

VALUE FOCUS

# Agribusiness

Segment Focus: Agriculture Machinery, Equipment & Implements  
First Quarter 2018

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## Segment Focus

### Agriculture Machinery, Equipment & Implements

Agricultural machinery, equipment, and implements are necessary components of every farm operation. Aging fleets that were purchased before 2014 require replacement, and resurgent net income in 2017 helped farmers come up with the money to make that necessary investment.

After several years of falling commodity prices, U.S. farms have been struggling to generate profits at levels seen in previous years. Industry net income in 2016 was about half of what it was in 2013. When the agricultural price index (API) rose in 2017, farms across the nation received a much-needed stimulus. This financial relief created an opportunity for agricultural equipment manufacturers, dealers, and financiers.

The first quarter of 2018 has gotten off to a strong start. However, the USDA forecasts a 16% decline in net income for 2018, followed by slow growth for several years. Some key factors that will affect the health of the industry are movements in the API, the continued health of export markets, and cyclical demand for new fleets.

#### U.S. Farm Sector Income Statement, 2012-2018F

\$ billions

|                               | 2013           | 2014          | 2015          | 2016          | 2017          | 2018F         |
|-------------------------------|----------------|---------------|---------------|---------------|---------------|---------------|
| Crops                         | 220.8          | 211.4         | 187.6         | 195.0         | 196.3         | 199.2         |
| Livestock                     | 182.7          | 212.8         | 189.5         | 162.8         | 176.0         | 175.6         |
| Direct Government Payments    | 11.0           | 9.8           | 10.8          | 13.0          | 11.5          | 13.6          |
| Other Farm-related Income     | 41.0           | 36.6          | 34.4          | 27.9          | 32.9          | 34.6          |
| <b>Gross Cash Income</b>      | <b>455.5</b>   | <b>470.6</b>  | <b>422.3</b>  | <b>398.7</b>  | <b>416.7</b>  | <b>423.0</b>  |
| Noncash Income                | 17.7           | 16.9          | 17.8          | 17.1          | 18.6          | 19.7          |
| Value of Inventory Adjustment | 10.6           | -4.3          | 0.5           | -4.1          | -5.6          | -7.3          |
| <b>Total Gross Income</b>     | <b>483.8</b>   | <b>483.1</b>  | <b>440.5</b>  | <b>411.8</b>  | <b>429.7</b>  | <b>435.4</b>  |
| Total Expenses                | 360.1          | 390.7         | 359.4         | 350.2         | 354.3         | 369.1         |
| <b>Net Farm Income</b>        | <b>\$123.8</b> | <b>\$92.4</b> | <b>\$81.1</b> | <b>\$61.5</b> | <b>\$75.4</b> | <b>\$66.3</b> |

Source: USDA WASDE Report, March 6, 2019

## Manufacturers

The agricultural equipment manufacturing sector rebounded in 2017, recovering from sliding revenue across the industry in 2015 (-17.6%) and 2016 (-20.7%). Increased sales fueled the turnaround, and the outlook for manufacturers has improved. Sales grew 8.1% in 2017, mostly due to demand for the 100-200 horsepower segment. A lack of domestic demand caused the post-2014 slump, but international demand has always been a large source of revenue for the industry and is continuing to grow. International business is expected to account for 46% of total sales in 2018.

The first quarter of 2018 is off to a strong start, projecting another year of gains. However, a repeat of the growth seen in 2017 might be too optimistic. Uncertainty among several external factors like agricultural prices, the strength of the U.S. dollar, and overnight lending rates could affect future tractor sales.

## Dealers

In 2017, there was an improved sentiment among agricultural equipment dealers. Increased sales and a shift toward consolidation sparked a turnaround year for the industry. Forty percent of dealers reported increased revenue in 2017, and these dealers expect 2018 to be another successful year. While another year of growth is likely, performance at levels seen in 2017 is less likely.

The industry has seen widespread consolidation among dealership groups. Companies like Deere and Co, AGCO, Case IH, Kubota, and New Holland have certified dealerships where consumers can go to receive specialized service, financing, and selection. Certified dealerships are becoming more common due to economies of scale, and economies of scale is driving profit margins higher. Since 2011, the number of big dealers has increased by 11%. During that same time, the largest dealers (those with 20 or more stores) grew by 88%. This trend is a response to consolidation in the farm sector. In 1982, 23% of farm revenue was generated by farms with over \$1 million in revenue. As of the 2012 U.S. ag census, 66% of farm revenue is generated by \$1 million farms. Going forward, balancing the local service that farmers value with healthier margins that consolidation provides will be critical to success.

