Barbarians at Smithfield's Gate

The attempt of a China Firm to take over a USA World Agribusiness Leader

Abstract

Larry Pope CEO of Smithfield the biggest world hog producer, an American Agribusiness Flagship; proposed to Shuanghui the biggest Chinese pork firm, to exchange 20% of both companies' shares at par value, in spite Shuanghui was half the size of Smithfield. That might had helped to solve many Smithfield problems accessing the world's biggest market. But Shuanghui did not want to save Smithfield,, they wanted to buy the whole US firm, offering to the shareholders US$ 34 per share when the current market price was 29 in the NYSE. The proposal raised many nationalistic, political, environmental, trade, etc. concerns. If the operation was announced and not approved by the US Senate Committee, Smithfield shares might plummet.

"Larry Pope sat in his office. An accountant by training, he'd spent the past 33 years climbing through the ranks of Smithfield Foods, the nation's largest pork company and the largest employer in Smithfield, Virginia, a pastoral town of 8,200." Says Halverson.

"Pope's office overlooked a tranquil tributary of the James River, where the first settlers sailed and established Jamestown about 30 miles away. Scattered around his office were memorabilia signed by NASCAR legend Richard Petty, whom the company sponsored and whose car was emblazoned with the Smithfield logo.

Pope had moved into the role of chief executive at Smithfield Foods seven years prior, taking the reins from the grandson of the company's founder. He oversaw the company's operations, including 46,000 worldwide employees, a research lab that had genetically engineered the leanest pigs on earth and nine slaughterhouses, including the world's largest in North Carolina.

The company processed 32 million pigs a year. On average, one pig moved through a Smithfield Foods processing plant every second to be slaughtered, butchered, packaged and shipped for consumption. Bacon, ribs and other pork cuts made Smithfield a multibillion-dollar company.

Smithfield supplied restaurant chains such as McDonald's and Denny's and many grocery stores in the United States. It represented the height of America's industrialized farming,

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This case is written by XXXX XXXXX of XXX Business School as a description of a business situation as a basis for discussion and not to illustrate either effective or ineffective handling of a given situation.
Inspired in the Case "A Case Study of Shuanghui International's Strategic Acquisition of Smithfield Foods" International Food and Agribusiness Management Review, Volume 18 Issue 1, 2015 by Hongjun Tao and Chaoping Xieb, this is a totally different version of the same situation, leading to a managerial decision, it is based on business magazines, legal and public information and also information provided by Mr. Chaoping Xieb, co-author.

owning everything from hog farms in Iowa to slaughterhouses outside Chicago and warehouses and distribution trucks that crisscrossed the United States, Canada and Europe.

But Smithfield Foods was struggling. Its shares price had fallen over the past five years. The company had gone through a series of layoffs. Major shareholders were getting restless. They wanted Pope to take drastic measures.

The phone rang in Pope's office. It was Russell Colaco, an investment banker with Morgan Stanley. Pope knew Colaco, and also his reputation as a big-time dealmaker. And Colaco knew Pope's interest in buying a 20 percent stake in China's largest meat company, Shuanghui International. Pope's plan to expand Smithfield Foods – and fend off his anxious investors – included tapping into China's booming consumer market.

Pope proposed to Wan to exchange 20 percent stake in each other's companies at par value. Smithfield would gain a powerful ally in Wan, who was politically connected to China's top leaders and also a member of the National People's Congress.

"The partnership would be equal, reflecting the fact that although Smithfield Foods generated more than twice the revenues and was far more advanced in terms of global reach and pork technology than Shuanghui, growth rates in China were far higher.

China had the consumers. America had the pigs. It was a match made in free-market heaven.

Pope picked up the phone. Colaco cut straight to the deal. The Chinese were ready, he said. But it wasn't a partnership they wanted.

"What is it?" Pope asked.

"They'd like to buy all of Smithfield."

Pope was taken aback.

"Russ, that wasn't the call I was expecting."

"They are very interested in making this happen."

"Smithfield is not for sale," Pope shot back.

But then Pope equivocated. The shareholders were on his mind. Smithfield needed to boost sales. A potential fortune lay in China.

"But I do like this discussion," he finished."

"Both Pope and Colaco told … the call as cordial and succinct. They hung up, agreeing to talk again. Pope, who had thought he could maneuver his way into the booming Chinese market, suddenly faced a takeover from the very place he had sought refuge. The Chinese didn't want to save him. They wanted to buy him."

Smithfield, the target's troubles.

Halverson commented that "Smithfield Foods is located in the town from which it takes its name, Smithfield, Virginia. The production of ham there goes back centuries. Some of the earliest colonists in the United States actually learned how to cure these hams from Native Americans, and it became such a well-recognized ham product that the King of England actually had standing orders to have them shipped back to London, where they could eat them. Incredibly popular, and that remains true today."

"I spoke to a lot of people in Smithfield who are really proud of this tradition, including Tommy Darden. He cures ham in a ramshackle smokehouse down an old country round."

"In total, the company employs 46,000 people. That's spread across 400 hog farms across the United States, slaughterhouses where the meat gets butchered and packaged and sent off across the country to the fast food restaurants that most people eat at, the grocery stores where most people shop at. They essentially produce 1/3 of the pork products manufactured in the United States."

Smithfield ranked in the Top Fortune 500. Hauter commented that the "Global pork titan Smithfield has ranked second among food production companies on Fortune magazine's 2013 list of "Most Admired Companies." Before we untangle how terribly strange and ironic this is, just what does "Most Admired" mean, and how was this list generated?"

"How did Smithfield become so big? Because the Department of Justice rarely finds the courage to say no to a merger. In the '70s, the company embarked on an aggressive strategy to buy out its competition. After buying up competition locally in Virginia, it honed in on the Midwest. The real turning point came in 1987, when it embarked on a partnership with Carroll's Foods. For the first time, Smithfield was vertically integrated: They not only slaughtered the hogs; they raised them. In 1999, Smithfield bought the company outright."

Larry Popelka mentioned "Smithfield has gone through a series of layoffs and plant closures and the company struggled to earn a profit (average 2 percent profit margin since 2003). The deal would also help reduce the U.S. trade deficit, strengthen relations with China, and help improve nutrition in a developing country by making protein more affordable. What's not to like?"

