaction comps also show that a 40% improvement over the stalking horse would still result in a reasonable 0.3x sales multiple. $72mm * 1.4 = $100mm - $74.5mm in liabilities = $25.5mm / 4.6mm shares = **$5.54/share recovery**.

There are severe liquidity constraints, so this is only appropriate for personal accounts, and even then only for beer money positions. That said, even if you can only put a tiny amount to work, there’s a good chance you’ll make a multiple of that in a very short time frame.

The docket is available at http://www.kccllc.net/Cagles

Liabilities

As always, let’s start with the liabilities. A wise man once said, “Assets are fleeting like the wind, liabilities are as real as passing a quarter-sized bladder stone.”

Pre-petition Debt: $62.8mm, consisting of $40.6mm of pre-petition debt and $22.2mm of accounts payable.

Cure Costs: $3mm to cure executory contacts to be assigned to Koch.

Professional Fees: $5mm. This is 10,000 hours of professional time billed at $500/hr. This isn't a complex bankruptcy and there isn't an army of professionals.

Banker Fees: $1.25mm. Lazard gets a $1.25mm restructuring fee. However, if a sale transaction is consummated, Lazard will receive 5% of aggregate consideration above $85mm.

Uncashed Checks: $2.5mm. Should be self-explanatory.

Assets

Cash: From the most recent monthly operating report, the March 3rd balance sheet contains $5.1mm of cash. In addition, with chicken pricing on the upswing, the Debtors actually made money during February. The recent MOR showed net income of ~$500K in February, but Debtors' counsel stated the company made $2mm in February (EBITDA?) at the April 4 hearing. In any case, the company should continue to build cash until the closing of the 363 sale. Assuming the sale closes in early June, that is potentially another $3mm of cash on the balance sheet ($1mm/month).

Stalking Horse: The stalking horse APA states the purchase price is a combination of $37mm in cash + the value of inventory and accounts receivable - the value of assumed post-petition liabilities. The Debtors estimates the value of the bid to be $37mm cash + $43mm inventory/AR - $7.7mm assumed liabilities = $72mm. Payment will consist of $55mm cash + $17mm 8% one-year note that is deferred and starts amortizing in Feb. 2013 (more on this later).

At the April 4 hearing, Debtors' counsel stated the Koch stalking horse was valued at $80mm, but for our purposes, I'm sticking with a $72mm value.

Other Assets: There are assets excluded from the sale, including the company's Macon, GA facility and a $1.2mm receivable from the Cagle family. According to the schedules, the Macon facility is closed and valued at $1.4mm (here it is on Google Maps: http://maps.google.com/maps?q=2125+7th+St,+Macon,%C2%A0GA,%C2%A0US%C2%A031206-1047). I'm not assigning value to anything in this category, but there's probably some value here.

Recovery Model Assuming No Auction

Taking our figures from above and assuming $3mm cash build, there is likely not much downside from current prices in the event of no auction. However, given the small number of shares, the recovery per share can swing substantially (for example, if you take the Debtors at their word that the Koch bid is worth $80mm, the recovery goes to $2.95/share). The point of this exercise isn't to get to an exact number, it's to demonstrate that even without an auction, we probably won't lose much (if anything at all) from the current stock price.

Assets	
Cash	$ 8.10
Stalking Horse	$ 72.00
Total	**$ 80.10**
Liabilities	
Pre-Petition	$ 62.80
Cure Costs	$ 3.00
Professional Fees	$ 5.00
Banker's Fee	$ 1.25
Uncashed Checks	$ 2.50
Total	**$ 74.55**
Equity Recovery	$ 5.55
Shares Outstanding	4.6
Per Share	**$ 1.21**

Why I Think There Will be an Auction

There are several reasons why I believe there will be a robust auction.

1) Continental/Bachoco: Debtors spent all of January and February negotiating an APA with C/B. Debtors' counsel is King & Spaulding and they filed their bill for services performed from 10/19/2011 to 2/29/2012 on March 23 (http://www.kccllc.net/documents/8819200/8819200120323000000000001.pdf). If you look through the time descriptions under code B130, you can see the significant amount of time spent on the C/B APA. I do not believe C/B would have spent that much time on negotiating an APA if they did not have serious interest in Cagle's assets. Discussions about C/B's APA were still being held on 2/29, so I imagine they continued through March, but the March bill has not yet been filed.

