

VALUE FOCUS

Agribusiness Industry



SEGMENT FOCUS

Agriculture Chemicals

Segment Focus

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Agribusiness Industry

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Special Supplement

**Fairness Opinions: Evaluating a Buyer's
Shares from the Seller's Perspective**

2014

Q1: Agriculture Machinery,
Equipment, & Implements
Q2: Crops and Crop Services
Q3: Agriculture Real Estate
Q4: Agriculture Chemicals

Segment Focus

Agriculture Chemicals

2014 Fourth Quarter

Agricultural Chemicals Overview

Agricultural chemical producers and manufacturers experienced strong revenue growth in 2013 and 2014 due to record-high agricultural production and crop yields.¹ The sharp decline in energy prices over the second half of 2014 boosted profitability in the sector as well, creating a favorable environment for industry participants.

Despite positive signals, the sector faces a number of potential headwinds exiting 2014. Deflated agricultural commodity prices, due to a glut of supply, along with a strengthening U.S. dollar, may decrease demand for industry products both domestically and abroad. New technological advances, including genetically modified seeds, may also reduce the need for agricultural chemicals. The sector faces a number of factors affecting industry viability, creating a high level of uncertainty going forward.

Fertilizer

The fertilizer manufacturing industry produces fertilizer products, primarily consisting of phosphorous-based and nitrogen-based fertilizers. Nearly 80% of industry products are used for various agricultural products, making the industry highly correlated with the general farming economy.

Despite fears that depressed commodity prices would lead farmers to lower their acreage planted and reduce fertilizer use, fertilizer demand remained strong through 2014. The Mosaic Company, the largest U.S. producer of phosphate fertilizer, saw expected 2014 fourth quarter profits exceed expectations, buoyed by strong demand for crop nutrients through 2014 year-end.²

“Demand for potash and phosphates exceeded our expectations during the fourth quarter... Customers came to the market in force, as they sought to position inventory in anticipation of a strong spring season and increasing crop nutrient prices.”

— Mosaic Chief Executive Officer Jim Prokopanko³

The near \$29 billion industry is dominated by a handful of large multinational corporations. Four fertilizer manufacturing companies comprise over 70% of overall market share due to factors such as access to natural resources and key inputs, along with intense price competition. Revenue growth is expected to grow 0.5% annually through 2017. Reduced demand from crop

Fertilizer (cont.)

production and lower farm incomes, along with technological breakthroughs reducing the need for industry products, account for lower growth expectations for the industry.

A large quantity of U.S. fertilizer consumption is supplied by imports. The USDA reports that in 2011 (most recent data available) more than 85% of the potash supply used in U.S. was imported.⁴ In the future, the U.S., with its limited domestic nitrogen and potash production capacity, will consume an even larger portion of these fertilizers from foreign imports. U.S. phosphate production, however, is overwhelmingly domestic. U.S. manufacturers produce more than 90% of U.S. consumed phosphate, and over 60% of phosphate produced in the U.S. is exported.⁵

Natural gas is the main raw material used to produce nitrogen fertilizer (38.8%), the second most popular type of fertilizer behind phosphate based fertilizer (42.9%). Recent energy price trends have benefitted the industry, lowering manufacturing costs. Natural gas prices have fallen to \$3.38 per million Btu in December 2014, an over 40% decline from their 2014 highs of \$6.00 per million Btu.⁶

A strengthening U.S. dollar over the second half of 2014 dampened export totals for both fertilizer and pesticides. The Wall Street Journal Dollar index, which measures the U.S. dollar against a number of currencies, rose more than 12% in 2014. Future dollar appreciation may hurt U.S. exports going forward, negatively affecting the profitability of both fertilizer and pesticide manufacturers.⁷