"Under U.S. ownership, Smithfield has not exactly been a model citizen, either. It has been criticized for overuse of antibiotics in its pigs. In the late 1990s, Smithfield was charged with more than 22,000 violations for illegally discharging of nitrogen, chlorine, and hog waste into the Chesapeake Bay and with falsifying and destroying records. Smithfield was ultimately fined $12.6 million, at the time the largest water pollution fine ever."

Shuanghui and the China Market

"The Chinese already consumed half of the world's pork, and they were growing wealthier and hungrier for meat every year. In a single generation, China's fast-growing wealth has transformed a nation of impoverished rice and noodle eaters into the world's largest middle class, which can increasingly afford meat in its diet." According to CCTV. They "had lifted to about 600 million people out of poverty, in 15 years." as mentioned by CHINA US Focus, probably more than all the NGOS of the world altogether.

It is commonly believed that Napoleon Bonaparte once said of China, "Let her sleep, for when she wakes, she will shake the world."

"… getting Smithfield pork into China wasn't simply a matter of shipping it overseas. The Chinese government maintained strict restrictions on pork imports from the United States, including banning any meat containing a growth hormone commonly used by producers such as Smithfield. So Pope had negotiated – using a Chinese interpreter – with Shuanghui's chairman, Wan Long. Wan Long had transformed a government-owned slaughterhouse, where he was appointed manager in 1984, into China's largest meat company, eventually listing it on the Hong Kong stock exchange and becoming its largest individual shareholder. Halverson

According to Brinkley, once Wan, who sits on the National People's Congress, owns the company, he could easily choose to relocate it to China"

Gomez mentioned that "the Chinese Wikipedia page for Shuanghui identifies the company type "國有企業," which is translated into "State-owned enterprises" by Bing, Microsoft's search engine and online translator."

In 1984, the Chinese government appointed Wan Long head of a small, unprofitable slaughterhouse about 500 miles southwest of Beijing. He had grown up only a few kilometers away. It was in a region akin to Nebraska, covered in fertile soil and with an economy driven by agriculture. For Wan, who had served as a foot soldier in Mao Zedong's army, the timing was great. China had begun opening its economy to Western business practices. Ambitious and entrepreneurial, Wan innovated and expanded the business.

He released the first meat in China that carried a logo. To the Chinese, who were accustomed to viewing meat as an indistinguishable commodity produced by the government, this was something new.

Shuanghui became the first trademarked meat in communist China in 1992. The same year that Americans were introduced to Crystal Pepsi, Wan was leading a commercial revolution in China simply by introducing a brand name.

Shuanghui *was already* the China's largest meat company, and with the addition of Smithfield Foods, it has become the world's largest producer of packaged meats, pumping out millions of tons of hot dogs and sausages every year.

“Pork is considered a national security issue in China,” he said. It takes 7 pounds of grain to increase a cow’s weight by 1 pound in a feedlot or 3 1/2 pounds of grain to add 1 pound to a pig.”

“The communist government’s plan to overhaul the countryside in the 1950s resulted in an estimated 37 million people starving to death and leaving another 200 million people close to death. Today, the event remains seared into the memories of China’s leaders, who understandably place great import on food security”. Halverson

Moving toward a meat-centric diet has put an incredible strain on China’s agriculture system. Simply put, Chinese farmers can no longer keep up.

Here in America, we have petroleum reserves, but there they have pork reserves because the government considers it such a high priority. What it is, is it's a giant warehouse with 110 million pounds of frozen pork. Anyone that's ever seen the Indiana Jones movie where they wheel in the Ark of the Covenant, and it's just this never-ending warehouse just lined with stuff stacked up. It's like that, except for its frozen pork parts. They remember 1958. That was the year of the Great Famine, where eventually 37 million people would starve to death because of crop failures and government mismanagement of the agriculture system.

If 37 million people starve to death that means that 200 million more people were near death, in the same society It's just ingrained in the psychology of Beijing. They want a strategic pork reserve that they can unleash onto the market if there's ever a food shortage.

Pork is the number one consumed protein in the world. It is number three in the US, but it's the primary part of the diet in China and Asia. It's more than 60% to 70% of their protein diet is pork. As their incomes go up, they want to eat the better cuts of the animal because they've got the money to do it, but they can't produce it.

Shuanghui is the leading pork producer in China, and its strong distribution network means it can sell Smithfield products throughout the country—something Smithfield could never do on its own. This in turn would increase Smithfield production and Shuanghui’s sales and profits.

It's a really unique system they've developed. No doubt they've moved their economy from strict Communism, which was modeled after the Soviets, to something that's really in between. It's a hybrid model. Companies like Shuanghui say they make their day-to-day business decisions on a rational distribution of capital, but the Communist Party still essentially acts like a board of directors for Shuanghui.” Halverson commented to Patrick&Chan

However as Tao&Xieb suggested that, “Shuanghui’s advantage lies in hog slaughtering, pork processing and pork distribution. It is not a competitive hog producer.”

Larry Popelka commented that "Shuanghui is a publicly traded company (under the name Henan Shuanghui Investment & Development (000895:CH)) with U.S. investors. In 2006, U.S. investment bank Goldman Sachs (GS) actually controlled the company, as it led an LBO of Shuanghui with a group of other private equity investors; the Chinese government approved the acquisition. Three years later Goldman sold half its holdings and earned a 500 percent return. Today, according to proxy filings, a Goldman fund still owns 5.2 percent of Shuanghui. It's possible some of these concerned senators may unknowingly own Shuanghui stock themselves."

Bachman said "In 2011, Shuanghui apologized to consumers for purchasing pigs that had consumed clenbuterol, a feed supplement designed to make pork leaner.

Joel Backaler alleged that, "after years of economic isolation, starting in the 1980s China experienced an influx of foreign direct investment from Western companies seeking to use China as a low-cost production base and more recently preparing to sell to its emerging consumer market. In the other direction, while small-scale Chinese traders operating through diaspora networks had long been active, larger Chinese firms did not start to invest overseas in earnest until the early 1990s. Annual outward investment flows barely exceeded $2 billion per year (inward flows at the time exceeded $40 billion) until the launch of China's *zouchuqu* or "going out" policy in 2000.

