November 2020

Field of Agronomic Dreams: Rethinking the Farm Supply Co-op to Drive Value

By Kenneth Scott Zuckerberg
Lead Economist

Inside…

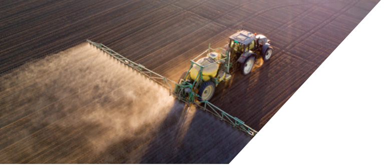
Key Points:

- Cooperatives have a long, proud history and remain the largest and most important providers of farm supplies to America's crop farmers. However, challenging fundamentals and disruptive forces – in place prior to COVID-19 – are pressuring the business model.
- Several agricultural cooperatives have merged or signed joint ventures during 2020. Unfortunately, consolidation alone does not fix difficult industry fundamentals, which include competition with independent ag retailers and the stresses on farmers' income.
- These pressures offer cooperatives' management teams and boards the chance to evaluate and explore various ideas to improve profitability. These ideas range from re-focusing on operational excellence to strategic partnerships that embrace new precision ag technologies and enhanced advice and service.

Introduction

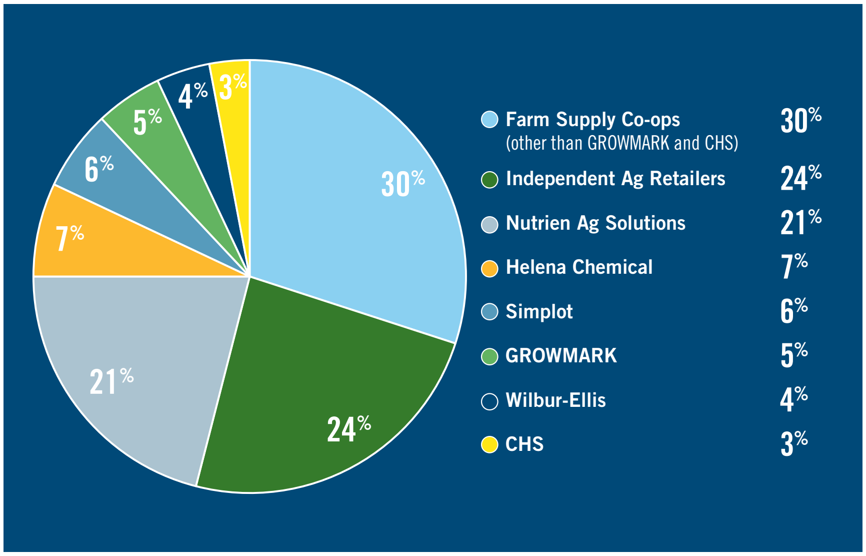
Farm supply service cooperatives remain the dominant form of input distribution in North America. However, in recent years competition has intensified with non-cooperative distributors (independents) as well as Nutrien Ag Solutions, a vertically integrated crop inputs supplier *(Exhibit 1)*. Several competitors have differentiated themselves with integrated digital farming offerings that leverage modern information technologies such as data analytics and AI (artificial intelligence).

Beyond the market share battle, farm supply co-ops' margins are being squeezed by customer pressures and macro variables. On the former, low grain prices since 2014 have weakened farmer income and cash flow, which has impacted farmer input purchase decisions. On the latter, margins for fertilizer and crop protection chemicals have contracted due to competition, plentiful supplies, generics and alternatives. In the case of fertilizer, lower margins from carry (i.e., buying nutrients when cheap during the summer growing season and reselling product at higher prices during the fall and spring) have largely evaporated.



All the while, the outlook for farmers and the farm supply cooperatives that serve them is stressed by growing competition from other major farming regions (namely Argentina, Brazil, Ukraine and Russia) and a generally strong dollar relative to the currencies of our export competitors. The cumulative effect of industry pressures has been a 24% decline in both the number of U.S. farm supply cooperatives and total U.S. agriculture cooperatives since 2009 *(Exhibit 2)*.