Figure 1: Fertilizer Manufacturing Industry Revenue

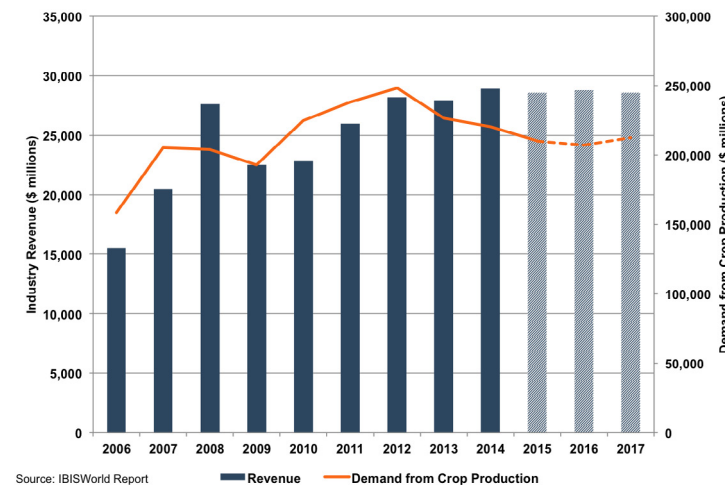
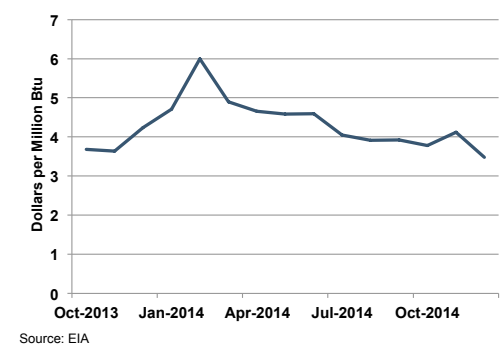


Figure 2: Henry Hub Natural Gas Spot Price



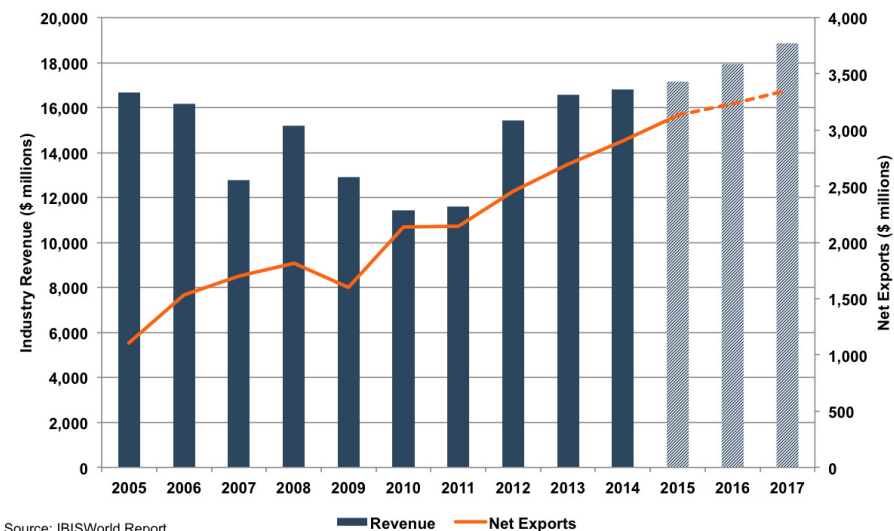
Pesticide

Pesticide manufacturers cover a wide variety of products for household and agricultural pest control. Herbicides (60%), insecticides (20%), and fungicides (10%) make up the majority of industry products. Crop industries in the U.S. accounted for nearly 44% of pesticide manufacturing revenue in 2014, followed by exports (25%) and livestock uses (11%). In 2012, over 60% of all herbicide treatments were applied to corn and soybean crops, while citrus and cotton crops received more than 50% of all insecticide treatments.^{8,9}

Industry revenue was volatile in the five years to 2014, as reduced farm incomes following the recession led to lower industry revenue. As producers emerged from the recession, elevated output and record crop yields benefitted the industry, and revenue grew to \$17 billion in 2014, an annualized rate of 5.4% since 2009.¹⁰

The U.S. pesticide manufacturing industry is a net exporter of industry products, and the importance of exports is expected to increase moving forward. Exports accounted for \$4.2 billion in industry revenue in 2014, 25% of overall revenue, with Canada (28%), Brazil (26%) and Mexico (7%) constituting the industry's major trading targets. Export totals have increased over 11% from 2009 to 2014, due to Brazil's economic growth and a weak U.S. dollar leading many to import industry products from the U.S., a trend that will be negatively impacted as the U.S. dollar continues to strengthen against most world currencies. Ratification of the Trans-Atlantic Trade and Investment Partnership (TTIP), which would ease trade restrictions of pesticides and other goods between the U.S. and European Union (EU), would serve to boost industry product demand.¹¹

Figure 3: Pesticide Manufacturing Industry Revenue

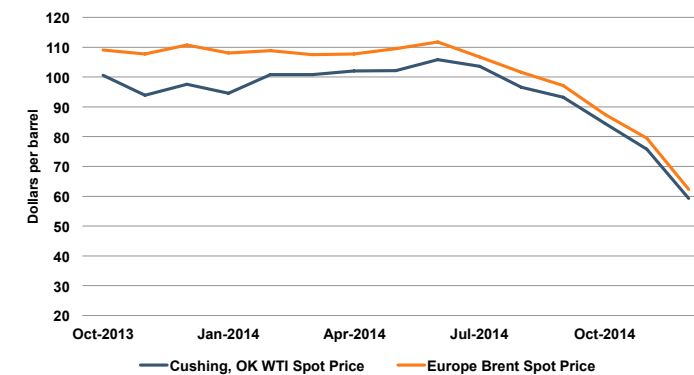


Pesticide (cont.)