The proposal and financial arrangements

Paul Davidson and Elizabeth Weise noted that "the companies put the deal's total value at about $7.1 billion, including debt. Shuanghui would "assume the debt and pay $4.7 billion to the stockholders. Smithfield shareholders will receive $34 a share under the deal, a 31% premium over Smithfield's closing stock price of $25.97 ... this would be "the largest acquisition of a U.S. company by a Chinese company".

Under the agreement, there will be no closures at Smithfield's facilities and locations, including its Smithfield, Va., headquarters in the historic southeastern Virginia town of about 8,100 where it was founded in 1936, the companies said.

Smithfield's existing management team would remain in place, and Shuanghui also would honor the collective bargaining agreements with Smithfield workers. The company had about 46,000 employees.

According to Lou Witheman "the deal will be financed through a combination of cash provided by Shuanghui and rollover of existing Smithfield debt, as well as debt financing committed by Morgan Stanley Senior Funding Inc. and a syndicate of banks."

Liz Hoffman mentioned that "Morgan Stanley … disclosed a 5.1 percent stake in

Smithfield Foods Inc., getting out in front of any claims that it was conflicted in its role as a lender and financial adviser on the pork producer's $7 billion sale to a Chinese buyer.

Morgan Stanley is advising Shuanghui International Holdings Ltd. on its acquisition of the U.S. pork producer and is providing some $3.1 billion in debt, according to public filings. Its stake in Smithfield could leave the bank vulnerable to litigation claims that it was conflicted, allegations that have drawn stern rebukes from Delaware judges in recent years."

Prudence Ho, Cynthia Koons And Isabella Steger, published that "The New York branch of Bank of China Ltd., the smallest of China's top four state-owned lenders, is providing $4 billion of financing to Shuanghui International Holdings Ltd. to cover most of the acquisition cost of buying Smithfield, said two people close to the deal.

Those loans by Bank of China, which has a long-standing relationship with Shuanghui, are secured against the Chinese pork producer's assets in China. Morgan Stanley, which is advising Shuanghui on the takeover, meanwhile is also providing funding which is secured against Smithfield's assets in the U.S., the people familiar with the deal said.

Morgan Stanley was "providing around $3 billion in loans, using Smithfield's assets as collateral. Its loan will cover Smithfield's current debt, including convertible bonds and loans held by the U.S. maker of sausages and other pork products, a person familiar with the situation said. Including debt, the deal by Shuanghui, also known as Shineway, values Smithfield at $7.1 billion.

After that, Shuanghui started reviewing due diligence materials that had been uploaded to a virtual data room."

By US laws, the transaction was conditioned to the approval from the board, the general assembly of shareholders, and also from different antimonopoly and foreign investment regulators, and the CFIUS the Committee on Foreign Investment and the Committee on Agriculture, Nutrition and Forestry of the United States Senate.

Casey and Shing reported that 'as CEO, Pope stood to earn at least $26.9 million in bonuses from the sale of America's largest pork company…George H. Richter, chief operating officer of the pork group, may get $4.5 million; Executive Vice President Dennis Treacy $2 million; Executive Vice President Dhamu Thamodaran $2.4 million; and Smithfield Europe President Dariusz Nowakowski $2.9 million and Smithfield also said there's an aggregate amount of $24 million in retention bonuses for "other officers and key employees,"

Pope explained that the deal would create jobs in the U.S., not destroy them. Shuanghui's plan to import more American pork would ramp up production at Smithfield's 460 hog farms, creating more money for farmers and more jobs at the slaughterhouses.

Joyce Koh, Jeffrey McCracken and David Welch "Under the terms of its deal, Smithfield has 30 days to continue talks with possible bidders Bangkok-based Charoen Pokphand Foods Pcl and Sao Paulo-based JBS SA, according to a person familiar with the matter who asked not to be named because the deliberations are private."

Reactions

This big agribusiness operation would recall the attention from regulators of trade, foreign investment, financial markets, health, consumer's defense and also politicians, etc.

The decision to sell the USA company that was the world's leader in the hogs market, to a Chinese company half the size of Smithfield was interesting: but this decision triggered many strategic, corporative, financial, political, legal, antimonopoly, environmental and sanitary issues. Some people spoke about national security and communism threats.

"Hog farming is one of the most polluting industries in the world, and so that will occur in Smithfield and elsewhere, the 400-plus farms that Smithfield … around the United States," she said. "But the processing of that food will go to China, and China will acquire the brand name, Smithfield." According to Usha Haley a business professor at West Virginia University. He said that the China government subsidies is "the destructive pattern China has developed to compete against other U.S. industries such as steel, paper and solar power".

"Chinese businesses use cheap labor to manufacture products for export back to the United States – offering lower prices in direct competition with established businesses in the U.S."

Sen. Debbie Stabenow, chairman of the Senate Committee on Agriculture, Nutrition and Forestry, said that "the U.S. government needs to do more to protect U.S. agriculture. Food is too vital an industry for the American people to allow it to be undercut by the Chinese government in the way that it has happened in other industries, Stabenow said when I visited her office in Washington. Food security is national security, she said. It's as much a threat for Americans if we don't control our own food supply as it is if another country gets some kind of defense secret."

She concluded that "if the situation were reversed, if Smithfield tried to buy Shuanghui, the Chinese government never would allow it."

In that committee hearings "Pope mentioned that Smithfield Foods owns 400 hog farms and has contracts with over 2000 family farms across the country. Our agreement with Shuanghui will maintain all of these contracts and arrangements. Moreover, this transaction creates a terrific opportunity through growth in exports for U.S. hog farmers to expand to meet the growing Chinese demand."

“Smithfield developed the leanest pig on the planet, and that they'll bring that back to China to develop their own pork industry, and as that grows more efficient, especially with their cheap labor, they'll be able to outmaneuver and outcompete with US pork businesses.” Halverson

Bjerga et al commented that “Shuanghui International Ltd.’s friendly deal, the largest Chinese takeover of a U.S. company, would give it control of the world’s largest pork supplier, with 460 U.S. farms and contracts with 2,100 others.

