

VALUE FOCUS

Agribusiness

Segment Focus: Crops and Crop Services
Second Quarter 2018

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SEGMENT FOCUS

Crops and Crop Services

The crops and crop services segment experienced significant losses in the period from 2013 to 2017. Slipping agricultural product prices, trade disputes, and rising expenses have made matters worse in the first two quarters of 2018. Certain commodities demand more production, while others are becoming less profitable, leading to a mixed-bag result for farm income statements.

Another year of margin contraction is a realistic expectation for the industry; however, long-term projections predict a slow recovery starting in 2019. Given the U.S. economy's dependence on the overall industry, long-term negative growth is not likely.

Figure 1: U.S. Farm Sector Income Statement, 2013–2018F

	2013	2014	2015	2016	2017	2018F
Crops	220.8	211.4	187.6	195.0	195.4	197.6
Livestock	182.7	212.8	189.5	162.8	176.0	175.3
Direct Government Payments	11.0	9.8	10.8	13.0	11.5	13.8
Other Farm-related Income	41.0	36.6	34.4	27.9	32.9	35.0
Gross Cash Income	\$455.5	\$470.6	\$422.3	\$398.7	\$415.8	\$421.6
Noncash Income	17.7	16.9	17.8	17.1	18.6	19.8
Value of Inventory Adjustment	10.6	(4.3)	0.5	(4.1)	(5.0)	(8.4)
Total Gross Income	\$483.8	\$483.1	\$440.5	\$411.7	\$429.5	\$433.0
Total Expenses	360.4	391.1	359.4	350.2	354.3	369.8
Net Farm Income	\$123.4	\$92.0	\$81.1	\$61.5	\$75.2	\$63.1

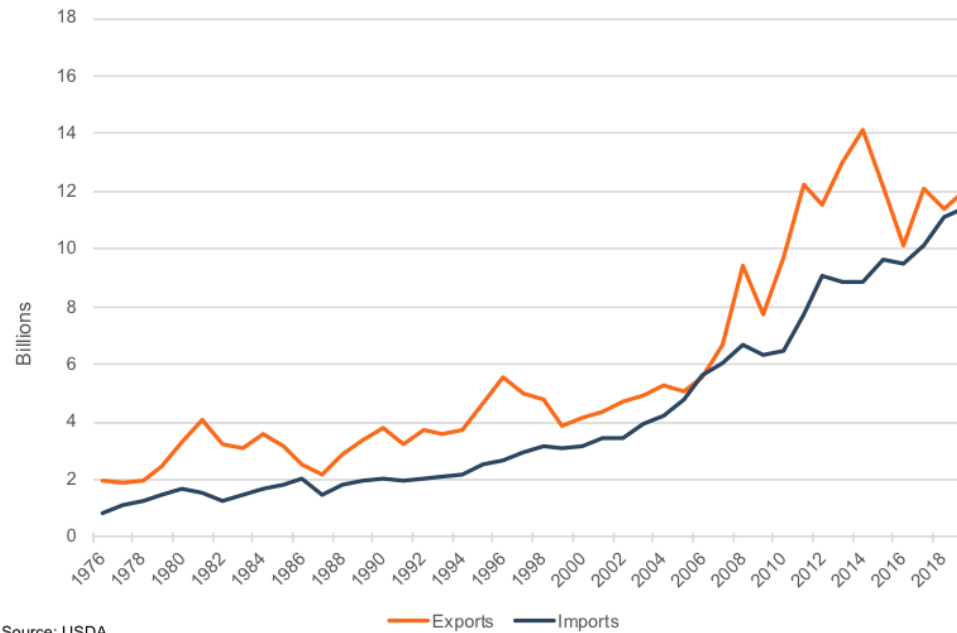
Source: U.S. Department of Agriculture

Imports/ Exports

The overall state of international agricultural trade has been thrust into uncertainty during the second quarter of 2018. The U.S. dollar index depreciated over 10% in 2017, making U.S. goods relatively cheaper abroad and stimulating trade. Agricultural exports are still in a long-time expansion, and a depreciated dollar drove demand even further up. China, the United States' largest agricultural export market, has continued to purchase U.S. agricultural products including soybeans and wheat. This overseas market has made exports a necessary and reliable revenue stream for U.S. farmers.