Oil is a major input for pesticide manufacturers and operators in the pesticide manufacturing industry have benefitted from the sharp drop in oil prices during the second half of 2014. Brent crude, the global oil benchmark, was down nearly 50% in 2014 and fell below \$60 a barrel in December for the first time since May 2009. Depressed oil prices are expected to remain through the early part of 2015, presenting an opportunity for industry operators.^{12, 13}

The increasing implementation of genetically modified crops has hurt industry product demand, as new seeds are created with a resistance to many agricultural diseases and pests. In addition, the growing trend of organic farming avoids from the use of synthetic chemical pesticides, opting instead to use production practices and natural means to reduce pests.

Figure 4: Crude Oil Prices



Agricultural Chemicals Recent M&A Activity

There were 61 transactions announced or closed in 2014 in the agricultural chemicals sector. According to data from Capital IQ, total deal volume for the industry (represented by SIC Code 2870) was over \$3.2 billion for the period, with an average transaction value of \$139.1 million.* Given the global nature of the industry, transaction volume includes a significant number of cross-border deals.

Major Transactions

- **March 17, 2014: CF Industrial Holdings Inc**, a U.S. based nitrogen fertilizer manufacturer and distributor, completed its sale of its phosphate business to **The Mosaic Company** for \$1.4 billion (approximately \$1.0 billion net taxes and other adjustments), following an agreement announced in the fourth quarter of 2013.¹⁴
- **September 8, 2014: FMC Corporation**, a chemical manufacturing company headquartered in the U.S, announced an agreement to acquire Danish pesticide maker **Cheminova** for \$1.8 billion, including debt. The deal will close in early 2015, and will help heighten FMC's focus on its health and nutrition and agricultural chemicals divisions. Two-thirds of Cheminova sales were in Europe and Latin America, with insecticides ranking as the company's largest product offering, followed by herbicides and fungicides. According to Cheminova Chief Financial Officer Rene Schneider, FMC is paying 11.7x times last twelve months earnings before interest, taxes, depreciation, and amortization (EBITDA) for the firm.¹⁵
- **December 1, 2014: Yara International ASA**, a Norwegian chemical company specializing in the production of ammonia, nitrates, and nitrogen fertilizers, entered into an agreement to acquire a majority interest in **Galvani Indústria, Comércio e Serviços S/A (Galvani)**, an independent privately held fertilizer company headquartered in Brazil. The enterprise value was \$318 million for 60% of Galvani, comprising of \$132 million for the existing business and \$186 million for the phosphate mining projects.^{16, 17}

* Capital IQ. Deal Volume and Averages are derived from disclosed deal information.

Industry Updates

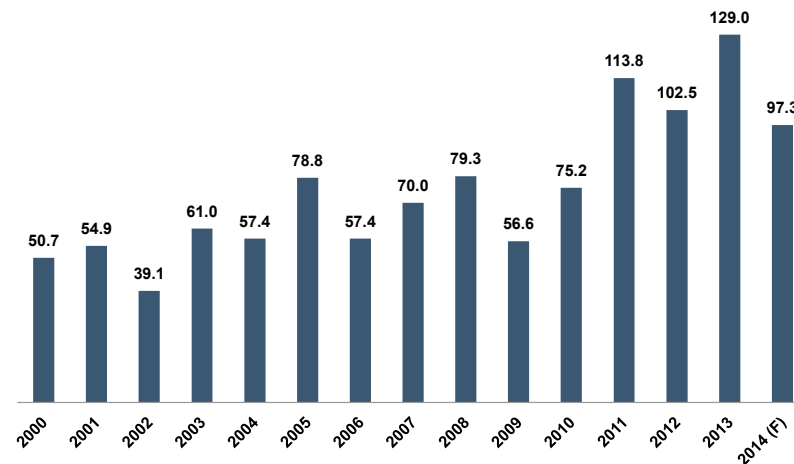
Net U.S. farm income is expected to register \$97.3 billion in 2014, a near 25% decrease from 2013 estimates of \$129.0 billion, according to the USDA. The 2014 forecast, if realized, would be the lowest level of farm income since 2010, while still remaining \$12.3 billion above the previous 10-year average (\$85 billion).¹⁸