He commented that “CFIUS has blocked at least three transactions in the past four years that would have resulted in Chinese companies gaining control of U.S. assets near military facilities. Several of Smithfield’s farms and contractors are near military operations, according to Patrick Woodall, research director and advocate with Food & Water Watch, a Washington-based group pushing for cleaner resources.

The deal also has raised concerns that less-stringent attitudes toward food safety in China might taint U.S. practices, Woodall said. Smithfield’s technology would be used to improve Chinese pork production, increasing competition with Japan and South Korea, and the takeover would allow more Smithfield exports to China, raising U.S. pork prices and creating more domestic hog feedlots, he said.”

They get the meat we get the manure said Patrick Woodall, Director of Food& Water watch environmental advocacy institution. China had become the larger US importer of agricultural goods.

“American grain companies had supported the deal. In the past five years, China *had* become their biggest foreign customer.”

According to Paul Davidson and Elizabeth Weise, “Shuanghui of Hong Kong owns businesses including food, logistics and flavoring products. It's the majority shareholder of China's leading meat processor, Henan Shuanghui Investment & Development.

"The acquisition presents a material export opportunity for Smithfield and is beneficial for the U.S. hog farming industry in general," analyst Timothy Ramey of D.A. Davidson & Co. said in a research note.

“For Shuanghui, the deal would provide a pipeline to a substantial pork supply. China accounts for half the world's pork supply and consumption, says analyst Tom Graves of S&P Capital IQ. In recent years, the country has been beset by food safety concerns. A boost in exports by Smithfield could put upward pressure on U.S. pork prices,” Graves said.

Shuanghui … *had*… 13 facilities that produce more than 2.7 million tons of meat per year.

Ms. Debbie Stabenow, *Chairwoman of the* Committee on Agriculture, Nutrition and Forestry in the US Senate said they "this was not about a form buyong another firm but about buyin 25% of the USA hog production."

Mr Slane, member of the Agriculture, Nutrition and Forestry Committee said "US firms are not competing against Chinese companies, but that they are competing against China´s Government and they can't win that competition."

The audiences of the US Senate Committee analyzed if the operation threatened to national security. "Pope mentioned that this was simply the case of one company buying another." That "Shuanghui was not a state controlled company."

Jeffrey C. Smith Starboard, said in a letter to the board, "We have been a shareholder of Smithfield since March 2013, several months prior to the announcement on May 29, 2013 that Smithfield and Shuanghui International Holdings Limited ("Shuanghui") entered into a definitive merger agreement valuing Smithfield at approximately $7.4 billion, or $34.00 per share (the "Proposed Merger"). To be clear, the purpose of our letter is not necessarily to come out in opposition to the Proposed Merger. As stated above, we believe the Proposed Merger goes a long way towards unlocking the intrinsic value of the Company for shareholders. We would be remiss, however, to let an opportunity slip by to determine whether the Company could realize even greater value for shareholders. We believe our involvement will be welcomed and supported by the numerous Smithfield investors who, like us, recognize the additional value that the Company's assets have over and above the current offer. Lending further credence to our views, we note that on the day the deal with Shuanghui was announced, the market capitalization of Henan Shuanghui, China's largest meat processing company majority owned by Shuangui International, *increased* by approximately $1.2 billion.

As one of Smithfield's largest beneficial owners, our interests are aligned with those of all shareholders. While the current transaction represents a premium to the historical Smithfield trading range based on management's current standalone plan, we believe superior value may be achieved through a transaction based on the considerable value of each of the Company's divisions. We look forward to determining whether there are potential interested parties who could facilitate a sum-of-the-parts transaction structure that could deliver even greater value for shareholders than the Proposed Merger at this time. By sending this letter to the Board, Starboard is not taking any position or making any recommendation on the Proposed Merger and reserves all rights related thereto."

Ho et al mentioned that "… ContiGroup Cos., a New York-based agribusiness and financial-services company that is one of Smithfield's biggest shareholders, said management was "destroying shareholder value" and urged the pork producer to sell underperforming assets and add three new directors."

USA China Cultural Differences

According to Tao&Xieb, "Shuanghui and Smithfield operate in quite different social, cultural, economic and environmental settings. The newly combined Shuanghui-Smithfield must overcome these differences, or the combination may fail.

Social Differences.

China's market economy reforms have accelerated since 1992 when the 14th National Congress of Communist Party of China was held in Beijing. Since China is a socialist country, the government plays an important role in resource allocation.

It is important … to understand how China's government manages its economy.

U.S. and Chinese firms view intellectual property rights differently. Chinese businessmen often think nothing is wrong with imitating technologies of other firms. It is true that intellectual property rights are often infringed in China, though the situation is improving.

Consumer Culture Differences.

Consumers in China and the U.S. prefer different pork parts. Chinese consumers use virtually all pork parts, while U.S. consumers eat muscle meat only. For example, some Chinese consumers think pig intestines is more delicious than muscle meat. Many elderly and sick Chinese also think pig's feet are more nutritious than other meat types. For a worship ceremony of a Chinese family, a pig's head is a necessary sacrifice in some rural areas of China.

Business Culture Differences.

"Decision-making processes vary in firms of the U.S. and China. Managers in a Chinese firm usually make quick decisions according to their experiences and expertise, while U.S. managers need more data and analysis to make a decision. In a Chinese firm, collectivism prevails in a decision-making process, while in a U.S. firm, individualism pervades when managers make decisions"

U.S. and Chinese firms also differ in understanding business ethics. It is very important for a Chinese businessman to establish a backdoor relationship … with other business partners and governmental agencies. U.S. firms do not necessarily depend on such backdoor relationships.

Economic Differences.

China has already become the world's second largest economy due to its economic success. China's per capita income is rising, but is still low when converted into U.S. dollars. Regional income disparity is huge in China. Social inequality exists, and the Gini index was reported to be higher than 0.4. Market structures also differ in the two countries. Chinese agricultural farms are smaller than those of the United States. Average rural farm size in China is 0.6 hectares (1.5 acres), and 30.6 hectares (76 acres) in the United States (Zhang, 2006).

Environmental Stress Differences. During economic growth, China sacrificed its environment. When President Hu Jintao held power, he pursued a harmonious relationship between economic growth and environment protection in his statement of Scientific Development Concept … Obviously, President Hu Jintao failed in this pursuance. Smog has become a severe threat to people's health in China's large cities.”