However, during the second quarter of 2018, the United States announced a series of tariffs on all international imports, and then specifically on Chinese imports. These tariffs were met with retaliatory actions from China, who placed their own sanctions on the U.S. This trade dispute is expected to hurt farmers' bottom lines, effecting downstream demand for all agribusiness products and services. With a falling Agricultural Price Index (API) already cutting into profits, the trade dispute is expected to hamper agribusiness profits across each different industry segment. Soybean and wheat exports are already down 10% and 16% respectively since the sanctions have taken hold.

U.S. Agricultural Trade Balance 1976-2018



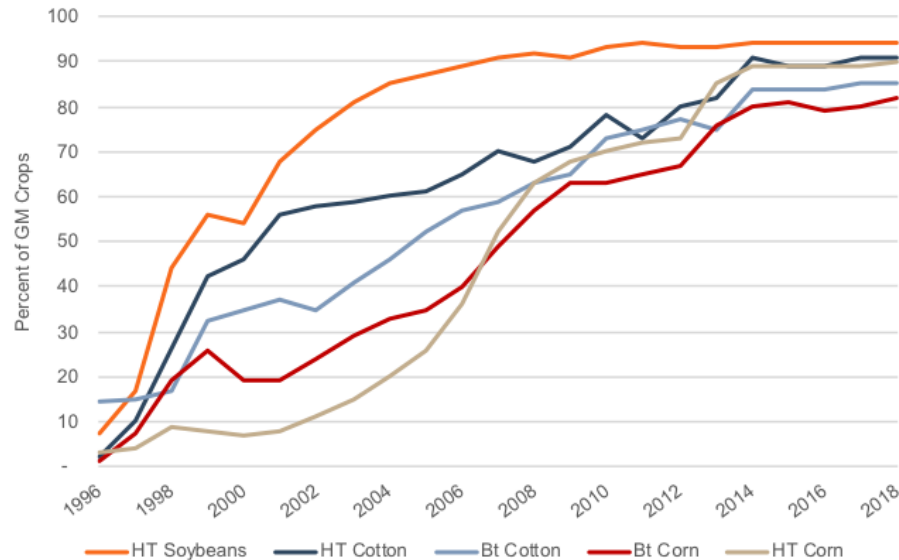
Source: USDA

Seeds

The seed industry is expected to grow to \$60 billion in 2018. The widespread adoption of genetically modified seeds has made farms more efficient, and producers of these seeds are reaping the benefits. These new seed technologies yield healthier plants, larger harvests, and resistance to insects/insect repellent chemicals. Four large companies dominate the industry, and synergies created from mergers and acquisitions has allowed these firms to cut costs, increase research and development funding, and streamline global distribution networks.

The market for seeds has experienced shifts in demand thus far in 2018. For example, there is a growing need for grains, oils, and vegetables. As the global population continues to grow, the need for these staples will grow with it. Corn has had the largest growth in demand during 2017 due to increased production from ethanol producers. Last year, 40% of all corn harvested was used in the production of ethanol. If these trends continue, ethanol producers could occupy a large portion of U.S. farmland in the years to come. Moving forward, some external factors that could impact corn production are EPA regulation changes or shocks in the price of oil.

