

SUPER SIZED OR RIGHT SIZED?

How many companies does it take to make a seed industry? Fewer than it used to it seems. So, what is the right size in the seed business?

By Robynne M. Anderson

THERE IS A NEW INJECTION OF CASH in the seed business. Sales are up. New investors from outside agriculture are buying stocks and commodities. Biofuels are the rage, and global grain reserves are at long-term lows. What will seed businesses do with the extra cash? Well some of the big ones will likely get bigger.

Trait Providers

Everyone in the seed business remembers the shopping spree in the '90s when multinational agro-chemical companies started buying seed businesses by the fist-full. There were some big multiples paid for many of those seed enterprises and there was skepticism, but time has shown that the investment was worthwhile.

Still, it is an expensive business, particularly for trait development. If it takes at least \$200 million a year to invest in trait research; about \$100 million to manage the regulatory portfolio for a trait; and R&D is usually about 10% of a company's net revenue, it doesn't take long to calculate the scale of the business needed to support development work.

With figures like that, the only players in traits are likely to be the large multinationals and tiny biotech start-ups that are focused on some specific genes. In fact, there is a great deal of speculation about whether this will end up being a business dominated by two companies. Most experts, though, aren't prepared to write off the competition. It is possible one or two of the big life science companies may be merged in the next decade; however, there is a belief this will further the competition by allowing those businesses with lower seed market share a chance to improve their position.

Today, "there are six major companies in the global seed industry and between them, they control about 50% of seed sales worldwide," Rod Stacey of Verdant says. "That doesn't scare me. I'd be uneasy if it was 90%, but that won't happen because there are plenty of corporations who are interested in this industry and there will continue to be competition."

Given the high costs and high risks, the big companies are already looking at new modes of business. Even the trait



providers themselves are taking new tacks compared to a decade ago. Recent announcements of partnerships between Monsanto and Bayer; Greenleaf, Syngenta and Pioneer; BASF and Monsanto; and Monsanto and Dow, on technology development/commercialization agreements demonstrate a spirit of partnership not seen before.

Access

These large companies also continue to seek access to germplasm, distribution and retail networks through the acquisition of smaller seed companies. American Seed Inc., a subsidiary of Monsanto, has been particularly active.

The flip side of this quest for mechanisms to release and sell traits is a question of access for smaller companies. Without a relationship to one of the trait providers, it will be very difficult to have a seed business. "Smaller seed companies don't want to admit it, yet are increasingly going to become distributors," predicts Bill Goodbar of AgriCapital. "I think there's a role for them there. They have the customer relationships, they have the name in the local market, but they probably have to let someone else handle their production and inventory control."

Sectors to Watch

There are some areas which are more likely than others to experience accelerated consolidation.

Vegetables – The increasing participation of some of the multinational trait providers may change the vegetable sector. Long a bastion of innovative breeding houses and diversity, there is no sector – other than flowers – where it will be easier to sustain a "boutique" business. Just the same, great demands from grocery chains, including Wal-Mart, will dictate how the business functions. Plus new, high-nutrition varieties may need extra regulatory approvals that can be expensive to undertake. This is likely to drive consolidation at the breeding and production level. Retail businesses in the vegetable sector are candidates for consolidation due to these pressures and rationalization forces among the large breeders to manage their key product lines.

Organics – Demand is rising and some major acquisitions are likely in the organics sector while others may merge to raise production. Many organic farms are increasing acreage dramatically to supply large grocery chains and it is inevitable the organic seed business will follow suit.

However, more than any other sector, it is likely there will be a place for small boutique businesses that believe in the ideology of organic production as much as the production standards.

Mid-America Corn and Soy – It may seem hard to believe while corn acreage is increasing that the mid-America corn and soy company could be at risk, but there has already been a great deal of consolidation among this category over the past decade and more is likely to come. Groups like Monsanto's ASI have actively been offering buy-out mechanisms and sweeping up many of the companies. Still, there are many left, serving very specific geographic areas with dedication. Unfortunately, that may not be enough in an era where a relationship with a trait-provider can make or break access to desirable varieties and competitive products. Only the most innovative and focused will survive.