EXHIBIT 1: Estimated Market Shares for Ag Retail Distributors



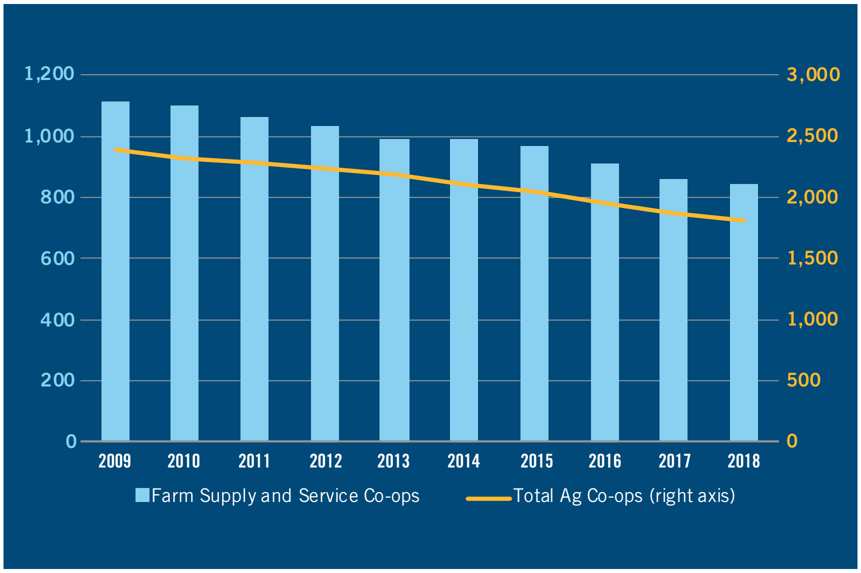
Source: Crop Life and Nutrien, September 15, 2020

A Deeper Look at the Industry's Challenges

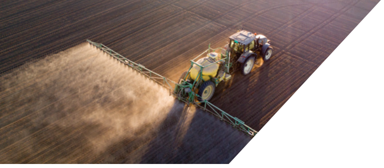
U.S. farmers are increasingly price conscious as they endure continued financial stress (lower income, higher debt and lower working capital levels) resulting from low commodity prices and high production costs. In recent years, rising yields and improved field productivity have depressed commodity prices, all of which is happening against a backdrop of changing dietary preferences and slowing population growth.

Cost pressures appear to be coming at the expense of traditionally loyal relationships as farmer business exits (either through bankruptcy or sales to competitors) reduce the number of customers available for ag retailers to

EXHIBIT 2: Trends in Number of U.S. Farm Supply and Total Agriculture Cooperatives