Additional highlights from the USDA farm income report include:^{19, 20}

- Total production expenses are forecast to be 5.1% higher in 2014, including a \$1.8 billion increase in seeds, fertilizer, and pesticide expenses.
- Livestock receipts are expected to increase over 14% (\$25.9 billion) to \$206.5 billion in 2014, due to an approximate 23% increase in dairy receipts, a 19% increase in cattle receipts, and an 8% increase in hog receipts.
- Crop receipts are expected to decrease 11.5% (\$25.1 billion) to \$193.5 billion in 2014, led by a \$10.9 billion decline in corn and a \$9.5 billion drop in oil crop receipts.
- Farm equity is projected to reach another record (\$2.7 trillion), led by strong land value appreciation over the last five years, despite a recent slowdown in asset growth and expected higher debt levels.
- Farm financial risk indicators, such as the debt-to-asset ratio, are expected to continue at historically low levels.

Figure 5: Net U.S. Farm Income

(\$ billions)



Source: USDA, ERS

Industry Updates (cont.)

Negotiations involving the U.S. and EU for the TTIP could have a positive effect on U.S. agricultural chemical exports to the EU. Current conflicting regulations diverge between the EPA's regulatory approach, which takes into account exposure and risk assessment, in addition to hazard identification, and EU standards, regulation based on a hazard identification basis alone. Currently 82 pesticides banned in the EU are allowed in the U.S. If ratified, the TTIP could reconcile regulatory differences between the two economies, making the trade of pesticides, chemicals, and goods more efficient.^{21, 22}

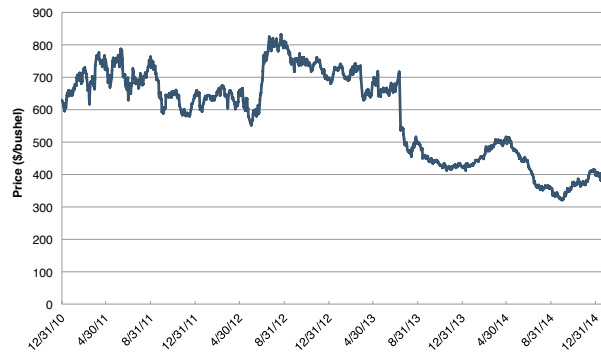
The Farm Bill, which has existed in various forms since the 1930s, is the most important piece of legislation affecting agribusiness. The omnibus bill has generally provided various types of assistance to the agriculture industry, including income and commodity price support, farm credit and risk management, research, and economic development, along with appropriations for the Supplemental Nutrition Assistance Program (SNAP). A Farm Bill is typically passed for a five year period, at the end of which it is renewed and updated.

The Agricultural Act of 2014 was signed into law in February of 2014, and will remain in effect through 2018. The bill appropriates \$89.8 billion for crop insurance (\$6 billion more than previous law), \$44.4 billion for commodity programs (\$14 billion less), \$56 billion for conservation (\$4 billion less), and \$3.5 billion for trade assistance (no substantial change) from Fiscal Year 2013 through 2023. Perhaps one of the most important changes that occurred in the new Bill relates to the Direct Payments program, a system that pays farmers whether they incur losses or not. The elimination of Direct Payments is partially offset by higher payments for supplemental disaster assistance. However, this change results in a net 15% decline in projected government payments to farmers.^{23, 24}

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- ¹⁶ "Yara Expands in South America with \$318 Million Purchase," Online, Available, <http://www.bloomberg.com/news/2014-08-05/yara-expands-in-south-america-with-318-million-galvani-purchase.html>, Accessed January 23, 2015.
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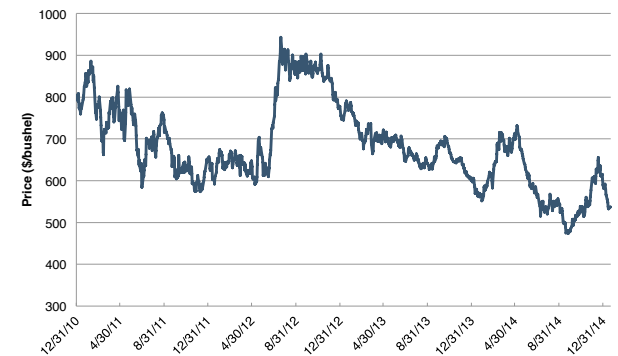
Corn