The industry has gotten off to a good start in 2018, with many operators claiming an uptick in pre-orders. Some dealers are projecting up to 8% growth for the year, citing heightened demand in consumer products and small equipment. This optimism has caused dealers to address marketplace needs like hiring new technicians. Hiring technicians has been a concern for years, especially with the rise of precision agriculture, and an improved industry outlook has brought this need to the front of dealer's minds.

## Dealers

(continued)

Despite this optimism, dealers should remain cautious. The market condition that materialized to drive 2017 growth was a rise in the Agricultural Price Index (API), which created wealth for farmers and downstream demand for the entire agribusiness industry. This upward shift in pricing broke a 5-year trend, and 2018 API projections predict a dip in 2018 pricing. Interest rates are also expected to rise in 2018, increasing the debt burden on farmers who decide to purchase equipment.

## United States Unit Retail Sales - March 2018

|                                | March         |               |              | YTD March     |               |            | Beginning Inventory |
|--------------------------------|---------------|---------------|--------------|---------------|---------------|------------|---------------------|
|                                | 2018          | 2017          | % Chg.       | 2018          | 2017          | % Chg.     | Mar-18              |
| <b>2WD Farm Tractors</b>       |               |               |              |               |               |            |                     |
| <40 HP                         | 13,531        | 12,834        | 5.4          | 26,381        | 26,083        | 1.1        | 92,694              |
| 40 < 100 HP                    | 4,929         | 4,896         | 0.7          | 11,553        | 11,559        | -0.1       | 33,996              |
| 100+ HP                        | 1,513         | 1,448         | 4.5          | 3,594         | 3,773         | -4.7       | 8,284               |
| <b>Total 2WD Farm Tractors</b> | <b>19,973</b> | <b>19,178</b> | <b>4.1</b>   | <b>41,528</b> | <b>41,415</b> | <b>0.3</b> | <b>134,974</b>      |
| <b>4WD Farm Tractors</b>       | <b>217</b>    | <b>229</b>    | <b>-5.2</b>  | <b>478</b>    | <b>456</b>    | <b>4.8</b> | <b>601</b>          |
| <b>Total Farm Tractors</b>     | <b>20,190</b> | <b>19,407</b> | <b>4</b>     | <b>42,006</b> | <b>41,871</b> | <b>0.3</b> | <b>135,575</b>      |
| <b>Self-Prop Combines</b>      | <b>240</b>    | <b>300</b>    | <b>-20.0</b> | <b>721</b>    | <b>693</b>    | <b>4</b>   | <b>794</b>          |

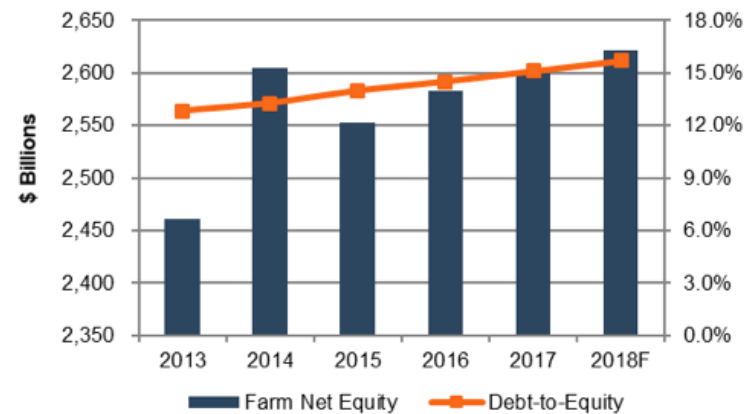
Source: AEM United States Ag Tractor and Combine Report March 2019

## Financing for Agricultural Machinery

The debt burden on U.S. farmers has grown over the last five years, with an expected 3% increase in the average industry debt-equity ratio from 2013-2018. The lending rates of agricultural equipment loans have been on the rise too, creating more expensive debt to add to the growing burden. Most agricultural equipment is purchased on credit, and farmers purchased more equipment in 2017 than any year in recent history.

Delinquency rates on farm equipment loans were low in 2017 (around 2%), signaling a healthy flow of cash in the industry. If farm revenues continue to grow into 2018, then rising debt levels could be managed and farmers could recover from a painful period of low crop prices. However, the Agricultural Price Index (API) is expected to fall in 2018, and cyclical lows in revenue could inflict more damage on farm balance sheets.