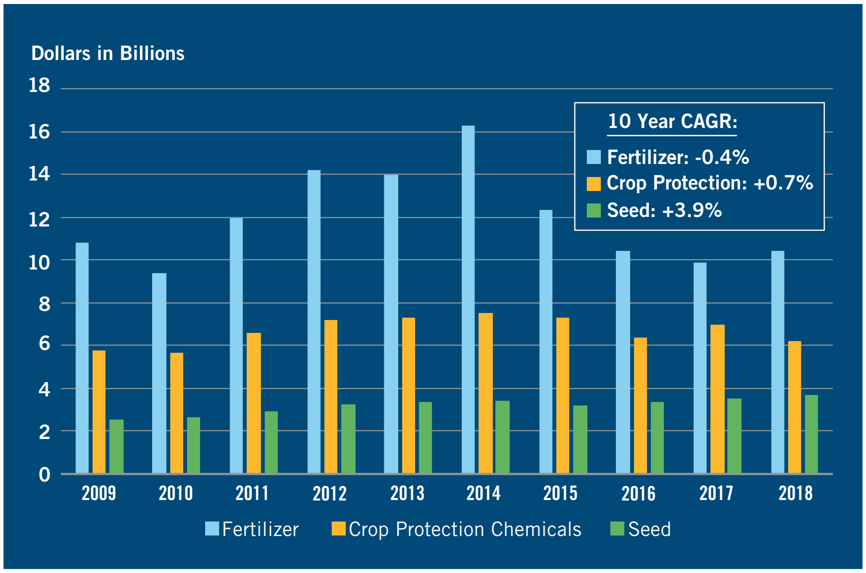


Source: USDA



serve. In absolute dollar terms, fertilizer and crop protection chemical sales are well below 2014 peak levels *(Exhibit 3)* and have grown at a compound annual rate of only -1% to +1% over the past 10 years – although we recognize that adverse weather and prevent and delayed planting also contributes to the lower growth. The modest rise in seed sales is positive, however, seed is a much smaller spend and has been an insufficient offset.

EXHIBIT 3: Fertilizer, Seed and Chemical Sales (2009-2018)



Source: USDA

Another threat comes from above – the input manufacturers supplying products for re-sale by the cooperatives – who may eventually cut out the cooperative and sell directly to farmers. Also, as farming enterprises grow larger and more sophisticated, it is likely that they will hire their own crop consultants, agronomic advisors and contract sprayers and reduce their reliance on the local co-op. A more recent phenomenon is the emergence of new entrants – including Farmers Business Network, Farmers Edge, Indigo Ag and others – although most have made very little traction in the real farm economy. Interestingly, a group of cooperatives have created their own proprietary network called CommoditAg as a means for the cooperative owners to sell products and services more effectively.

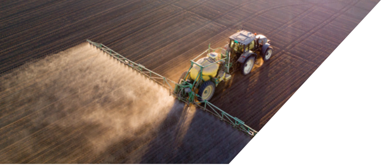
Industry Responses

Farm supply co-ops are responding to challenging industry operating conditions in several ways. Some players are selling or leasing out their agronomy divisions while others are capturing additional margin by eliminating wholesale and retail layers via M&A and partnerships. Examples of the latter:

- **Agri-AFC, GreenPoint AG and Tennessee Farmers Cooperative** announced in September 2020 the formation of a joint venture combining specific agronomy assets. The combination includes all operations of Agri-AFC's wholesale and retail business, GreenPoint AG's retail business, and Tennessee Farmers Cooperative's wholesale agronomy business. The new venture will operate commercially as GreenPoint AG and will be jointly owned by Alabama Farmers Cooperative (AFC), Tennessee Farmers Cooperative, and WinField United.

- **GROWMARK** continues its opportunistic expansion as evidenced by its recent acquisition of the wholesale agronomy and energy assets of Southern States Cooperative, and several of its Delaware and Maryland retail locations. Beyond obtaining propane service capabilities, GROWMARK should be able to cross-sell existing products and services to a new customer list.

- **Land O'Lakes** (LoL) is establishing partnerships with cooperatives that see value in aligning with WinField United, its agronomy division.



Independent distributors are also in the process of transforming their business models to increase resiliency and profitability:

- **Nutrien** pioneered a new, vertically integrated, supplier-plus-distributor business model through the transformational 2018 merger of Agrium, Inc. and PotashCorp of Saskatchewan, combined under the brand name Nutrien Ag Solutions. Subsequent to the initial deal, Nutrien has acquired retailers in the United States, Brazil, and Australia, along with a California specialty-nutrients business (Actagro) and a large Brazilian branded soybean seed business.

- Among other major players, **J.R. Simplot Company** expanded its input retail business this year by acquiring Pinnacle Ag, itself a product of past mergers. **Helena Chemical** and **Wilbur-Ellis**, both part of much larger diversified organizations, have made investments in customer spraying, aerial application services and various "digital farming" solutions to differentiate their customer offering.