Noise in the Financial Market

According to the Security Exchange Commission records on those days BADIN RUNGRUANGNAV ARAT, was trading out of the money options, and futures on Smithfield Socks and also Smithfield shares based on insider information.

The SEC records say that “This is an insider trading case involving highly profitable and highly suspicious trading in the securities of Smithfield Foods, Inc. ("Smithfield"). The Defendant purchased thousands of Smithfield "out-of-the-money" call options and single-stock futures, as well as Smithfield stock, shortly before the public announcement that Shuanghui International Holdings Ltd. ("Shuanghui") had agreed to acquire Smithfield. The Defendant's well-timed trades yielded unrealized gains of more than $3.2 million. He reaped a return on investment of more than 3,400% in a span of eight days.

Equity call options, such as those traded at the CBOE, give the buyer the right, but not the obligation, to purchase a company's stock at a set price (the "strike price") for a certain period of time (through "expiration"). In general, a trader buys a call option, or call, when the stock price is set to rise, or sells a call when the stock price is expected to fall. For example, one "July 2013 30" call on Smithfield stock would give the purchaser the right to buy l00 shares of Smithfield stock for $30 per share before the call expired on July 20, 20 13. If Smithfield stock went above $30 before the call expired, the call owner could either exercise the call and acquire the stock at $30 per share, or sell the call, which would have increased in value. If Smithfield's stock price failed to reach the $30 strike price before the call expired and the holder had not sold the option, the call would expire as worthless.

If, at the time of purchase, the call strike price was above the price at which the stock was then trading, the call would be "out-of-the-money" because it would be unprofitable to exercise the call and pay more for the stock than if it were purchased on a stock market. Conversely, if at the time of purchase the strike price was below the then-current trading price, the call would be "in the money!' For a given expiration month, out-of-the-money

options are cheaper to buy than those that are in-the-money, which affords the buyer increased leverage to compensate for the increase in risk.

Single-stock futures contracts, such .as those traded at OneChicago, are a type of futures contract where the buyer agrees to buy a specified number of shares of a company's stock for a set price on a specified future date. Single-stock futures typically entitle the purchaser to buy 100 shares of stock. For example, by purchasing one July Smithfield single-stock futures contract at $25, the buyer would be obligated to purchase 100 shares of Smithfield common stock on July 19 for $25.

With the exception of commissions, a single-stock futures purchaser typically does not pay any money upfront at the time of purchase. Rather, single-stock futures are traded on margin, thus offering the buyer increased leverage at the expense of taking on greater risk. On the days Rungruangnavarat purchased Smithfield single-stock futures, he was required to post an initial margin payment equal to 20% of the value of the underlying shares of Smithfield stock.

Pope's Dilema

If the boards of both companies … approved the merger, this still had to be approved by Smithfield shareholders and U.S. regulators, including the U.S. Committee on Foreign Investment. The committee, which is made up of representatives from nine government agencies such as Treasury and the Justice Department, reviews foreign investments in U.S. companies for national security concerns.

Pope had to decide to stimulate or not stimulate the merger within Smithfield. The main risk was that if the operation was not approved, given all the different kinds of nationalistic, political and other issues, the Smithfield shares would decrease further. Pope was aware that when Smithfield tried to buy Campofrio in Europe, the target's shares prices increased by 13% after the announcement. However the operation was not approved by the government, and those shares fell down by 17%. Cincodias

Given the current feelings of the shareholders about Smithfield performance in the capitals market a further decrease in the price of the stocks would be devastating.

Exhibit N 1 Comparative Balances

Balance Millions US$							
Shuanghui			Smithfield				
Year	**2012**	**2011**	**Year**	**2012**	**2012**	**2010**	**2009**
Monetary Capital	646	446	Cash & Equivalents	311	324	375	451
Notes Receivable	6	5	Accounts Receivable - Trade, Net	663	625	710	622
Interest Receivable	0	0	Receivables - Other				
Net Accounts Receivable	44	43	Total Receivables, Net	743	625	710	622
Net Other Receivables	8	7					
Prepayment	10	17	Prepaid Expenses	130	278	234	388
Net Inventories	328	389	Total Inventory	2,348	2,072	2,020	1,860
Other Current Assets	115	125	Other Current Assets	20			
Total Current Assets	1,149	1,029	Total Current Assets	3,552	3,299	3,338	3,320
			Property/Plant/Equipment	4,470	4,270	4,187	4,039
			Accumulated Depreciation	-2,172	-1,993	-1,878	-1,680
Net Fixed Assets	1,246	1,226	Net Fixed Assets	2,298	2,277	2,309	2,359
			Goodwill, Net	782	768	793	823
Intangible Assets	136	126	Intangibles, Net	390	382	387	390
Project Materials	2	8					
Construction in Process	60	63					
Long-term Deferred Cost	10	10	Other Long Term Assets, Total	161	173	202	192
Deferred Income Tax Asset	12	11					
Net Long-term Equity Investment	27	26	Long Term Investments	532	523	583	625
Intangibles and Other Asstes	247			1,084	1,078	1,172	1,207
Total Assets	**2,646**	**2,506**	**Total Assets**	**7,716**	**7,422**	**7,612**	**7,709**
Accounts Payable	254	288	Accounts Payable	429	416	434	384
Advance Collections	97	106	Accrued Expenses	282	275	304	263
Short-term Borrowing	32	25	Notes Payable/Short Term Debt	0	0	0	17
Salaries Payable	89	79					
Dividend Payable	0	1	Current Port. of LT Debt/Capital Leases	676	64	144	73
Other Payables	101	104	Other Current liabilities, Total	359	382	346	456
Tax Payable	43	69					
Other Current Liabilities	1	4					
Total Current Liabilities	616	671	Total Current Liabilities	1,746	1,136	1,228	1,192
Long-term Borrowing	28	23	Long Term Debt	1,829	1,901	1,979	2,918
Increase of Deferred Income Tax Liab	1	1	Deferred Income Tax	206			
			Minority Interest	13	3	3	5
			Other Liabilities, Total	825	995	857	838
Total Liabilities	656	702	Total Liabilities	4,619	4,035	4,066	4,953
Minority Interest in Equity	130	119	Common Stock, Total	70	79	83	83
Paid-up Share Capital	174	173	Additional Paid-In Capital	1,390	1,561	1,639	1,627
Capital Reserve	512	501	Other Equity, Total	-685	-579	-236	-493
Earned Surplus Reserve	109	219					
Undistributed Profit	1,065	791	Retained Earnings	2,323	2,326	2,060	1,539
Total Shareholders' Equity	1,990	1,803	Total Equity	3,097	3,387	3,546	2,756
Liabilities & Shareholders' Equity	**2,646**	**2,506**	**Total Liabilities & Shareholders' Equity**	**7,716**	**7,422**	**7,612**	**7,709**
			Total Common Shares Outstanding	139	157	166	166
			Share Accounting Value	22	22	21	17