Continental Grains (http://contigroup.com/) is a large conglomerate with agribusinesses including Smithfield and Wayne Farms. Wayne Farms is located in Georgia as well and did $1.4b in 2010 revenue processing 5.6mm chickens per week. Bachoco (NYSE: IBA) is a large Mexican chicken producer with ambitions to expand into the U.S. Bachoco acquired another U.S. chicken producer, O.K. Industries, in October 2011. The Cagle's bid appears to be a joint one between Continental and Bachoco, and both parties have plenty of resources to bid at auction.

Koch Foods is the 4th largest U.S. chicken producer and appears to have substantial firepower at an auction as well. Debtors' counsel stated at the April 4 hearing that Koch did $2b in 2011 sales and has a $110mm undrawn credit facility.

2) The $17mm 8% Note: Koch obviously has the resources to make an all-cash bid, but why bother with a note that in the initial APA was personally guaranteed by the CEO? Well, if you thought there was a meaningful chance of an auction, you would structure your stalking horse with "easy gives", i.e., easy ways to improve your bid at auction. I believe converting the 8% note to cash would be an easy give at auction for Koch.

3) Unsecured Creditors Committee Objection: The UCC filed a limited objection to the sale on April 3 (http://www.kccllc.net/documents/8819200/8819200120403000000000005.pdf). From the nature of their objections, I think the UCC thinks there will be an auction. The UCC focused on the credit risk from the 8% note and wanted the note valued at less than face for purposes of determining value at auction. This was a smart move by the UCC – they wanted Koch to give up the obvious "easy give" before the auction even began. The UCC was also focused on making sure other bid structures were not foreclosed by the Bid Procedures.

The UCC was somewhat successful. In the amended stalking horse APA, the 8% note now amortizes over 4 quarters instead of 8 and is also guaranteed by Koch in addition to the CEO.

4) The bid deadline is May 4 and the auction is scheduled for May 10. I've seen a number of 363 processes and generally when there is a long time period between the bid deadline and the auction, the company expects other bidders to come in. Conversely, if the bid deadline and auction are close together, don't expect an auction. Debtors typically know if additional bidder(s) are in the game, so a longer time period allows the Debtor time to work with bidder(s) to make sure their submitted bid(s) are fully qualified before the auction. The 6 days between the bid deadline and auction is a positive in this case.

5) A Delaware LLC named Bachoco USA, LLC was formed on March 2, 2012. This is presumably the vehicle for Bachoco to acquire Cagle's assets. Bachoco was getting all the pieces in place to complete an acquisition.

Frequently Asked Questions View Search Results

Entity Details

THIS IS NOT A STATEMENT OF GOOD STANDING

File Number:	5118163	Incorporation Date / Formation Date:	03/02/2012 (mm/dd/yyyy)
Entity Name:	BACHOCO USA, LLC		
Entity Kind:	LIMITED LIABILITY COMPANY (LLC)	Entity Type:	GENERAL
Residency:	DOMESTIC	State:	DE

REGISTERED AGENT INFORMATION

Name:	CAPITOL SERVICES, INC.		
Address:	1675 SOUTH STATE STREET, SUITE B		
City:	DOVER	County:	KENT
State:	DE	Postal Code:	19901
Phone:	(800)316-6660		

6) JCG Foods LLC is the Koch entity that is the stalking horse. JCG was formed on March 21, only two days before the stalking horse was announced. Koch also does not show up in the King & Spaulding bill until Feb. 14. I think C/B was prepared to be the stalking horse and Koch swooped in at the last minute. It does not appear that C/B walked away at any point, but rather may have been surprised by another bid coming in late in the process.