Adoption of Genetically Engineered Crops in the United States 1996-2018



Source: USDA

Crop Services

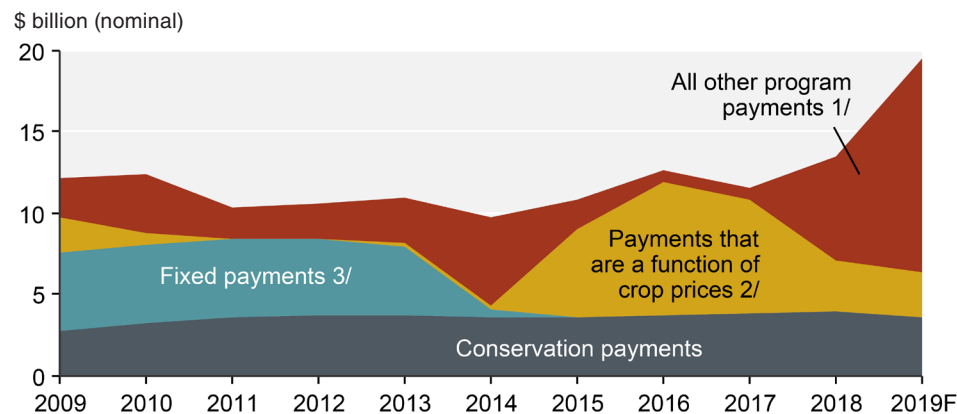
Crop services like harvesting, ginning, and fertilizer application have carved out a stable position in the agribusiness industry. Industry revenue has flattened out over the last five years (0.3% annualized growth '12-'17), showing signs of sector maturity. This slow growth is expected to increase to 0.7% annual growth from '18-'22. Some external drivers of this growth are increased crop production, rising lending rates, and demand from fruit farms.

As agricultural inputs and seeds themselves become more sophisticated, farmers across the United States are producing fuller harvests. This growth in crop volume has led the farming community to call on crop services providers to pick and transport these harvests. The crop services industry has also benefitted from an increase in lending rates. These higher rates make it more expensive for farmers to purchase and upgrade equipment. Aging fleets, in turn, spurn demand for crop services, as it is often cheaper to outsource the work than to upgrade old machinery.

Government and Regulatory Activity

Farmers rely on support from the U.S. government in the form of subsidies, disaster relief, conservation payments, and other payment programs. These resources are allocated to U.S. farms in the Farm Bill. Farm Bills must be renewed every four years by the House and Senate, and 2018 is another chance at renewal. There are many questions regarding changes that might be made, including extra funding that lawmakers might want to award farmers, or programs that might see funding cuts. If lawmakers want a smooth transition that involves no gaps in farmer aid, then getting the Farm Bill passed by the end of 2018 is necessary. Given the great number of other issues demanding congressional attention, passing the bill before December seems highly unlikely.

Government Farm Program Payments to Farm Producers, 2009-19F



Note: F = forecast. 1/ All other payments include supplemental and ad hoc disaster assistance, tobacco transition, Cotton Ginning Cost Share, dairy, and miscellaneous programs (such as the Market Facilitation Program). 2/ Includes Price Loss Coverage (PLC), Agriculture Risk Coverage (ARC), counter-cyclical payments (CCP), Average Crop Revenue Election (ACRE) payments, loan deficiency payments (excluding grazeout payments), marketing loan gains, and certificate exchange gains. CCP and ACRE were not continued in the 2014 Farm Bill. PLC and ARC payments began in 2015. 3/ Includes direct fixed payments portion of Direct and Counter-Cyclical Program (DCP) and Cotton Transition Assistance Program (CTAP) payments (in 2014/15). Source: USDA, Economic Research Service, Farm Income and Wealth Statistics. Data as of August 30, 2019.

Government and Regulatory Activity

(continued)

Aside from the uncertainty of future government aid to farms across the country, FDA regulations heavily affect the crops and crop services industry. Post-harvest activities make up 41.8% of industry revenue, and constantly shifting food safety laws require compliance. In 2011, the Food Safety Modernization Act (FSMA) was passed, requiring food processing companies to prevent food-borne illnesses and reach certain standards of food safety. Any future FDA legislation aimed at food safety concerns might marginally affect industry net income through rising costs, but firm specific risks are much more likely as compliance on a large scale can be tricky.

