

# Ag & Vet Weekly



Friday August 7, 2020

*All the news on ASX-listed agriculture and veterinary companies*

## Dr Boreham's Crucible: Nufarm

By TIM BOREHAM

**ASX code:** NUF

**Share price:** \$4.14; **Shares on issue:** 379,694,706; **Market cap:** \$1,571.9 million

**Chief executive officer:** Greg Hunt

**Board:** Donald McGauchie (chair) John Gillam\*, Mr Hunt, Anne Brennan\*\*, Gordon Davis, Frank Ford, Peter Margin, Marie McDonald, Toshikazu Takasaki (Sumitomo). \* Mr Gillam replaces Mr McGauchie as chairman from September 24. Mr McGauchie retires from the board on September 23. \*\* Ms Brennan will step down on December 3

**Financials\* (half year to January 31 2020):** revenue \$1,476.9 million (down 6%), loss of \$121.7 million (previously \$13.58 million profit), underlying loss before interest tax depreciation and amortization \$5.64 million (previously \$48.5 million profit), cash of \$489 million\*\*, net debt of \$538 million\*\*

Continuing operations (excluding divested South American operations): revenue \$901.1 million (down 12%) \* To align with its peers, the company has changed its balance date from July 31 to September 30. \*\* Credit Suisse estimates for the year to July 31, 2020

**Major identifiable holders:** Sumitomo Chemical Co 14.88%, Ellerston Capital 8.07%, Sumitomo Mitsui Trust Holdings 8.05%, Allan Gray Australia 8.65%, Firetrail Investments 6.69%, Schroder Investment Management 5.25%, United Super Pty Ltd 5.07%.

Is something fishy going on at one of the world's leading crop protection groups?

We're not talking about the industry-wide controversy over glyphosate - and we'll come back to that later - but Nufarm's low profile Nuseed arm, which is doing some interesting things with its plant breeding technology.

In liaison with the esteemed CSIRO, Nuseed is developing a canola seed with long-chain omega-3 fatty acids - the world's first plant-based source of the coveted nutrient.

Omega-3 is usually obtained from fish oil, so Nuseed is striving to relieve the pressure on the world's fish stocks. The omega-3 fat docosahexaenoic acid (DHA) is a mandatory component of infant formula, given it is said to benefit brain development among other benefits.

As for Nufarm's traditional pest and weed zapping game, the improving outlook for the tillers of the soil is yet to rub off on the company, which rates among the world's top 10 herbicide and pesticide suppliers.

On June 30 this year, Nufarm announced that it would close one of its three Australian factories, in the western Melbourne industrial enclave of Laverton, as well as curtailing operations of a plant at Linz in Austria.

Nufarm is also quitting insecticide and fungicide manufacturing, which is less reliable than the market for herbicides (which have to be used at the outset of every crop).

The Linz facility will no longer produce 2,4-dichlorophenoxyacetic acid or 2,4-D - one of the world's most popular defoliants and beloved of manufacturers because its patent has long expired.

Nufarm's core problem is import competition which has eroded margins in some key categories, as well as Chinese supply disruptions which have affected its European operations.

In the US, the problem has been "unprecedented floods" rather than drought.

The confluence of woes means Nufarm shares are trading at close to record lows, but chief executive Greg Hunt is not using the "proverbial perfect storm" as an excuse.

"Capital markets can have a low tolerance for delayed performance and, frankly, we're not always good at setting those expectations clearly enough either," he told a recent online investor confab.

## **Nufarm's Kiwi roots**

As with Russell Crowe 'our' Nufarm originated across the Tasman, as the New Zealand Farmers Fertiliser Co-op registered in 1916.

A chap called Max Fremder founded the Melbourne-based Australian operations in the 1950s, selling herbicides door to door.

Four more than four decades Nufarm was synonymous with its chief executive officer and then major shareholder Doug Rathbone, who built the company from a \$20 million tiddler to a weed conquering giant selling in 100 countries.

A former science teacher, Mr Rathbone was hired by Mr Fremder in 1973. In February 2015 Mr Rathbone handed over the tiller to Greg Hunt, former Elders exec and not to be confused with the current Federal Health Minister.

Under Mr Hunt, the company has embarked on a number of get-fit initiatives, including a more singular focus on core crops: corn, soybean cotton and cereals.

Last year Nufarm sold its profitable Brazilian operations to its biggest shareholder, Sumitomo for just under \$1.2 billion.

## **Seed capital**

Nufarm's Nuseed arm has been germinating since 2011 - but is only just sprouting into a commercial business.

Co-developed with the CSIRO and the Grains Research and Development Corporation, Nuseed's omega-3 rich canola is being marketed as a fish feed (Aquaterra) and for human nutrition (Nutriterra).

Other potential markets include food additives and pharmaceuticals.

Canadian regulators in late July approved Nuseed omega-3 canola for both human consumption and a feedstock for aquaculture and livestock.

"The Canadian market is particularly important because it is the world's largest market for canola cultivation and also the third largest producer of farmed salmon," Mr Hunt says.

Nuseed's canola is also approved for food and feed locally and for cultivation in the US.

Nuseed's second-tier product is its genetically modified version of carinata, a canola-like plant that can be used as a feedstock to produce biodiesel.

Carinata grows like a weed - ironically - and doesn't require fertilizer.

The idea is that farmers grow carinata between their rows of crops, typically soy. Thus, carinata does not replace land for food crops and is useful for carbon credits.