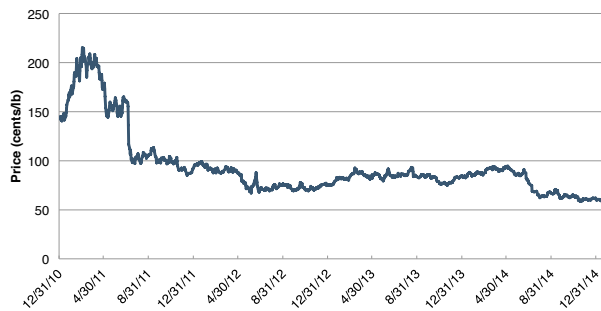
Soybeans



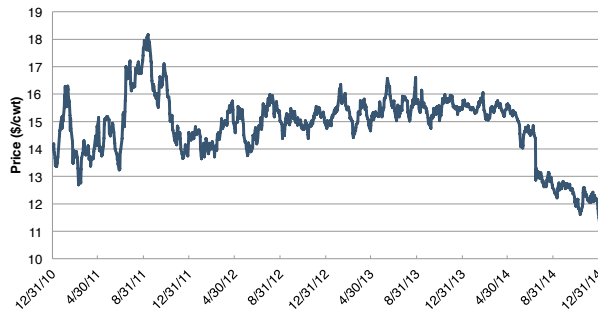
Wheat



Cotton



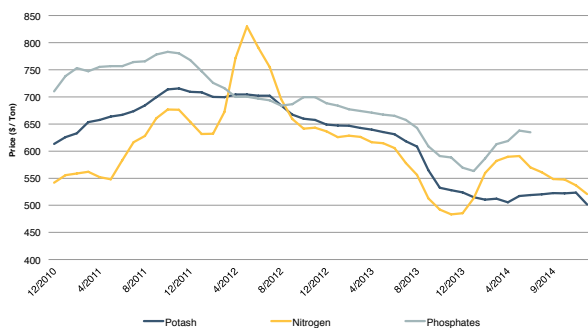
Rough Rice



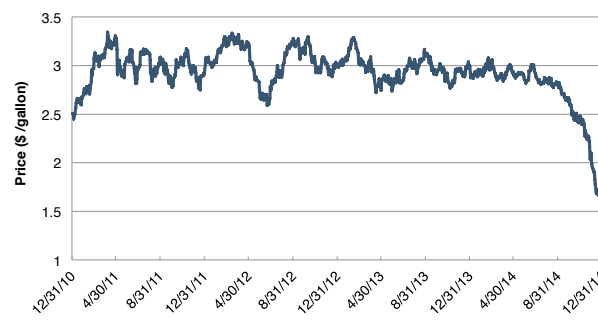
Oats



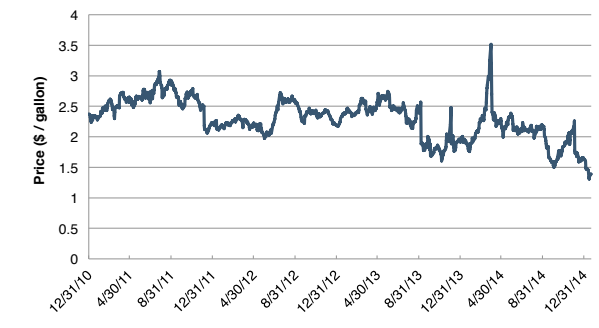
Retail Fertilizer



Gulf Coast Diesel: Ultra-low Sulfur No. 2



Ethanol

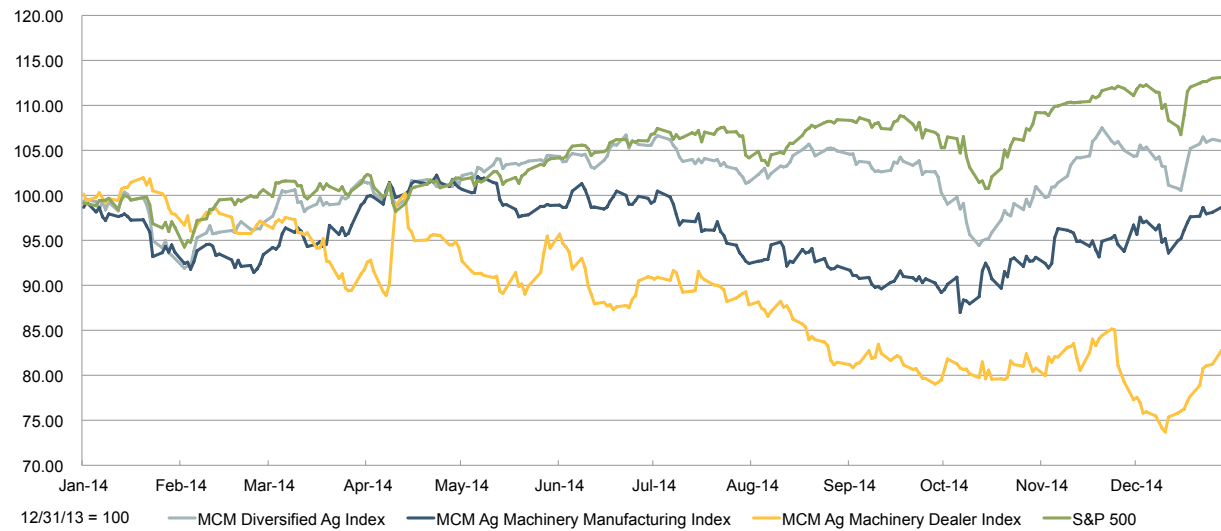


Publicly Traded Agriculture Companies

Company Name	Ticker	Dec. 31 Price (\$)	52 Wk Perform	Sales (\$)	Enterprise Value (\$M)	Debt/Equity	EBITDA Margin	EV/EBITDA (x)	EV / Nxt Yr EBITDA (x)	Price/Earnings (x)
Diversified Agribusiness										
Agrium Inc	AGU	94.72	7.0%	16,204	18,590	26.6%	10.5%	10.95	8.30	16.36
CF Industries Holdings Inc	CF	272.54	6.3%	4,853	18,146	25.3%	59.9%	6.24	8.32	9.97
Mosaic Co/The	MOS	45.65	-13.6%	8,859	20,849	18.3%	20.9%	11.26	8.48	22.60
Potash Corp of Saskatchewan Inc	POT	35.32	8.2%	6,754	33,497	12.5%	38.6%	12.86	10.31	22.08
Intrepid Potash Inc	IPI	13.88	-12.2%	386	1,198	12.5%	20.3%	15.29	11.95	nm
Rentech Nitrogen Partners LP	RNF	10.51	-39.0%	309	729	43.9%	13.8%	17.10	8.12	nm
Terra Nitrogen Co LP	TNH	102.70	-22.3%	649	1,919	0.0%	63.7%	4.64	nm	8.05
Yara International ASA	YARIY	44.06	6.0%	14,690	13,719	11.3%	13.9%	6.70	nm	12.77