### Farm Balance Sheet Leverage



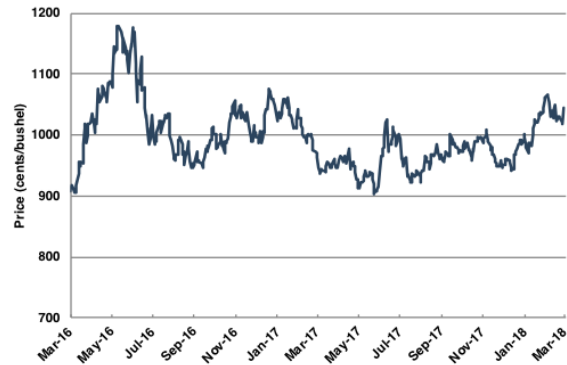
Source:USDA

**Corn**



Source: Bloomberg

**Soybeans**



Source: Bloomberg

**Wheat**



Source: Bloomberg

**Cotton**



Source: Bloomberg

**Rough Rice**



Source: Bloomberg

**Oats**



Source: Bloomberg

**Gulf Coast Diesel: Ultra-low Sulfur No. 2**



**Ethanol**



**Lean Hogs**



**Live Cattle**



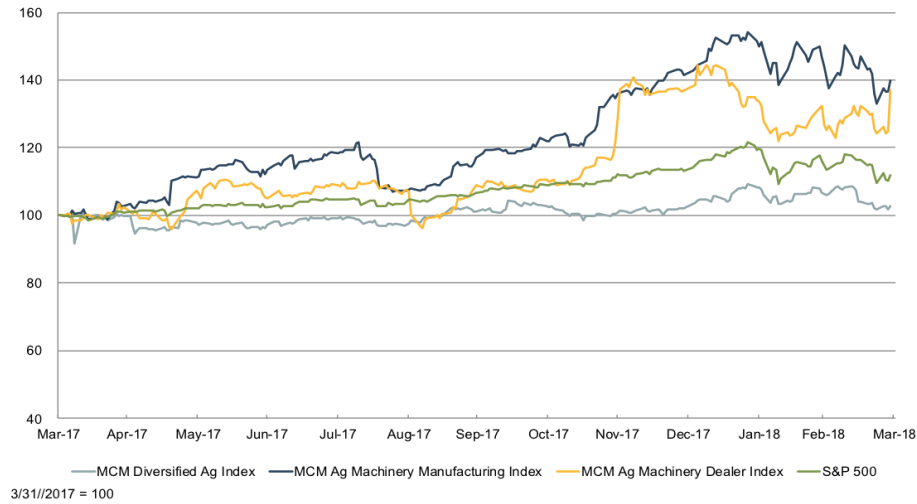
## Publicly Traded Agribusiness Companies