Retail – Retail chains are also undergoing pressure. To some extent, this comes from the input suppliers, but even more it arises from the consolidation of farms. Not only are there

Benchmarking

Here are some approximate estimates of the size of annual sales (seed, trait and other related sales) needed currently to have critical mass in sectors of the seed business. These estimates represent an amalgamation of opinion from leaders across the country:

Trait Providers	\$3 billion
Global Breeders	\$700 million
Regional Breeders	\$40 million
Distributors	\$18 million
Regional Retailer (multi-outlet)	\$10 million

fewer customers to serve, there is evidence that large farmers are more inclined to shop on price and squeeze retail margins. It is going to take an extensive network or a very specialized relationship with farmers to help retailers survive these pressures.

Innovators

Before the consolidation factor starts seeming too daunting, consider the observations of Bill Latham of Latham Seeds: "It's like a boiling kettle. We see the companies coming off the top and evaporating so we think everyone is going that way. However, at the bottom, there are new entrepreneurs bubbling away."

"Survival of small seed companies depends on loyalty from customers," notes Bill Chase, Chairman of the Production and Stewardship Action Team for the National Corn Growers Association, adding the observation that smaller farmers, too, may find it harder as marketing teams focus on the large customers. It also takes focus and a willingness to find unique markets.

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Wild Cards

For all the internal structural changes in the U.S. seed business, there are still some wild cards that may create surprises.

BASF – BASF has stakes in various seed businesses, including SW Seed, DNA Landmarks, and its own imi-tolerant traits, as well as its recent partnership with Monsanto. However, most commentators agree BASF remains the agro-chemical company that is the biggest wild card in the seed business. The company has watched a lot of consolidation and investment activity occur and appears to have selected a path of strategic partnerships. However, due to the diverse nature of its chemical business, it has the resources to add greatly to its seed portfolio, with total sales of US\$73 billion in 2006 (Monsanto had sales of \$7 billion; DuPont \$26.5 billion).



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Oil Industry – As has been observed by the Context Network; a small portion of Exxon/Mobil’s quarterly profits could buy the entire ethanol business. If biofuels does get oil money involved, they have the capacity to buy up processing, and any feedstock resources (including seed technology) that they may want.

China and India – Recently, Monsanto publicly noted that the next wave of competition in the seed sector is likely to be from China and India. Both countries have very strong information technology sectors, huge growing markets, a need for food security, and a strong political will to invest in agricultural productivity. It may be time to look across the Pacific for the new giants in the seed sector.

The Right Size

If you want to be engaged in the trait development business, you’d better be worth a few billion. That would be super-sized in the seed distribution business, but is a bare minimum in the development sector. By the same token, playing in the corn and soy genetics game is going to take \$500 million or more and can only work if there is an established relationship with the trait providers.

Some companies can beat the odds by finding niches or operating incredibly tight ships. But it is a very tricky task, particularly in a business that is based on science, but is subject to the unpredictability of biology and Mother Nature.

It makes the most sense to be realistic about what critical mass is needed to be successful. If the size isn’t right, then it is time to start thinking creatively. That may mean exiting the business, partnering with others, and/or thinking laterally to readjust the business into other areas where the company is right-sized.

Certainly, the farm economy globally is buoyant and that may mean less pressure for companies to file bankruptcy, but that injection of cash is also the fodder for a new round of mergers and acquisitions. The seed industry is going through another structural change, lock-step with agriculture itself. So as end-use markets change and global demand shifts, it will be inevitable that the seed industry will respond.

The right size is going to get a little more super.



How Big is the Sandbox?

Consolidation is occurring at all levels of the seed business – research, distribution, retail – even among farm customers. There’s room in the sandbox for all shapes and sizes of players, though. For consideration:

Sand Castles aren’t Permanent – Despite the seed industry’s long cycles with one key player on top, change does happen. Now is a time when there could be a lot of change, particularly in the non-corn sectors.

Don’t Play Alone – Look at mergers, partnerships and alliances, especially if you are investing in mainstream crops like soy and corn – even more so if that includes R&D investment.

Don’t Kick Sand – That bitter rival may soon end up owning your company, being your boss or having a variety/trait you want.

Be Prepared to Shovel – Dig deep for expertise. A seed company must be good at all aspects of the business – a good variety is not enough without good marketing. Find or hone talents in key areas.

Find Your Own Corner – Differentiate. Differentiate. Differentiate. Even as a distributor or breeder, you need to find something to offer trait-providers, as well as end-users, that sets you apart.

Import Some Sand – As the manufacturing and housing sectors are less stable, ag is an attractive investment. Look for cash outside traditional ag areas, including end-use processors and energy dollars.