Monsanto Co	MON	119.47	-3.8%	15,855	65,735	11.8%	30.1%	13.79	12.93	23.29
Syngenta AG	SYT	64.24	-17.2%	14,806	10,667	43.9%	18.5%	3.89	3.36	3.61
Archer-Daniels-Midland Co	ADM	52.00	19.9%	84,450	39,133	14.2%	4.0%	11.57	9.08	17.87
Bunge Ltd	BG	90.91	10.4%	60,305	20,762	33.2%	2.9%	12.04	9.05	22.80
Median - Diversified Agribusiness			1.1%	11,774	18,368	16.2%	19.4%	11.42	8.76	17.11
Agricultural Machinery & Equipment										
Manufacturers										
Deere & Co	DE	88.47	-4.6%	36,067	68,668	53.8%	18.8%	10.15	18.80	10.26
AGCO Corp	AGCO	45.20	-26.6%	10,098	5,613	25.3%	10.0%	5.56	7.47	9.24
Lindsay Corp	LNN	85.74	1.0%	618	1,067	0.0%	15.1%	11.45	11.91	21.44
Blount International Inc	BLT	17.57	21.5%	930	1,250	30.6%	10.6%	12.73	8.23	50.20
Art's-Way Manufacturing Co Inc	ARTW	5.21	-14.4%	35	33	37.0%	6.0%	16.04	nm	28.93
Median - Manufacturers			-4.6%	930	1,250	30.6%	10.6%	11.45	10.07	21.44
Dealers										
Titan Machinery Inc	TITN	13.94	-21.2%	2,118	1,329	77.5%	3.3%	18.90	21.38	nm
Rocy Mountain Dealerships	RME	9.54	-22.4%	962	225	20.4%	4.3%	5.51	nm	12.39
Cervus Equipment	CVL	20.59	-10.1%	926	432	27.5%	4.7%	9.84	nm	17.45
Median - Manufacturers			-21.2%	962	432	27.5%	4.3%	9.84	21.38	14.92

