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HD **Seeds of doubt linger at Nufarm**

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Nufarm boss Doug Rathbone probably had more than strategy on his mind when his six global division heads jetted into Australia last week for five days of meetings ahead of Nufarm's interim result on March 26.

The crop protection **group**'s top brass descend on Melbourne every March. But this year the meetings came just weeks after the end of a 10-year distribution agreement with German chemical giant BASF.

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Last year the executives hit the tarmac shortly after US giant Monsanto terminated Nufarm's distribution rights for its popular RoundUp **brand** of weedkillers, sending Nufarm shares tumbling.

With Nufarm stock languishing near five-year lows, Rathbone and his high-profile chairman, Donald McGauchie, have spent the past year reassuring the market that neither agreement is material to Nufarm.

But Rathbone fuelled doubts about the **company**'s prospects when he tapped Credit Suisse to sell the majority of his Nufarm holding, about $31 **million** worth of stock, in January. The crop protection mogul needed the cash to shore up his family **wine** businesses, which employ his three sons, and to get lender ANZ Bank off his back.Past demons recalled

But for some investors the sale recalled past demons.

Back in 2011, Rathbone **sold** 4.5 **million** shares just two months before Nufarm downgraded earnings. In April 2010, Nufarm completed a $250 **million** equity raising only to breach its banking covenants and suffer a credit rating downgrade weeks later, prompting an ASIC investigation and a shareholder class action (settled for $46.6 **million** in 2012).

This series of events seriously damaged Nufarm's reputation and the bridge has been burned for some fund managers.

This history means Rathbone has a battle on his hands selling a positive story to the market – namely, that Nufarm is through the toughest part of its turnaround since the global glyphosate market collapsed in 2010.

Glyphosate – a key ingredient in weedkiller and the most important chemistry in agriculture – was about 40 per cent of Nufarm's **business** when a flood of new supply blew up the market and Nufarm's margins on the product line plunged from 30 per cent to 12 per cent.

Glyphosate is now about 20 per cent of Nufarm's **business** and the **company** is talking up its prospects in seeds and growth opportunities in markets outside Australia. Nufarm thinks it can grow considerably in North America, Europe, Asia and South America. But the short-term heat is in the fast-growing South American market – particularly in Brazil.

With the global team in Australia last week, Nufarm took the opportunity to put South American general manager Valdemar Fischer and European GM Hugo Schweers in front of analysts and fund managers on Thursday and Friday.Two bad seasons in a row

Australia has had two bad seasons in a row and the hot, dry weather hitting the nation's growing regions belted margins and sales for most agribusinesses.

Last year Nufarm's Australian revenue plunged 14 per cent to $604.4 million and earnings dived 67 per cent to $35.4 million.

Rathbone has called in Deloitte and specialist manufacturing and logistics consultancy D.Betts to conduct a root and branch review of Nufarm's Australian operations to try and get a more flexible cost base that can shift in line with demand.

In Australia Nufarm has about a 50 per cent share of the glyphosate market. The company knows it will lose some market share to BASF and Sinochem, the group that took on the RoundUp rights, but Nufarm has been maintaining sales with the launch of its own Weedmaster brand and strong network effects through agricultural supply channels. Nufarm is determined to defend its market leadership in Australia, but wants investors to focus on the growth opportunities in its international businesses.More than just Australian

At the general meeting in December, McGauchie took pains to point out that Nufarm is "more than an Australian company", with just 28 per cent of 2013 group revenue coming from Australia and New Zealand. In 2013, crop protection sales in Australia fell 14 per cent but jumped 30 per cent in South America.

The South American market is worth about $US16 billion ($17.7 billion) and Nufarm's market share is about 3.4 per cent.

While it is a key part of Nufarm's growth story, the surge in demand from South America has been something of a mixed blessing in the short run. A heavy inventory build to meet demand has meant elevated working capital requirements and has put added stress on the balance sheet.

That is a serious concern for many investors, given past history and the fact that Nufarm is overgeared and exposed to weather and agricultural risks. Nufarm has insisted there is no need for an equity raising but some analysts remain unconvinced.

Getting the balance sheet in better health is a key priority and will be done by releasing as much working capital as possible.

Nufarm's goal is to slash its average working capital to sales ratio down from about 48 per cent to 40 per cent.Rigorous customer checks

One of the problems is the common practice in Brazil for farmers to take product in advance and pay their supplier after harvest. This has pushed the average days of receivables – the amount of time it takes Nufarm to get paid – to about 200 days in South America compared with 90 days elsewhere.

The company mitigates this issue by rigorous customer checks – bad debts in Brazil are less than 1 per cent – and by growing the share of its business done directly with large-scale farming enterprises in Brazil rather than going through distributors. In the past two years Nufarm has grown its direct business with Brazilian farmers from 2 per cent to 20 per cent.

Working capital is also being addressed in a review of the global product portfolio aimed at eliminating slow-moving and low-value products. Rathbone and McGauchie are also keen to get the market excited about Brent Zacharias's Nuseed division.

Nufarm has spent more than $200 million, including over a dozen acquisitions, building a foothold in the high-margin seed treatment and traits business.Hybrids with desirable disease

Seed technology aims to deliver top yielding hybrids with desirable disease, stress and productivity traits.

Gross margins in seeds are about 55 per cent and Nufarm wants to double earnings before interest and tax from the segment from $32.4 million to about $60 million over the next few years. The strategy is to avoid competing against the global powerhouses in seed technology such as Monsanto and Syngenta by focusing on niche crops like sorghum, sunflower and canola.

Many sell-side analysts are on board with the turnaround story. PAC Partners analyst Paul Jensz values the stock at $6 and is forecasting earnings growth of 12 per cent a year.

Belinda Moore from RBS Morgans says her $4.75 a share valuation is conservative and the stock could re-rate in line with global peers once the seeds **business** is more established.

But the problem remains that some investors have stopped listening. There is a view in the market that Rathbone needs to call time on his 30-plus years at the **company** to give a clean break with the past.

Rathbone said in February that he has no plans to go and his job is to make his remaining Nufarm stock worth four or five times the $3.92 it is worth now.Nufarm shares may regain

If he manages the feat, Nufarm shares may get back to the $13 a share **China**'s Sinochem bid for Nufarm in 2009.

The takeover play saw Japan's Sumitomo Chemical take its 20 per cent **stake** in Nufarm at $14 a share. The Japanese **company** has since crept its **stake** up to 23 per cent and has a representative on the **board**.

Sumitomo and Nufarm have a number of joint-venture agreements, including a deal inked this year for Nufarm to distribute Sumitomo's Valent branded lawn and ornamental products in the US.

There is an agreement in place that means Sumitomo cannot creep any higher and must come to the **board** with a full takeover offer to get its hands on any more stock.

Sumitomo has had a good opportunity to get an inside look at the synergies it could extract from an acquisition, but there are questions about its ability to finance a deal at the moment.

The endgame looks like a takeover but the Japanese are notorious for having long-term time horizons.

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