Exhibit N 2

Comparative Income Statements

In Millions of USD (except for per share items)	Shianghui			Smithfield			
Year	**2012**	**2011**		**2012**	**2011**	**2010**	**2009**
Total Revenue	6,293	4,580		13,221	13,094	12,203	11,203
Cost of Revenue, Total	5,194	3,773		11,901	11,542	10,461	10,463
Gross Profit	1,099	807		1,319	1,553	1,742	739
Selling/General/Admin. Expenses, Total	209	133		819	816	790	701
Extraordinary Income	44	17		121	16	0	25
Operating Income				399	710	1,003	52
Income Before Tax	620	447		230	534	757	-215
Net Income	486	353		184	361	521	-101
Diluted Weighted Average Shares	n.a	n.a		146	164	167	157
Depreciation	n.a	n.a		240	243	232	242
Cash Flow				424	604	753	141

Exhibit N 3

Starboard Valuation of Smithfield

Smithfield Valuation- Sum of the Parts	Mill US$	
	Low	High
Value of Hog Production	1,892	2,318
Value of International	1,296	1,520
Value of Pork	6,201	7,911
Less Taxes	425	935
Total Smithfield Value	**8,964**	**10,815**
Plus: Cash & Equivalents	139	139
Less: Gross Debt	1,947	1,947
Less: Minority Interests	13	13
Equity Value	**7,143**	**8,993**
Fully diluted Shares (millions)	163	163
Value per Fully Diluted Shares	43.85	55.21

Exhibit N 3 **Selected Financial Indicators of Smithfield Foods (Million US Dollars)**

Year	Sales	Gross Profit	Net Income	Total Asset
2000	4511.0	529.3	75.1	3129.6
2001	5123.7	762.3	223.5	3250.9
2002	6604.9	885.9	196.9	3872.7
2003	7135.4	602.2	26.3	4210.6
2004	6807.7	787.9	227.1	4818.1
2005	8983.6	1173.9	296.2	5773.6
2006	8828.1	1040.1	172.7	6177.3
2007	9359.3	1060.5	166.8	6968.6
2008	11351.2	1148.4	128.9	8867.9
2009	12487.7	624.6	(198.4)	7200.2
2010	11202.6	730.1	(101.4)	7708.9
2011	12202.7	1714.1	521.0	7611.8
2012	13094.3	1549.4	361.3	7422.2

Source. Xieb

Exhibit N 4 Selected Financial Indicators of Shuanghui International (Million US Dollars)

Year	Sales	Gross Profit	Net Income	Total Asset
2000	375.3	54.9	18.2	187.1
2001	406.9	61.8	20.6	195.4
2002	575.0	89.9	24.2	316.7
2003	867.4	115.1	31.9	375.2
2004	1215.0	124.0	36.1	395.1
2005	1626.3	178.3	44.8	423.0
2006	1930.8	230.1	69.8	461.4
2007	2871.5	253.6	86.7	529.0
2008	3729.3	340.4	101.9	649.5
2009	4041.6	397.1	133.3	842.0
2010	5197.6	493.8	170.8	988.7
2011	5662.7	413.2	206.3	1211.9
2012	6240.5	1083.6	456.9	2643.9

NOTE: Original data are measured in Chinese RMB, and they are revaluated using July 1 exchange rate of every year.

Source Xieb

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US Senate. SMITHFIELD AND BEYOND: EXAMINING FOREIGN PURCHASES OF AMERICAN FOOD COMPANIES. HEARING BEFORE THE COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY. UNITED STATES SENATE. ONE HUNDRED THIRTEENTH CONGRESS. FIRST SESSION. JULY 10, 2013. Printed for the use of the Committee on Agriculture, Nutrition and Forestry.

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Xieb. Personal Communication

Teaching Note Fist Draft

Issues

Important firms described in the case several subjects that can be analyzed, most of those subjects are interrelated.

Strategic Issues

Agribusiness Value Chain
Sources of Value
Value creation, sharing and appropriation.

Financial Issues

Firm Valuation
Leveraged Buyouts
Principal agent theory
Insider trading and SEC

Other

Food security
Private vs National Interests
Externalities

Opening question

Should Pope promote the sale of the biggest US Pork firm producing 25% of the USA supply to a Chinese company?

Discussion paths

How can the Chinese pay a price 20% above the stock exchange price of the firm? What are the value sources they can take advantage?
Why can't Smithfield create the same level of value?
What if the Security Exchange Commission for the Foreign Investment ban the transaction?
Why not sell a sum of parts of the company to capture all the value as suggested by Starboard, an important new shareholder?

Transition

What interest should Pope care about? His own interest, or shareholders' interests?
What will happen to the workers and integrated farmers is the Chinese take the company over?
Comment on this affirmation "They get the meat we get the manure"
The financial statements show that Shuanghui revenues are half the size of the Smithfield's.

The sources of Value Creation

Current situation under Smithfield management

The current market value and the rice of Smithfield stocks is the expected value of the cash flows generated by Smithfield as perceived by the capital markets, discounted at the local cost of capital.

