

FINE CHEMICALS

Can China ever buy in agro?

Chinese conglomerates keep failing to complete major agrochemicals acquisitions. Why?, asks C.S Liew of Pacific Agriscience

ChemChina and Sinochem have each in turn failed to acquire Nufarm. The latter fell at the last hurdle in December, failing to complete an acquisition that seemed to be a done deal. The former had also previously been unable to acquire Dow Agrosciences last year. What is the problem here? There are three inter-related questions to ask:

1. What has gone wrong so far in the M&A strategies of these Chinese conglomerates?
2. They are clearly able to raise the necessary funding from state-owned banks but are they ready, structurally and psychologically, to make such mammoth acquisitions?
3. Are there any other acquisition targets for them to look at? And if so, will the targets be keen on negotiations and subjecting themselves to due diligence by potential competitors who have such a poor track record at closing deals?

What's gone wrong?

The first problem is that ChemChina and Sinochem did not appear to have a solid post-acquisition strategy in place before they embarked on making an approach. They appear to have simply opted for one major acquisition rather than a series of smaller ones and to have targeted major R&D-based companies, e.g. Dow, DuPont, BASF, Syngenta or Bayer.

ChemChina, admittedly, first targeted a generic agchem player in Nufarm but switched tack and came close to acquiring Dow Agrosciences. The window of opportunity was lost because Dow backed out at the last minute.

Sinochem, by contrast, sought first to buy a company with GM seed technologies and assets and R&D capabilities. In the end, it was persuaded that a generics company such as Nufarm had a better strategic fit for them – hence the bid in mid-2009 that finally collapsed on 29 December.

The rationale in going after an R&D-based company centres around the need to acquire advanced technologies and marketing experience, as well as capabilities in synthesis and commercialisation of new molecules. In both areas, China is weak and lacking in capabilities.

Even China's premier pesticide research centre, Shenyang Pesticide Research Institute (now owned by Sinochem), which conducts new molecule synthesis and various toxicology studies, has not yet brought a single molecule to the global market, nor has it secured GLP certification and status. The relatively low-profile Koreans, LG and DongBu, have done better in R&D, while India has a better track record in GLP.

China's 500 or so generic agchem manufacturers are under pressure to make good in these areas, but many of them create pollution and neither add nor capture much value in the supply chain. At this stage, it would seem logical for them to focus on acquiring companies with international market access and product registrations and – since they have no experience at all in acquiring and managing international agchem firms – to target buys under \$1 billion and learn from these before going after the majors.

In parallel to seeking major targets, Chinese companies ought to follow the lead set by Nufarm, Makhteshim Agan and UPL, i.e. gain offshore product registrations and market access by acquiring national distributors. In these ways, they will begin to truly understand what it takes to accomplish their ultimate goals and not think that money or funding is all they need. Money can buy any company but cannot alone enhance the value of what has been acquired.

Another mistake the Chinese have apparently made has been to seek bargain prices in order to lessen potential losses and minimise risks. To me, this is also a sign of lack of a post-acquisition plan and strategy.

If there was a value-enhancement strategy in harnessing synergies from the acquisition(s) or a follow-up acquisition that has a potential for a one-plus-one-equals-three, then, what is the difference between paying, say, \$13/share rather than \$12? I would suggest they need to focus more on such value-enhancement strategies rather than haggling over price.

A third issue is exemplified by ChemChina's agreement with two private equity investors, Blackstone and Fox Paine to buy Nufarm in a 60:20:20 ratio. I cannot see the rationale for an industrialist with long-term value enhancement goals buying in partnership with private equity investors with upfront value extraction and shorter-term value enhancement and exit goals.

There was a glaring conflict of objectives amongst the partners right from the start. So, had the deal gone forward, I foresaw ChemChina being faced with the dilemma of paying for its own success by having to buy up the shares of the two private equity firms later or being faced with new partners it might not like.

Are they ready?

Are the Chinese conglomerates ready to make such mammoth acquisitions? No, not quite yet. Given that this industry is so highly regulated and they have no international experience in managing such an entity, it makes it quite risky for them in this uncharted territory.

Both ChemChina and Sinochem, along with their financiers and their financiers' ultimate owners, the state, need to understand that acquiring and subsequently managing one of these international agchem product development and marketing companies is quite different to acquiring 'dig-and-dump' iron ore or coal mining assets.

