

## A Time of Challenge

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*February 1, 2009*



President Obama is faced with a number of domestic and global challenges that require his immediate attention. At the top of the list is the global recession and the impact it is having on the U.S. economy and our country's financial system. The depth and breadth of economic problems have not been experienced in the United States for many years. The problems are complex and the solutions will not come easily or quickly. As our new administration works through the potential solutions to the underlying causes of the current crisis, we undoubtedly think about how and when this global problem affects our industry and its individual companies and people.

U.S. agriculture has enjoyed great success over the past couple of years due mainly to the convergence of the rapid development of third world economies and the explosive demand for ethanol brought about by political decisions aimed at environmental and energy policy. In recent years, the economies of China and India have been expanding at record rates. This expansion carries with it a substantial increase in the demand for animal protein. A portion of this demand has been satisfied through importation of grains produced by American farmers. During this same period, world demand for oil skyrocketed and the price of a barrel followed suit. With the price of oil at all-time highs, the economics of ethanol made much more sense. U.S. government policy man-

dated the use of more ethanol as part of its energy and environmental policy. The convergence of these events created the perfect storm – commodity prices for the major grain crops exploded, planted acreage of those crops expanded, and farm income rose. The prevailing attitude at the time was that acreage would continue to expand and that commodity prices would remain high. Farmers, flush with cash, invested in land, new equipment, high-performing seed, and cutting edge technology. Farmers' production costs increased substantially, but the increase was more than offset by the high commodity prices and record farm-gate sales.

The recession, which economists determined to have officially started just over one year ago, reaches well beyond the boundaries of the U.S. This recession is having a profound impact around the globe, including China and India; two of the largest populations in the world and two of the fastest growing economies in recent years. Economic activity in those two developing nations has now slowed considerably. This is bound to impact the demand for products that provide better diets for the people in those developing countries. Current literature supports the premise that this is already happening.

The U.S. ethanol industry is suffering. With the collapse of oil prices, corn ethanol producers are now struggling to turn a profit and support their cash flow requirements. As a result, ethanol plants are closing, slowing production, or undergoing significant financial restructuring. The number of bankruptcies among ethanol producers is alarming. It is interesting to note, however, that many of these bank-

ruptcies are Chapter 11 reorganizations solely for the purpose of rejecting high-priced grain contracts and replacing them with current market supplies. It is too soon to predict what the new administration in Washington will do in terms of energy policy, but research investments in new ethanol technologies utilizing non-food feedstocks such as cellulosic biomass will almost certainly be a focal point. These trends will likely impact future levels of ethanol production. In the shorter term, the hardships of the ethanol industry will almost certainly result in the decline of the demand for corn as a raw ingredient for alternative fuel production.

Last year was a profitable year, in general, for U.S. agriculture. There may be some residual benefits carrying over to the current production year although many farmers are faced with a high cost structure at a time when commodity prices have shrunk to levels that are below breakeven.

At this time last year, many in the U.S. seed industry were talking about a significant rebound in corn acres in 2009. Some expected 90 million planted acres and a few were even targeting 95 million planted acres. That now seems improbable. With the reduced demand to support corn ethanol production and with export targets being lowered, it is unlikely that planted acres will be much different than 2008. Most analysts are now predicting 84 to 87 million acres subject to weather conditions. This means that the demand for planting seed in 2009 will probably be reduced considering the level of carryover inventory throughout the industry. Winter seed production during the 2008-2009 growing year has been curtailed and many companies are expected to reduce planting plans for this summer. This

obviously does not bode well for the U.S. seed sector and especially for the smaller independent companies who have less financial staying power. As a result, Verdant expects to see a continuation, and perhaps even an acceleration, of the current consolidation movement which began in 2004.

The availability of credit is at the root of our country's financial crisis. So far, the dearth of credit has not been a significant limiting factor for most companies in the U.S. seed sector. It appears that smaller local banks and regional banks with an ag lending history have not curtailed their lending to the same extent that gets reported in the public press on a daily basis. This may be good news for the seed industry and, hopefully, will continue while the broader crisis is being attended to by the federal government. It is difficult, however, to accept that these banks can remain immune indefinitely since they are closely linked to the money center banks. Industry participants would be wise to make management of their cash flow a top priority. The timely collection of receivables and the maintenance of loan covenants is an absolute necessity. Companies simply cannot give their bank an excuse to terminate their credit agreement or fail to renew it when it comes due.

The large, multinational agricultural companies are somewhat diversified from a geographical, crop, and product standpoint, thus giving them somewhat more insulation from the recession compared to the smaller independent companies who are focused on just one product line, such as seed and on one primary geography. This is not to say that the multinationals are immune from the impact of the recession. They are not.

They are simply more diversified and have more financial resources from which to withstand the impact. Some of these companies see this period as an opportunity to strengthen their germplasm base, distribution system, and market share.

The country and the world is in the midst of a financial challenge unlike anything that has been experienced since the Great Depression. That era is something that we have studied as part of American history and, no doubt, heard personal accounts of surviving the depression from parents or grandparents. The so-called Great Recession has not reached the depths of the 1929 disaster and, hopefully, it will not. In President Obama's inaugural address, he said that things will get worse before they get better. We are quite certain that he is right. The question is how this will all play out in the domestic and international agricultural environment and how it will impact the companies and the people

operating in this sector. While we must do everything possible to prudently manage our way through this current crisis, the troubling aspect is that none of us know what is really going to happen and how deep and how prolonged the recession is likely to be. At this point, it is simply an educated guess. This is a time of significant challenge; we can only do our part and do it the very best that we can.

*Verdant Partners LLC is a leading investment banking and consulting firm specializing in the global crop genetics sector. With over 300 years of combined experience in all crops and in all phases of the international crop genetics industry, as well as in other sectors of agribusiness, Verdant's investment banking and consulting skills are sharply focused and experience-based. Each of Verdant's principals has senior management experience in leading agribusiness companies. Together, Verdant has initiated and managed transactions and alliances valued in excess of U.S. \$1.5 billion. ■*