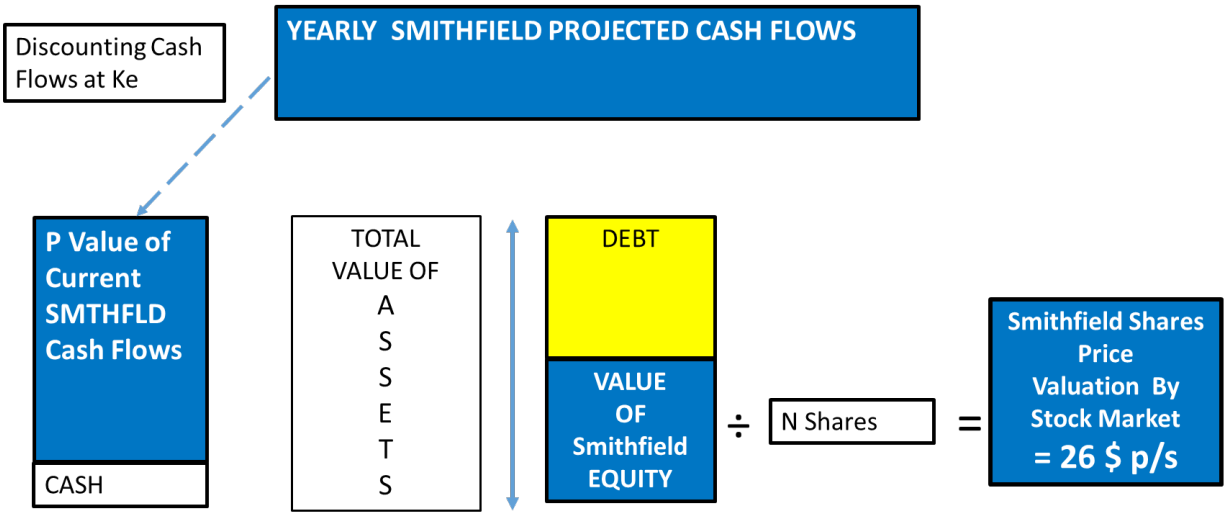

Exhibit TN 1. The current market price of Smithfield Shares.

Value created, value shared and vale appropriated by Shuanghui

Shuanghui adds value from a reliable source of hogs in quantity, quality and costs, because
1) They have the market channels in China,
2) This market consumes the whole hog not only the muscles, and
3), Shuanghui will generate the real option of conquering the huge Asian hogs market.

Those are the sources of value that only Shuanghui can create in China Market. That is the reason why Smithfield wanted to exchange stocks at par value with Smithfield, to capture of part of the value laying in China market.

