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PROFIT MARGIN AND SOUTHERN TASTES

GOLDEN FLAKE CEO CHIPS AWAY AT COMPETITION WITH NICHE FLAVORS

Golden Flake snacks Chief Executive Mark McCutcheon has a strategy to deal with his main competition, Frito-Lay Inc., which has an \$8.4 billion edge in annual revenue: experienced box packers and dill pickles. The Birmingham-based maker of potato chips and other salted snacks survives in the shadow of Frito-Lay by zigging when the larger rival zags. That includes keeping seasoned employees, some of whom are older than 70 years, on the packing line as long as they want to work, McCutcheon said. It also means keeping the competition off balance with a roster of niche flavors, such as the popular dill pickle chips, which appeal to a customer base too small to interest bigger snack makers.

McCutcheon, a 47-year-old Birmingham native who was named CEO of Golden Enterprises Inc. in 2001, will need a grab bag of tactics as he enters his fourth year on the job. He faces falling sales and higher energy and commodity costs amid increased competition from Frito-Lay, the unit of soft-drink maker Pepsico Inc.

He needs to turn sales and profit around at Golden so he can keep paying dividends to which shareholders such as the founding Bashinsky family, which owns 52 percent of the stock, have become accustomed. The family's dividend income for its 6.2 million shares goes up or down by \$62,000 every time the dividend changes by a penny.

"Running a company as big as Frito is a tough proposition, no question," said Paul Lapidès, a corporate governance professor at Kennesaw State University in Georgia. "But it's also pretty tough to have just one large shareholder who is depending on your results."

Dividends have fallen by half in the past year, to 3 cents each quarter from 6 cents per quarter, as revenue has dropped. Sales at Golden have fallen from \$126 million in 2000, steadily down to \$96 million last year. Lagging sales caught up with the company this year, when it had a loss of \$1.4 million, from a \$3 million profit a year earlier. Golden's fiscal year ends in May.

Golden Enterprises, the publicly traded company that owns the Golden Flake business, has about 1,500 shareholders, some of whom own only a few dozen shares. An employee stock plan, which pays dividends to retirees who depend on the money, holds another 8 percent. With so many shares concentrated in so few hands, average trading volume is about 4,000 shares a day. No Wall Street stock analysts follow the company.

"There's no question about it, we are a dividend-driven stock," said McCutcheon, who was born in Wylam and whose father owned a pharmacy in the town west of Birmingham.

His main competition is FritoLay, which is the dominant snack maker nationally and in the nine-state area in which Golden sells snacks. As competition goes, it doesn't get much tougher. Frito had \$8.5 billion in sales in 2003, or about \$8.4 billion more than Golden. The bigger rival has spent between \$1.4 billion and \$1.1 billion on capital expenditures each year since 1998. McCutcheon has never had more than \$5 million a year to spend on his two plants, one of which employs 300 people in Birmingham's Titusville neighborhood. The other is in Ocala, Fla.

The size difference means Frito has the money to capture the most valuable things in supermarkets and convenience stores: eyeballs. The Pepsi unit spends tens of millions a year paying grocers for premium shelf space, such as the flashy displays at the ends of aisles. Golden can't outbid for the space, and won't try, McCutcheon said. "Flavor is where we compete," he said. "We have to constantly reinvent products to keep demand up."

Pork skins are an example. The low-carbohydrate snack has taken off because it's been discovered by dieters following high-protein eating plans. Golden has responded by recently upgrading its offering to combine several similar flavors on one pork skin. Frito has noticed the trend and rolled out a competing product, which Golden says it's outselling at stores that offer both. "Head-to-head, we are winning," McCutcheon said. "They used to be a blue-collar thing, but have really taken off."

The company's big seller now is the "Sweet Heat" potato chip, McCutcheon said. The chips have a barbecue tang at first bite, followed by a sweeter flavor the longer the chip is chewed. "Our advantage is that we can appeal to Southern tastes, and we just beat their brains out with that," said McCutcheon, who started at Golden in 1980. "If the national competition comes out with a hot chip, it won't be hot enough for Louisiana and will scorch folks in Nebraska." In most cases, Frito chooses not to bother with niche flavors, although it has tried a dill pickle flavored potato chip in some Southern markets. "Golden has a great strategy for a regional company," said Debbie Wang, a snack industry analyst for financial advisers Morningstar Inc. "Frito is all about size and scale and wants to go after the biggest part of the market."

McCutcheon has cut costs at Golden Flake with the money he is given to spend on upgrades. The company has spent about \$5 million on new equipment during his tenure. About \$2 million went for potato chips packaging equipment that runs twice as fast as before and uses two machines to do work previously done by eight. The company also spent about \$3 million on new machinery that applies seasoning to the chips. The more modern machine wastes less seasoning, which accounts for 5 to 10 percent of manufacturing costs, and is projected to save about \$200,000 a year.

Working for people he knows - the Bashinsky family and the company's retirees - beats running a larger company with thousands of pensions and mutual funds breathing down his neck, McCutcheon said. "I got the best job in the world," he said. "Most manufacturing CEOs in Birmingham have to work at an industrial plant. I get to work where we make fun."

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Instructions: Ignoring the fact that this article is very old, describe the corporate governance mechanism that is presented in this article. Do you believe that it is effective? Why or why not?