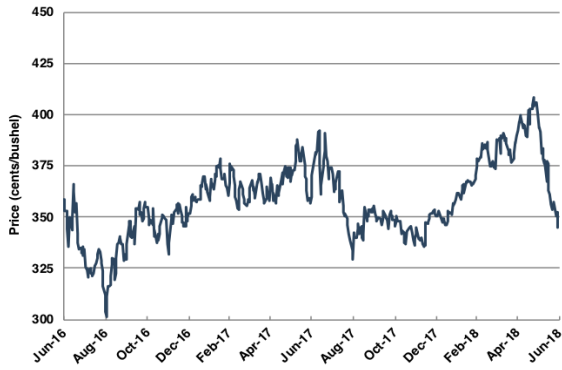
Mergers and Acquisitions

The crops and crop services industry includes several distinct subsectors with big players in each niche. There were deals in each subsector, and consolidation is the trend in the industry. Out of all the deals that have been transacted in 2018, one merger stands out as a disruptive move.

On January 2, 2018, Agrium and PotashCorp finalized a merger to become Nutrien (NYSE: NTR). Both Agrium and PotashCorp were major players in the fertilizer industry. PotashCorp, formerly headquartered in Saskatoon, Saskatchewan, has a large portfolio of potash, nitrogen, and phosphate products. Agrium, formerly headquartered in Calgary, Alberta, is known for its global fertilizer distribution network.

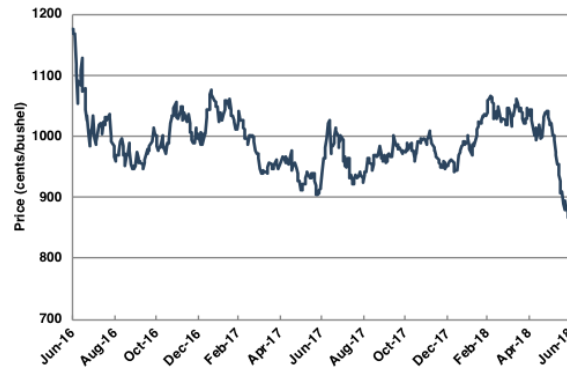
This merger created the world's premier provider of crop inputs and services. Nutrien has over 20,000 employees, 1,500 farm retail centers, and operates in 14 countries. The merger is set to create around \$500 million in synergies, and Nutrien is expected to sell 25 million tons of fertilizer product per year. Nutrien's estimated worldwide market share in the fertilizer industry is around 23%, with a 60% market share in North America. The estimated market capitalization of the merged entities is approximately \$27 billion.

Corn



Source: Bloomberg

Soybeans



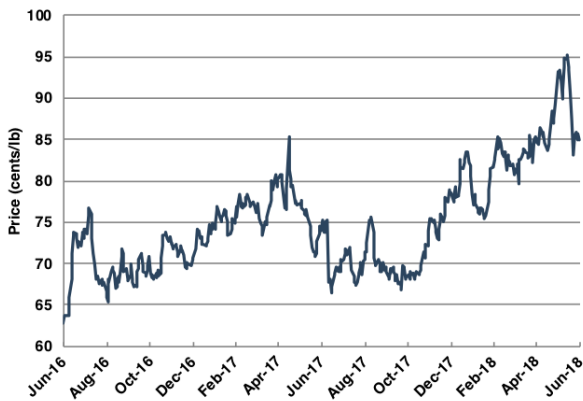
Source: Bloomberg

Wheat



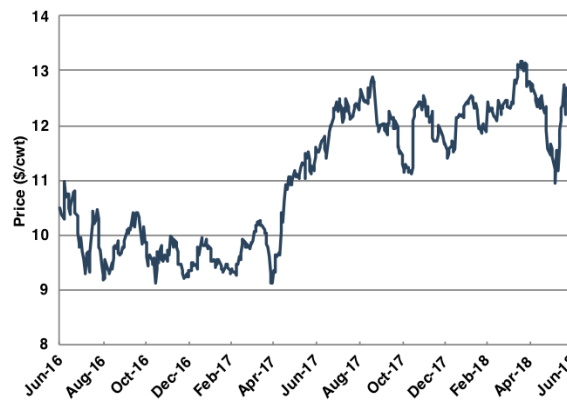
Source: Bloomberg

Cotton



Source: Bloomberg

Rough Rice



Source: Bloomberg

Oats



Source: Bloomberg

U.S. Gulf Coast Ultra-Low Sulfur No 2 Diesel Spot Price (Dollars per Gallon)