Frequently Asked Questions View Search Results

Entity Details

THIS IS NOT A STATEMENT OF GOOD STANDING

File Number:	5127520	Incorporation Date / Formation Date:	03/21/2012 (mm/dd/yyyy)
Entity Name:	JCG FOODS LLC		
Entity Kind:	LIMITED LIABILITY COMPANY (LLC)	Entity Type:	GENERAL
Residency:	DOMESTIC	State:	DE

REGISTERED AGENT INFORMATION

Name:	NATIONAL REGISTERED AGENTS, INC.		
Address:	160 GREENTREE DRIVE SUITE 101		
City:	DOVER	County:	KENT
State:	DE	Postal Code:	19904
Phone:	(302)674-4089		

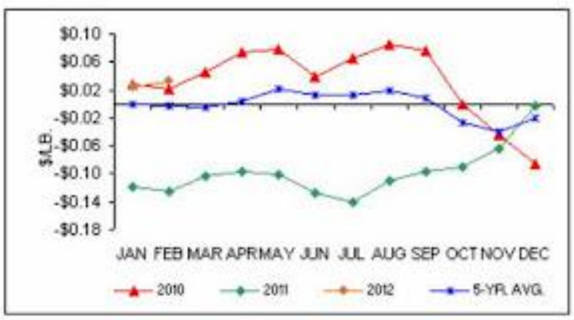
7) I've read a lot of APAs/bid procedures and the Debtors appear to have negotiated the Koch APA/bid procedures from a position of strength.

1. The Debtors have a unilateral right to extend the bid deadline;
2. Koch does not get to see other bid(s) that come in;
3. Koch had to put down a $4mm good faith deposit like other potential bidder(s);
4. Koch's bid protection is only the $1.8mm break-up fee (2.5% of the stalking horse value) and no expense reimbursement; and
5. Most telling, in the amended APA, Koch improved its bid before the auction by adding a corporate guaranty and shortening the amortization schedule from 2 years to 1 year. If Koch thought their bid was the only viable one, they would have told the Debtors and the UCC to go pound sand. Otherwise, they are essentially bidding against themselves and what rational actor would do that?

Potential Auction Overbid

The good news is that after being negative since the fall of 2010, margins on chicken are positive again due to reduced production (down 5.9% YoY in Q4 2011, expected to be down 2-3% in 2012) and tight inventories. The chart below from Stephens Inc. illustrates the chicken margin, which turned positive in January 2012 for the first time since September 2010.

Figure 1 — Stephens Chicken Margin



Source: The Wall Street Journal, USDA and Stephens Inc.

Chicken production and processing looks like an absolutely horrible industry, and the combination of high feed prices (hello ethanol) and weak pricing have lead to a number of bankruptcies in the industry. However, the industry looks ripe for consolidation as the scale players gobble up the assets of sub-scale players. I imagine all the top producers are angling for an end-game where most of the market is concentrated and price discipline can be enforced. It makes sense that Koch and C/B want to acquire Cagle's assets.

The two recent comps I could find were the JBS acquisition of a stake in Pilgrim's Pride out of bankruptcy in late 2009 and Bachoco's acquisition of O.K. Industries in fall 2011 (http://www.prnewswire.com/news-releases/industrias-bachoco-reached-an-agreement-to-acquire-ok-industries-inc-an-american-poultry-company-132772938.html). The JBS/PPC acquisition was done at a 0.43x EV/Sales multiple, while Bachoco acquired O.K. Industries for $95mm. O.K. Industries did $600mm of revenue, but since the company was private, we do not know the amount of liabilities Bachoco assumed in the deal (and Bachoco did assume all liabilities since they purchased the entire company). The Bachoco/O.K. deal was done at a 0.2x Price/Sales multiple (not EV/Sales and EV is what really matters). Sanderson Farms trades at 0.7x EV/Sales. Smithfield trades at 0.4x EV/Sales.

The current Koch stalking horse is at roughly 0.2x Price/Sales, but given the PPC, O.K. Industries, and SAFM, SFD comps, a final 0.3x Price/Sales multiple at auction appears well within reason and would result in ~$100mm final bid (40% increase over the stalking horse). In addition, Lazard pinned its 5% kicker at $85mm. Bankers tend to be both smart and greedy, so it's probably a fair bet that $85mm is a readily achievable hurdle.

Conclusion

You're betting that there will be an auction for Cagle's assets, but even if there isn't one, you probably won't lose much money. All the signs point toward an auction, and if Koch and C/B get into a room, both bidders have a strong strategic interest in Cagle's assets and the firepower to substantially improve their bids. **A $100mm final auction price combined with $8mm cash on hand results in a ~$7/share recovery to equity holders.**

Additional Qualified Bid(s) submitted on May 4.

Auction held on May 10.