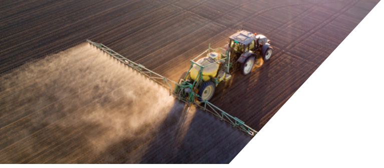
The Path Forward

CoBank believes that the current environment provides farm supply cooperatives with a very good reason to evaluate strategic opportunities as a means to transform the existing business model. A useful starting point involves Porter's Five Competitive Forces model, an analytical tool that helps explain the variation in profitability among different industries.[1] The table below *(Exhibit 4)* applies Porter's model to farm supply co-ops.

EXHIBIT 4: Porter's Competitive Forces Applied to Farm Supply Cooperatives

Competitive Force	Risk Level	Explanation
Competition and Rivalries Among Existing Players	**HIGH**	The co-op has historically added value to members through local knowledge and expertise and a loyal customer-owner base. However, multiple years of margin pressure has caused farmers to reevaluate how they buy and through which channel.
Threat of New Entrants	Low but Rising	Alternative distribution models are somewhat disruptive for co-ops, but suppliers pose a greater threat (see below).
Power of Suppliers	**HIGH**	The mega-mergers of 2014-16 (e.g., Bayer/Monsanto, Dow-DuPont) has resulted in a concentration of market share among five large suppliers. Beyond the ability to dictate terms of trade (commission and rebate levels), large input manufactures are likely to sell directly to farmers in the future and thus compete with the cooperative.
Power of Buyers	**Medium**	Farmer power is increasing as farms consolidate and leverage their size to obtain better pricing.
Threat of Substitutes	Low but Rising	The need for crop protection and nutrients remains fairly constant. The offset is that precision and climate smart agriculture practices focus on optimizing input (i.e., using less) to achieve the same level of yield.

Source: CoBank Knowledge Exchange



Following are some ideas the cooperative management teams and boards may wish to consider as part of their annual strategic planning process. The ideas here are not recommendations but rather tactical ideas to create value that consider strategies other than consolidation:

1. **Pursue the "low hanging fruit" with initiatives to improve general operational excellence and efficiency.** This would include rationalization of business assets and locations, making investments in automation, active and more aggressive management of accounts receivables and inventory, and better alignment of marketing and customer segmentation.

2. **Align with a strategic partner(s), such as a local or regional competitor.** Look for those with transportation or infrastructure assets (fertilizer blending and formulation facilities) or advanced automation and technological capabilities, or an expanded set of products and services that can be cross-sold to the existing customer list.

3. **Partner with an aerial imagery or robotics company.** This step enables a co-op to offer both agronomy and precision field application services and digital agronomic advice. Depending on region, the advice could include and/or incorporate crop diagnostics, soil analysis precision irrigation, integrated pest management and various other field-specific services.

Conclusion

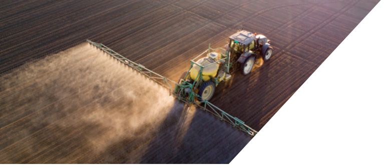
Crop farmers and the cooperatives serving them have endured a difficult operating environment for nearly seven consecutive years. These challenges will ultimately force co-ops to rethink business models to serve an evolving farm customer interested in embracing technology and innovation. This report is intended to provide a starting point for thinking about the future. In any business in any industry, "failure is not fatal, but failure to change could be," as noted by John Wooden.[2] We believe that if the American farm supply cooperative can build greater product and service capabilities, the farmer will show up to embrace it.[3] ■

References

[1] Porter's Five Forces model was published in Harvard Professor Michael E. Porter's book, "Competitive Strategy: Techniques for Analyzing Industries and Competitors" in 1980.

[2] John Wooden was known as one of the greatest basketball coaches of all time as well as a prominent leader, author, and motivational speaker.

[3] This statement is a play on the phrase "if you build it, he will come" from the 1989 U.S. film *Field of Dreams*, directed by Phil Alden Robinson.



**CoBank's Knowledge Exchange Division welcomes readers' comments and suggestions.
Please send them to KEDRESEARCH@cobank.com.**