Source: eia

Ethanol



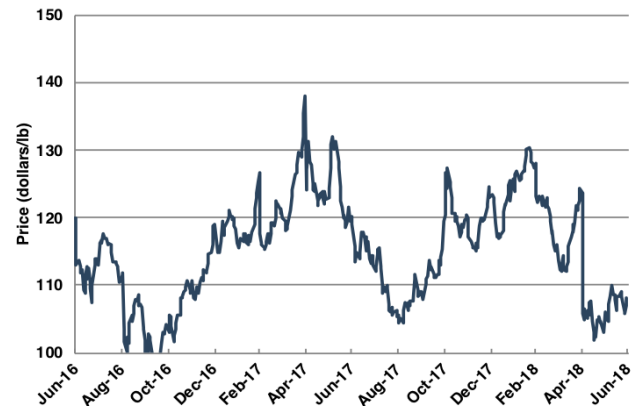
Source: Bloomberg

Lean Hogs



Source: Bloomberg

Live Cattle



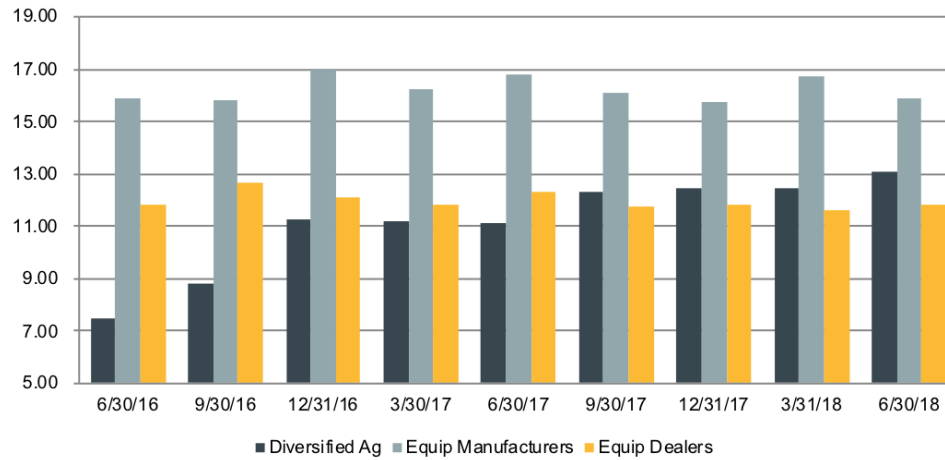
Source: Bloomberg

Publicly Traded Agribusiness Companies

Company Name	Ticker	Price 6/30/18	52 Wk Perform (Market Cap)	LTM Revenue (\$)	Enterprise Value (\$M)	Debt/ MVTC	EBITDA Margin	EV / LTM EBITDA (x)	EV / Nxt Yr EBITDA (x)	Price/ LTM Earnings (x)
Diversified Agribusiness										
CF Industries Holdings, Inc.	NYSE:CF	44.40	58.8%	4,226	17,189	27.3%	32.2%	12.65	12.33	17.63
The Mosaic Company	NYSE:MOS	28.05	22.9%	8,215	15,522	32.3%	18.1%	10.42	7.95	NM
Intrepid Potash, Inc.	NYSE:IPI	4.10	81.4%	148	564	10.5%	27.5%	13.82	10.11	NM
Yara International ASA	OB:YAR	41.47	10.8%	11,941	14,371	28.9%	9.2%	13.09	7.80	114.46
Nutrien Ltd.	TSX:NTR	54.38	N/A	13,416	44,532	27.1%	19.8%	16.73	11.66	63.13
Archer-Daniels-Midland Company	NYSE:ADM	45.83	10.8%	63,491	33,894	22.5%	4.3%	12.34	10.46	13.33
Bunge Limited	NYSE:BG	69.71	-6.6%	45,816	17,402	45.9%	2.6%	14.47	8.48	NM
Median - Diversified Agribusiness			17%	11,941	17,189	27.3%	18.1%	13.09	10.11	40.38
Agricultural Machinery & Equipment										
Manufacturers										