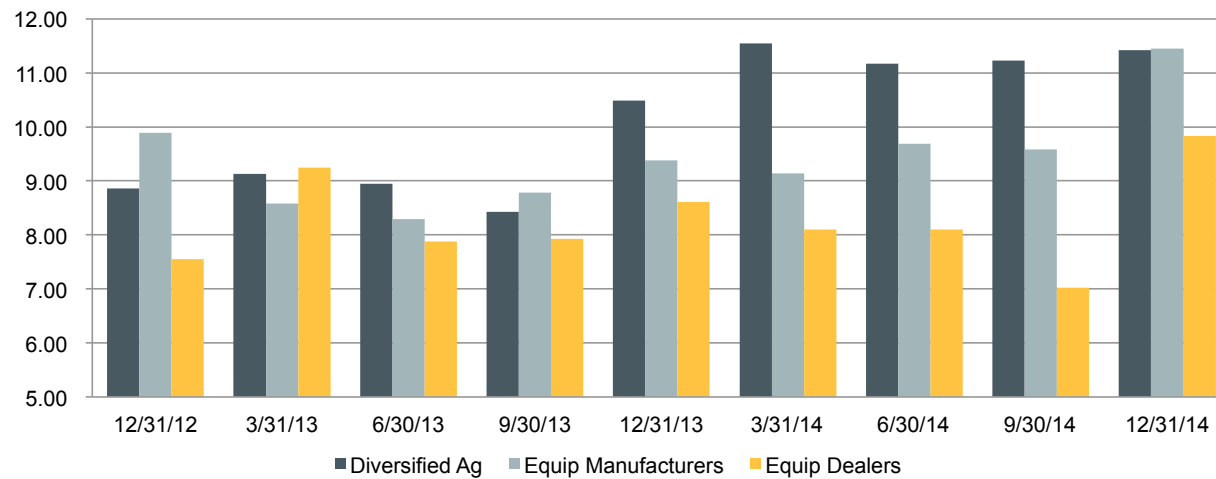
Source: Bloomberg

Mercer Capital Agriculture Indices: One Year Performance



Source: Yahoo! Finance

Historical EV / EBITDA Multiples



Source: Bloomberg

Mercer Capital

Agribusiness Industry
Services

Mercer Capital has expertise providing business valuation and financial advisory services to companies in the agribusiness industry.

Industry Segments

Mercer Capital serves the following industry segments:

- Agriculture Machinery, Equipment, & Implements
- Crop and Crop Services
- Agriculture Real Estate
- Agriculture Chemicals

Services Provided

- Valuation of agriculture companies
- Transaction advisory for acquisitions and divestitures
- Valuations for purchase accounting and impairment testing
- Fairness and solvency opinions
- Litigation support for economic damages and valuation and shareholder disputes

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Fairness Opinions

Evaluating a Buyer's Shares from the Seller's Perspective

M&A activity in the U.S. (and globally) has accelerated in 2014 after years of gradual improvement following the financial crisis. According to Dealogic, M&A volume where the target was a U.S. company totaled \$1.4 trillion YTD through November 10, the highest YTD volume on record and up 43% from the same period last year. Excluding cross-border acquisitions, domestic-only M&A was \$1.1 trillion, which represented the second highest YTD volume since 1999 and up 27% from last year. Healthcare and telecommunications were the first and second most targeted sectors.

The improvement has taken a long time even though corporate cash is high, financing costs are very low and organic revenue growth in most industries has been sluggish. Aside from improving confidence, another key foundation for increased M&A activity fell into place in 2013 when equity markets staged a strong rally as the S&P 500 rose 30% (32% with dividends) and the Russell 2000 increased 37% (39%). The absence of a meaningful pull-back in 2014 and a 12% advance in the S&P 500 and 2% in the Russell 2000 have further supported activity.

The rally in equities, like low borrowing rates, has reduced the cost to finance acquisitions because the majority of stocks experienced multiple expansion rather than material growth in EPS. It is easier for a buyer to issue shares to finance an acquisition if the shares trade at rich valuation than issuing "cheap" shares. As of November 24, the S&P 500's P/E based upon trailing earnings (as reported) was 20.0x compared to 18.2x at year-end 2013, 17.0x at year-end 2012 and 14.9x at year-end 2011. The long-term average P/E since 1871 is 15.5x (Source: <http://www.multpl.com>).

High multiple stocks can be viewed as strong acquisition currencies for acquisitive companies because fewer shares have to be issued to achieve a targeted dollar value. As

such, it is no surprise that the extended rally in equities has supported deal activity this year. However, high multiple stocks may represent an under-appreciated risk to sellers who receive the shares as consideration. Accepting the buyer's stock raises a number of questions, most which fall into the genre of: what are the investment merits of the buyer's shares? The answer may not be as obvious as it seems, even when the buyer's shares are actively traded.