| Company Name                                  | Ticker        | Price<br>6/30/18<br>(\$) | 52 Wk<br>Perform<br>(Market<br>Cap) | LTM<br>Revenue<br>(\$) | Enterprise<br>Value<br>(\$M) | Debt/<br>EV  | EBITDA<br>Margin | EV / LTM<br>EBITDA<br>(x) | TEV / Nxt<br>Yr EBITDA<br>(x) | Price/<br>LTM<br>Earnings<br>(x) |
|---|---------------|--------------------------|-------------------------------------|------------------------|------------------------------|--------------|------------------|---------------------------|-------------------------------|----------------------------------|
| <b>Diversified Agribusiness</b>               |               |                          |                                     |                        |                              |              |                  |                           |                               |                                  |
| CF Industries Holdings, Inc.                  | NYSE:CF       | 37.73                    | 28.6%                               | 4,050                  | 15,764                       | 29.8%        | 29.4%            | 13.22                     | 11.00                         | 19.86                            |
| The Mosaic Company                            | NYSE:MOS      | 24.28                    | -16.8%                              | 7,765                  | 12,454                       | 41.3%        | 16.9%            | 9.47                      | 7.53                          | NM                               |
| Intrepid Potash, Inc.                         | NYSE:IPI      | 3.64                     | 111.6%                              | 144                    | 515                          | 11.8%        | 28.9%            | 12.44                     | 9.17                          | NM                               |
| Yara International ASA                        | OB:YAR        | 42.22                    | 9.6%                                | 11,501                 | 14,299                       | 23.8%        | 10.1%            | 12.28                     | 7.28                          | 29.43                            |
| Archer-Daniels-Midland Company                | NYSE:ADM      | 43.37                    | -5.8%                               | 61,366                 | 30,989                       | 29.0%        | 4.1%             | 12.45                     | 9.69                          | 14.88                            |
| Bunge Limited                                 | NYSE:BG       | 73.94                    | -6.7%                               | 45,314                 | 15,314                       | 46.5%        | 2.3%             | 14.78                     | 9.37                          | 192.53                           |
| <b>Median - Diversified Agribusiness</b>      |               |                          | <b>2%</b>                           | <b>9,633</b>           | <b>14,807</b>                | <b>29.4%</b> | <b>13.5%</b>     | <b>12.44</b>              | <b>9.27</b>                   | <b>24.64</b>                     |
| <b>Agricultural Machinery &amp; Equipment</b> |               |                          |                                     |                        |                              |              |                  |                           |                               |                                  |
| <b>Manufacturers</b>                          |               |                          |                                     |                        |                              |              |                  |                           |                               |                                  |
| Deere & Company                               | NYSE:DE       | 155.32                   | 43%                                 | 30,360                 | 88,424                       | 46.2%        | 16.4%            | 17.74                     | 16.34                         | 35.00                            |
| AGCO Corporation                              | NYSE:AGCO     | 64.85                    | 8%                                  | 8,686                  | 6,573                        | 32.3%        | 8.5%             | 8.91                      | 8.37                          | 23.36                            |
| Lindsay Corporation                           | NYSE:LNN      | 91.44                    | 4%                                  | 538                    | 995                          | 11.7%        | 11.0%            | 16.75                     | 11.27                         | 44.06                            |
| <b>Median - Manufacturers</b>                 |               |                          | <b>8%</b>                           | <b>8,686</b>           | <b>6,573</b>                 | <b>32.3%</b> | <b>11.0%</b>     | <b>16.75</b>              | <b>11.27</b>                  | <b>35.00</b>                     |
| <b>Dealers</b>                                |               |                          |                                     |                        |                              |              |                  |                           |                               |                                  |
| Titan Machinery Inc.                          | NasdaqGS:TITN | 23.56                    | 54%                                 | 1,193                  | 795                          | 43.5%        | 3.1%             | 21.38                     | 17.35                         | NM                               |
| Rocky Mountain Dealerships Inc.               | TSX:RME       | 9.51                     | 24.8%                               | 751                    | 440                          | 69.7%        | 5.0%             | 11.64                     | 12.26                         | 12.00                            |
| Cervus Equipment Corporation                  | TSX:CERV      | 10.63                    | 20.0%                               | 961                    | 299                          | 65.5%        | 4.4%             | 7.04                      | 7.10                          | 10.07                            |
| <b>Median - Dealers</b>                       |               |                          | <b>25%</b>                          | <b>961</b>             | <b>440</b>                   | <b>65.5%</b> | <b>4.4%</b>      | <b>11.64</b>              | <b>12.26</b>                  | <b>11.04</b>                     |

Source: S&amp;P Capital IQ

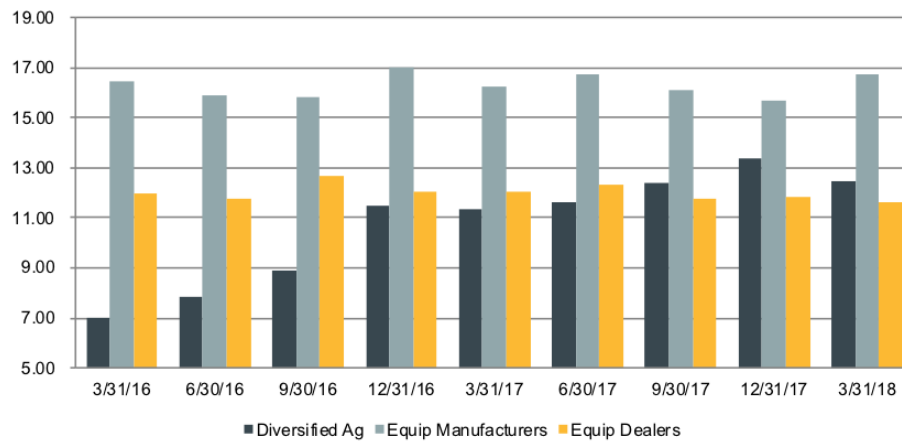


**Mercer Capital Agriculture Indices: One Year Performance**



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

Contact a Mercer Capital professional to discuss your needs in confidence.

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