Deere & Company	NYSE:DE	139.80	13%	32,969	84,178	49.8%	16.1%	15.89	16.05	24.69
AGCO Corporation	NYSE:AGCO	60.72	-10%	9,059	6,672	29.2%	8.5%	8.71	7.99	21.86
Lindsay Corporation	NYSE:LNN	96.99	9%	556	1,048	11.1%	10.9%	17.27	13.47	48.06
Median - Manufacturers			9%	9,059	6,672	29.2%	10.9%	15.89	13.47	24.69
Dealers										
Titan Machinery Inc.	NasdaqGS:TITN	15.55	-14%	1,172	687	59.3%	3.5%	16.95	15.00	NM
Rocky Mountain Dealerships Inc.	TSX:RME	8.37	9.3%	787	452	67.6%	4.8%	11.86	12.97	10.05
Cervus Equipment Corporation	TSX:CERV	10.83	27.1%	981	359	50.9%	4.5%	8.19	8.13	9.91
Median - Dealers			9%	981	452	59.3%	4.5%	11.86	12.97	9.98

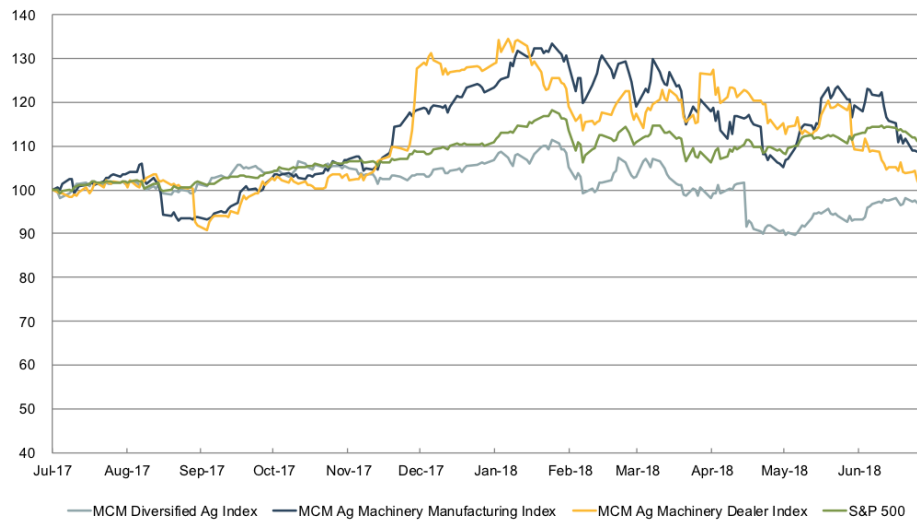
Source: Capital IQ

Historical EV / EBITDA Multiples



Source: Capital IQ

Mercer Capital Agriculture Indices: One Year Performance



6/30/2017 = 100

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.

Contact Us

Nicholas J. Heinz, ASA

901.322.9788

heinzn@mercercapital.com

Timothy R. Lee, ASA

901.322.9740

leet@mercercapital.com

John T. (Tripp) Crews, III

901.322.9735

crewst@mercercapital.com

Mercer Capital

5100 Poplar Avenue, Suite 2600

Memphis, TN 38137

901.685.2120 (P)

www.mercercapital.com