Saipol, Europe's biggest biofuels producer has signed on as Nuseed's first commercial client. Qantas and United Airlines have also dabbled in carinata fuels - or at least back in the days when they actually flew aeroplanes.

More broadly, Nufarm takes a cautious approach to research and development and avoids the early stage stuff.

Mr Hunt says research-focused crop protection companies generated strong returns from their own brand products up to the mid-Noughties.

But after that, generic products gained the upper hand and the “research companies” pivoted to generics, spurring a round of consolidation.

At the same time the generic providers moved to differentiate their products and the generic-branded delineation became blurred.

The repercussions are clear though: with apologies to Coles, prices are down, down.

## **Europe’s war on pesticides**

One of Nufarm’s longer term challenges is to counter consumer trends to chemical-free produce - or perhaps go with the flow.

A recent European Commission strategy paper, Farm to Fork, outlines a “clearly stated political ambition” of halving the use of chemical pesticides by 2030.

Mr Hunt notes the targets are not yet binding, with legislation not expected before 2024 at the earliest.

Still, to hedge its bets, Nufarm recently acquired a biological seed treatment product from German chemical giant BASF, “which may be suitable for commercialization in Europe.”

Nufarm is also willing to invest “small amounts” into alternatives such as electrical weeding. Also known as digital herbiciding, digital weeding involves zapping weeds with a shot of high voltage energy.

## **Rounding Up the lawyers**

Nufarm’s valuation is likely to remain under pressure given a rash of US-based litigation alleging that glyphosate - one of the most widely used herbicide ingredients - is carcinogenic.

Glyphosate is popularized in suburbia by the off-the-shelf product Roundup.

Nufarm does not manufacture glyphosate but uses it in other product formulations. The heat is on agri-chemical giant Bayer, which acquired Roundup maker Monsanto.

In the US, three jury cases have ruled against Bayer with the first plaintiff, a school groundskeeper, awarded \$US289 million (\$A400 million). Bayer is appealing the decision.

Locally, a Melbourne landscape gardener has launched an action against Monsanto (Bayer) alleging his non-Hodgkin’s lymphoma (cancer) resulted from glyphosate exposure over two decades.

Mr Hunt says glyphosate has been used for 40 years, “with a large body of scientific studies [supporting] this safe product when used in accordance with label recommendations”.

His protestations are backed by the Australian Pesticides and Veterinary Medicines Authority, which registered glyphosate products as “safe and effective if used according to the label directions”.

The US environmental regulator also decreed glyphosate as safe - but the Germans have declared it verboten from 2023.

Suffice to say, the issue won't go away in a hurry.

### **Where have all the flowers gone?**

The corona-crisis has affected Nufarm in an unexpected way: wilting demand in the North American 'turf and ornamental' sector.

Nufarm is ranked number three in this market, which includes turf growers, golf courses and cut flower producers. “Many farmers are not able to access the seasonal labor required to harvest the crops,” Mr Hunt says. “They are not investing to maximize the yields of crops they may not harvest.”

Mr Hunt says Nufarm likes the sector because it taps the same inputs as the agricultural products. “It's higher margin and generally less seasonal than the other markets.”

### **Finances and performance**

Nufarm had a weak first half, under-performing across all its operations except the (since divested) South American operation.

Nufarm's operating loss came in at \$85.2 million, compared with an \$11.5 million loss previously. Seasonally, the company's second half is more important.

Allowing for the South American divestment, Nufarm gleaned 43 percent of its revenue from North America, with Europe accounting for 25 percent and Australia and Kiwibubbleland 19 percent.

Nuseed chipped in five percent of turnover, with crop protection accounting for the remainder.

On a brighter note, third (April) quarter sales and earnings rebounded. But the company was constrained by reduced inventory as it sought to manage working capital during the drought.

Broker Credit Suisse forecasts a current-year loss of \$66 million on revenue of \$2,544 million, a 33 percent decline.

The closure of the Laverton (Raymond Road) site is expected to cost \$50 million, but management has also guided to a \$15 million annual profit boost from the efficiency drive, as measured by earnings before interest tax depreciation and amortization (ebitda).

The \$50 million figure includes a \$25 million cash impost, but this will be offset partially by the sale of the Laverton site (and property values out that way are holding up well).

Over the last year Nufarm shares have traded between \$6.76 (mid-October 2019) and \$3.94 (mid-July). Over the last 10 years they have wandered between \$9.57 (May 2017) and \$3.63 (September 2010).

### **Dr Boreham's diagnosis:**

As with its farming clients, Nufarm always needs a dose of good luck - and we're mainly talking about the weather - to perform at its peak.

Nature's cycles aside, Nufarm also needs to control its own destiny and it's doing so with its cost cutting program and a more singular approach.

"We focus our activities and resources on five core crops and the key geographies we've chosen because of their size, growth potential and their ability to leverage our strengths," Mr Hunt says.

"We believe this focus - deeper rather than broader - will allow us to generate better returns for shareholders over time."

Mr Hunt expects the performance improvement program to affect every part of the business, with a further update due at the company's full year results on September 23.

In the longer term, Nuseed appears to be sowing a promising business and is one to watch.

From acorns, oak trees grow.

***Disclosure: Dr Boreham is not an agronomist and does not possess a relevant - or irrelevant - doctorate of any sort. Roundup has been banned in the Crucible household ever since your author killed the neighbor's nature strip on a gusty day.***