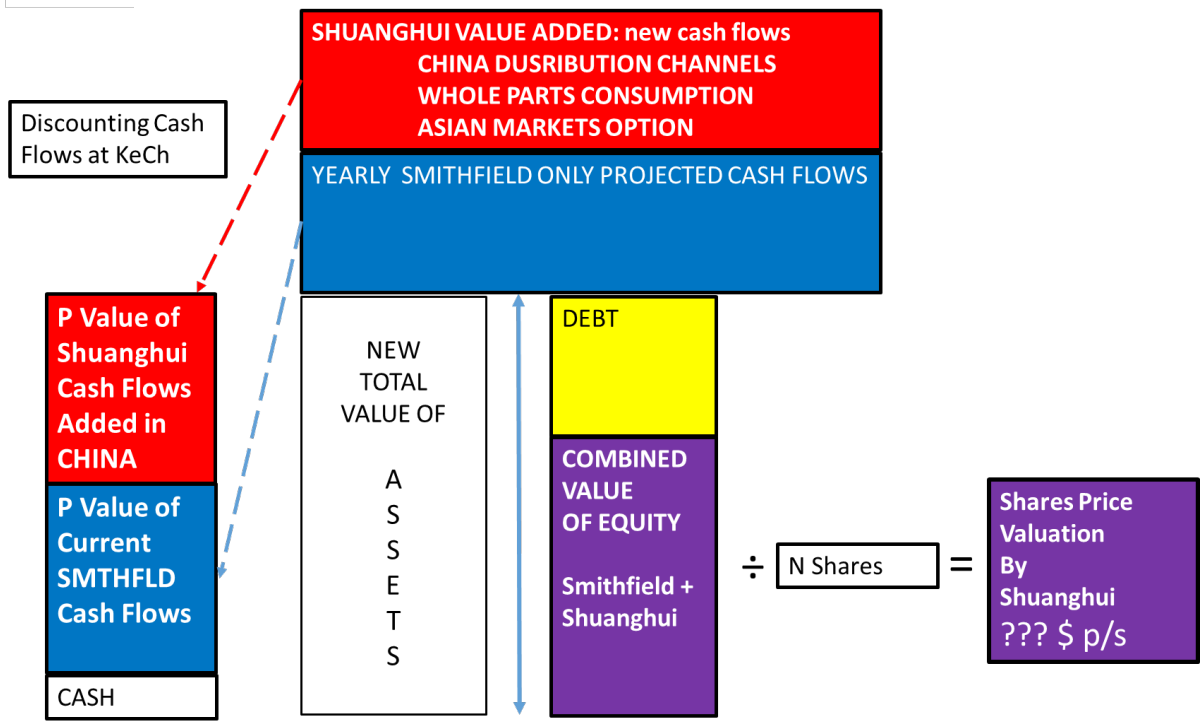

Exhibit TN2 Value Created by Shuanghui in addition to Smithfield creation

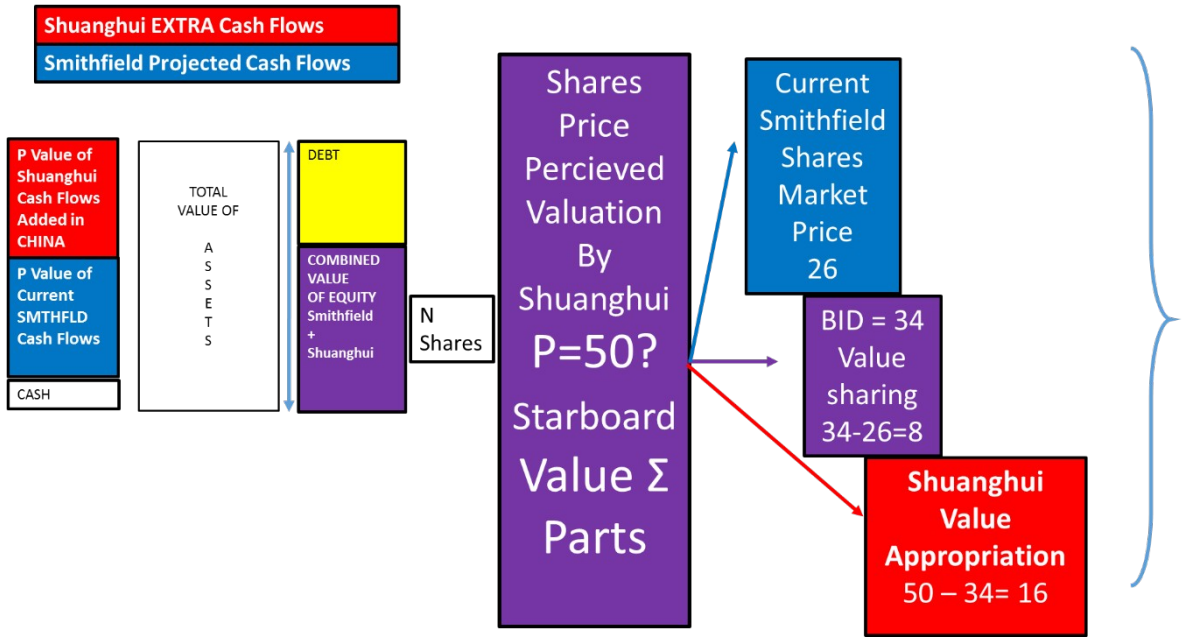

Exhibit TN3 Value Shared and appropriated by Shuanghui if value is 50

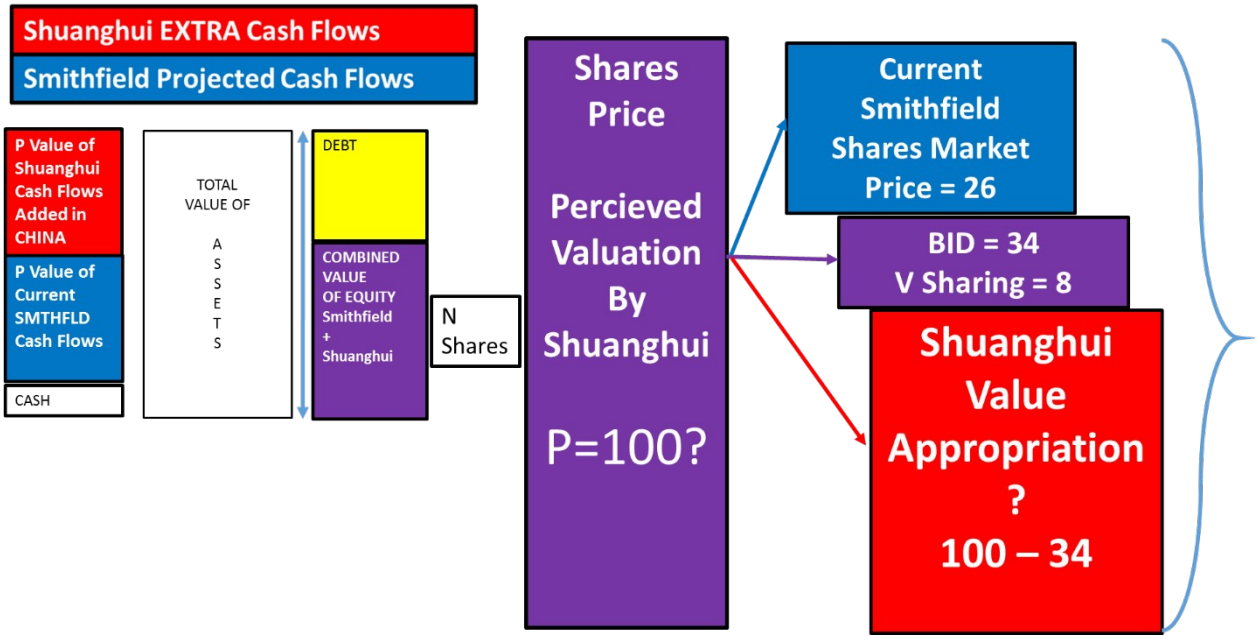

Exhibit TN4 Value Shared and appropriated by Shuanghui if value is 100

Blackboard N 1
Issues

	Inputs	Production	Processing	Market	Finance
Smithfield	Cheap corn soy Genetics Median farmers	400 own farms 2000 integrated Growth Hormone Leanest Pork Negative Exrernalities Fines	9 plants world's biggest Safety Flagship USA	USA muscle USA MX JP Europe China barriers 13 billion	Recent Losses Layoffs Low price Fortune 500 Starboard Low profit
Shuanghui	Expensive Corn	small fragments	Biggest China	Decommoditized Hog Huge Market Whole animal Protectionism Distribution Network	Leverage 7 Bill Profits twice SMF

Blackboard 2
Characters and Interests

Pope	**Wan**	**ShareholdersSMF**	**Government**	**Society**
Accountant	Mao Soldier	Worried low price	Rules	Population growth
Current CEO	Shareholder	Disperse	Competition	Hunger wars
Benefits	Political Relations	Funds	FDI	P Power
	Transforms the Firm	Senators own Sghui?	Research	China 660 out of pvty
			Jobs	1 country 2 systems
				Napoleon

Comments on Noise in the Financial Markets

The Investor accused by the SEC had private information from the electronic data room because he had contact with Choren a possible buyer. Knowing the value of the form and the possible increase in the price of the stocks, gave him superior information. That is why he bought, out of the money, securities, stocks, options and futures on Smithfield shares, knowing that the stock would rise, after the closing of the deal. If the deal did not work he still had de option but not the obligation to buy the shares.

Comment to Agency Theory

Financial theory would suggest that Popes is the agent of his principals the shareholders, a "perfect agent" should sell the stocks to favor the shareholders, because he can't create more value; besides Chinese buyers offer 20 million to Pope, to motivate him to behave as a good agent.

The Chinese wanted food, actually proteins, and the best world hog producer was Smithfield, buying the firm they would ensure the best supply. But this firm is not made by hogs, but by people, they also incentivized executives to stay and guaranteed to workers and integrated suppliers that they would respect all the previous agreements.

Comment on Trump China Trade War

Tariffs will reduce net revenues from exporting Hogs from USA to China; that will hurt Shuanghui and also will hurt Chinese consumers who will have to pay higher prices for the hog.