Our experience is that some, if not most, members of a board weighing an acquisition proposal do not have the background to thoroughly evaluate the buyer's shares. Even when financial advisors are involved there still may not be a thorough vetting of the buyer's shares because there is too much focus on "price" instead of, or in addition to, "value."

A fairness opinion is more than a three or four page letter that opines as to the fairness from a financial point of a contemplated transaction; it should be backed by a robust analysis of all of the relevant factors considered in rendering the opinion, including an evaluation of the shares to be issued to the selling company's shareholders. The intent is not to express an opinion about where the shares may trade in the future, but rather to evaluate the investment merits of the shares before and after a transaction is consummated.

Key questions to ask about the buyer's shares include the following:

- **Liquidity of the Shares.** What is the capacity to sell the shares issued in the merger? SEC registration and even NASDAQ and NYSE listings do not guarantee that large blocks can be liquidated efficiently. Generally, the higher the institutional ownership, the better the liquidity. Also, liquidity may improve with an acquisition if the number of shares outstanding and shareholders increase sufficiently.

- **Profitability and Revenue Trends.** The analysis should consider the buyer's historical growth and projected growth in revenues, and operating earnings, (usually EBITDA or EBITDA less capital expenditures) in addition to EPS. Issues to be vetted include customer concentrations, the source of growth, the source of any margin pressure and the like. The quality of earnings and a comparison of core vs. reported earnings over a multi-year period should be evaluated.
- **Pro Forma Impact.** The analysis should consider the impact of a proposed transaction on revenues, EBITDA, margins, EPS and capital structure. The per share accretion and dilution analysis of such metrics as earnings, EBITDA and dividends should consider both the buyer's and seller's perspectives.
- **Dividends.** In a yield starved world, dividend paying stocks have greater attraction than in past years. Sellers should not be overly swayed by the pick-up in dividends from swapping into the buyer's shares; however, multiple studies have demonstrated that a sizable portion of an investor's return comes from dividends over long periods of time. If the dividend yield is notably above the peer average, the seller should ask why? Is it payout related, or are the shares depressed? Worse would be if the market expected a dividend cut. These same questions should also be asked in the context of the prospects for further increases.
- **Capital Structure.** Does the acquirer operate with an appropriate capital structure given industry norms, cyclicity of the business and investment needs to sustain operations? Will the proposed acquisition result in an over-leveraged company, which in turn may lead to pressure on the buyer's shares and/or a rating downgrade if the buyer has rated debt?
- **Balance Sheet Flexibility.** Related to the capital structure should be a detailed review of the buyer's balance sheet that examines such areas as liquidity, access to bank credit, and the carrying value of assets such as deferred tax assets.
- **Ability to Raise Cash to Close.** What is the source of funds for the buyer to fund the cash portion of consideration? If the buyer has to go to market to issue equity and/or debt, what is the contingency plan if unfavorable market conditions preclude floating an issue?
- **Consensus Analyst Estimates.** If the buyer is publicly traded and has analyst coverage, consideration should be given to Street expectations vs. what the diligence process

determines. If Street expectations are too high, then the shares may be vulnerable once investors reassess their earnings and growth expectations.

- **Valuation.** Like profitability, valuation of the buyer's shares should be judged relative to its history and a peer group presently as well as relative to a peer group through time to examine how investors' views of the shares may have evolved through market and profit cycles.
- **Share Performance.** Sellers should understand the source of the buyer's shares performance over several multi-year holding periods. For example, if the shares have significantly outperformed an index over a given holding period, is it because earnings growth accelerated? Or, is it because the shares were depressed at the beginning of the measurement period? Likewise, underperformance may signal disappointing earnings, or it may reflect a starting point valuation that was unusually high.
- **Strategic Position.** Assuming an acquisition is material for the buyer, directors of the selling board should consider the strategic position of the buyer, asking such questions about the attractiveness of the pro forma company to other acquirers.
- **Contingent Liabilities.** Contingent liabilities are a standard item on the due diligence punch list for a buyer. Sellers should evaluate contingent liabilities too.

The list does not encompass every question that should be asked as part of the fairness analysis, but it does illustrate that a liquid market for a buyer's shares does not necessarily answer questions about value, growth potential and risk profile.

We at Mercer Capital have extensive experience in valuing and evaluating the shares (and debt) of financial and non-financial service companies garnered from over three decades of business. Feel free to contact us to discuss your situation in confidence.



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