Although Sinochem has a listed company in Hong Kong and ChemChina has made a couple of acquisitions abroad, neither has set foot internationally in the highly regulated agchem industry. Here, the landscape is changing rapidly due to GM

technologies, successful international market penetration by Chinese and Indian generic pesticides and the strong defence put up by the major players through tactics and strategies very unfamiliar to Chinese companies.

Surely one of the objectives in making such a large acquisition is to integrate the newly acquired firm into the current operations of the conglomerates and to harness the synergies arising from the combined operations. Yet neither ChemChina nor Sinochem currently has any key managers with international agchem experience who could interact effectively with the managers of any acquired entities.

It appears that the Chinese would adopt the Japanese approach to foreign acquisitions in leaving them to their own devices in terms of the day-to-day management. ChemChina's approach with its current portfolio, such as the Australian olefins and polyethylene producer Qenos and the French feed additives producer Adisseo, is certainly hands-off. It has merely sent some managers over there to learn various aspects from these acquisitions.

This is fine where there are no significant integration, consolidation and synergies to be harnessed between the acquirer and the acquired firm. However, with a Nufarm, it seems strange that the conglomerates have no staff in their current organisations that could effectively perform the needed integration and harness the ensuing synergies, as both have several agchem plants and marketing operations in China.

Even from the technology and management expertise transfer points of view, one would think that they would have a team of core managers with the language and educational background ready to learn from the more experienced managers in the acquired entities. Perhaps they would prefer to do it the other way round - acquire, let the acquired entity manage them and their domestic operations and then learn from them?

The lack of a team of core managers with international agchem experience who 'speak the language' suggests that the Chinese giants are not psychologically prepared for major acquisitions either. This deficiency might leave them unable to make strategic assessments during the acquisition process, particularly in due diligence. And the likes of Blackstone and RBS will not be able to plug the gap for them.

As discussed earlier, the lack of a post-acquisition plan and strategy led the Chinese firms to focus too much on acquiring the target at the lowest possible price, which ultimately led to the deals collapsing. With the right management and strategy, they would have been able to see that another dollar/share on the offer price was a minor detail.

Are there other targets?

So, where would the Chinese conglomerates go from here? Obviously, they have looked at just about every possible target out there since, thanks to industry consolidation in the past decade, there are not that many there in the first place. The question is whether they know and understand what they have looked at.

Here again, without good and insightful agchem industry advice and the fact that they do not currently have on board managers with the right industry experience in the

international arena, strategic assessments of what does and does not fit and why leads to the wrong conclusions and maybe even good targets being overlooked.

Of course the number of targets available to look at also largely depends on one's ability to think outside the box. Here, what I am suggesting is that there is a need to rethink and understand that a mix-and-match of all targets along the agchem supply chain could be a way going forward.

Doing this could open up a lot more possibilities. However, without a clear understanding of the agchem landscape and the current and future changes in this landscape, they have no way of embarking on what I called 'creative acquisitions', i.e. acquiring what is not yet out there as a whole.

To go forward, the Chinese conglomerates will need to iron out a few fundamentals first. They need to invest in people with the right industry expertise. It is ironic that they have such huge acquisition funds at their disposal but not yet the specialised and industry expertise needed.

They need to value a lot more industry advice and expertise that comes from years of operating and networking in the industry. Most of all, they need to tone down their over-confidence, if not arrogance, if they want to play and operate successfully in the international agchem industry and capture more value along the supply chain, instead of merely being a low-cost manufacturer and gaining minimal returns on investment.

Future acquisition targets will, nonetheless, enter into negotiations with the Chinese agchem suitors, despite their poor track record at closing deals. In some cases, they will have to, especially in the light of the changing landscape brought about by the ever increasing price and value erosion caused by the Chinese agchem producers themselves!

However, the Chinese will need to show that they are not out there looking for bargains again. They need to show that they are ready to play seriously and not just look-see.

To be convincing, they need to be armed with the right industry expertise and focus on what can be done with the acquired entity or entities. They need to show that they have the confidence to close deals, moving on to enhancing the value of the acquired entities. They must play seriously in this highly regulated industry and be accepted by the major players on the international stage.