

Protecting Shareholder Value in Structurally Changing Markets

by Scott McDermott

Agriculture companies, food companies, energy distributors and renewable fuels companies are going through the most challenging environment Ascendant Partners has seen in more than 30 years. We are in a time of unprecedented market volatility, industry structural change and credit challenges. Rising energy prices and the following biofuels expansion are the largest factors driving the structural change in these industries. The focal point of the biofuels expansion is in southern Minnesota, eastern Nebraska and Iowa, although every area in the country has seen some activity.

This has been a good thing for most rural communities. It has provided an opportunity to invest capital in rural industry, has helped farmers by increasing demand for commodities and has contributed materially to rural economic development and employment. For others, such as feed companies and livestock producers, the biofuels expansion has created challenges as higher feed prices squeeze margins. Another group that has felt the impact of the biofuels expansion, although not as obvious, is grain marketers.

Iowa, Minnesota and Nebraska have over 1,200 grain merchants and almost 1,000 farm supply companies. Many of these companies are combined grain and farm supply companies¹. These companies have over \$35 billion in sales and employ over 23,000 people. Corn use in ethanol has gone from less than 10% of Iowa's corn production in 2000 to consuming greater than 60% of the state's average corn crop. Nebraska is similar with corn use for ethanol going from about 15% of the state's corn production in 2000 to consuming greater than 50% of the state's average corn crop.

This creates a potential battleground with ethanol plants buying corn to make ethanol, feed companies and livestock producers buying grain to feed livestock and grain merchandising companies trying to secure grain to market outside of these states. Another factor that complicates things is the speed at which the change has occurred. The majority of the structural change has occurred over the last 24 months. The question that remains is how these companies will manage through this environment. Some have adapted and are positioned well; others do not yet realize the world has changed. If everybody battles for the same corn, it is very likely that shareholders will be the ones to lose in the end.

The irony is that many of these shareholders have investments in two or all three of these industries. As ethanol plants and livestock producers bid up corn, it does nothing except erode margins and dividends to shareholders. Similarly, as grain merchandisers bid up the corn price to market nationally and internationally, they erode the merchandising margins. One of the realities of some of the grain, farm supply, feed and petroleum enterprises is that the grain business is the core earnings contributor for these enterprises. If the grain business is marginalized, it could jeopardize shareholder investments in the overall enterprise.

The only way to minimize the risk to shareholders in this environment is to understand the business implications and rethink how they are doing business. Companies in these industries need to take a critical look at their reason for existing as a company and make sure they can viably still fulfill the same role in the marketplace. Historically, we have seen firms be stubborn about rethinking their business, and they end up being the ones to drive the company under and destroy shareholder value. With any challenge, the key to resolution options is to identify and address the challenges early.

Some of the critical focus areas to consider are:

- Strategically – The board and senior management need a clear and aligned understanding about where they want the company to go. If this is not the case, the board and senior management will have a tougher time identifying that their business environment has changed and will struggle to come together around important decisions, which may lead to inaction at critical points in time and destroy shareholder value.
- Market Environment – The market environment that many companies do business in has changed, and they do not know it. Business is not as usual, but it is being considered as an anomaly instead of a structural change. If the board and management do not track information regarding their market environment so they can see how things are changing, they will not likely identify and change in time to protect shareholder value.

¹ 2002 Economic Census



- Business Realignment – There are many options available for realigning a business, but do the homework and do not react. A disciplined process when adding new ventures is key to increasing the odds that new ventures succeed and return value back to shareholders.
- May be time to consider Mergers, Acquisitions and Sales – One of the most common traits of our customers is independence. This quality can be a real strength when it comes to trying to make a strong organization. The challenge to shareholders comes when independence becomes the reason not to do what is in the best interest of shareholders, which leads to destruction of shareholder value.
- Business Discipline and Performance Improvement – There are always places to improve the business and tighten the belt. The problem occurs when this is not done in a disciplined and thoughtful way. Sometimes they focus on cost cutting at the expense of the core business or without thinking about ways to try to increase revenue. The goal is not cost cutting--it is performance improvement that improves shareholder value. Cost cutting is only one of many tools that can be used to improve performance.
- Competitive Benchmarking – This practice is not common in grain, farm supply and renewable fuels; but it is effectively used in livestock, food, refining and many other industries to keep companies in cost-competitive industries from being at a competitive disadvantage.
- Enterprise Risk Management – This is not only being effective at commodity risk management, but it is also thinking about counterparty risk with service providers and partners, contract risk of poorly written contracts, fiduciary risk to the board overseeing the company, credit risk to credit counterparties and regulatory compliance. These are areas that are often neglected until companies get into trouble. They then unduly negatively impact shareholder equity in a restructuring, merger or sale.
- Capital Planning – The company needs to integrate conservative capital planning to make sure the company is prepared to meet obligations in difficult times. As part of this planning, companies need to keep good communication with lenders to make sure the lenders will be there when needed. A lack of conservative capital planning can unduly negatively impact shareholder equity in a restructuring, merger or sale.
- Restructuring and Recapitalizing – Companies may be getting pressure from some shareholders or creditors to make rash decisions that are not in the best interest of the majority of longer-term shareholders. This misalignment could put everyone's capital at risk. It is important to make sure lenders and shareholders agree with the vision of the company and support the company's actions. Otherwise, shareholder value can be destroyed when the bank pulls its loan or shareholders do not support key business decisions.

Ascendant Partners Inc. was formed to respond to market demand for tailored business solutions delivered through capable, committed and accountable professional resources. Ascendant Partners has an intimate knowledge of client markets, what it takes to succeed and how to manage volatile environments. Ascendant's historical focus has been serving mid-size clients in the food, agribusiness and renewable fuels industries. Ascendant Partners formed Ascendant Financial Partners, LLC, a licensed FINRA Broker-Dealer, to perform dedicated investment banking services. Ascendant Partners, in partnership with seasoned credit and banking professionals, formed Ascendant Risk Management to provide credit risk management consulting, training and appraisal services. Ascendant Partners Inc. is headquartered in Greenwood Village, Colorado.

Scott McDermott is a partner with Ascendant Partners Inc. – 303.221.4700 or www.ascendantpartners.com.