GROWERTALKS

Cover Story

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The Big Get Bigger

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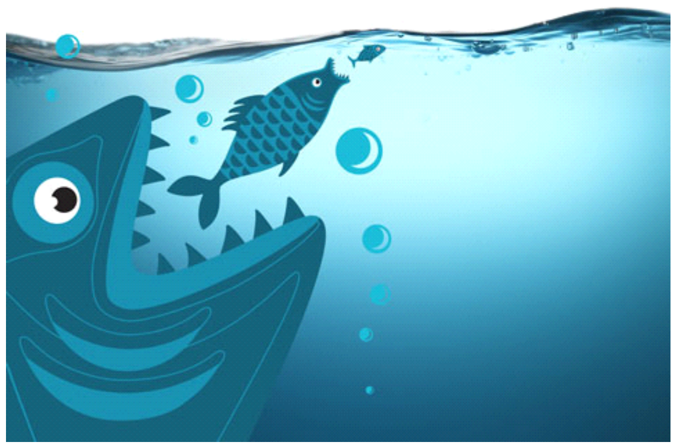

You've probably played the game of Monopoly at least once in your life, but you probably didn't know that it was created in 1906 by an anti-monopolist to show what happens when private land is bought up by large corporations. Originally called "The Landlord's Game," it was meant to serve as an educational tool on the evils of monopolies. In the early 1930s, Parker Brothers bought the patent and the rest you already know.

The game is entertaining (especially if you own all the property), but in real life, the term "monopoly" is usually met with fear and suspicion. Capitalism is part of American culture, but there's an implied understanding that ONE organization should not control EVERYTHING. This is why antitrust laws are in place to restrict mergers and acquisitions between companies from unfairly lessening competition and preventing one company from having all of the power.

So what about our little world of horticulture? As a trade publication, we feel like we've been reporting on news of acquisitions and bankruptcies more often, especially during the last 10 years. Obviously, we're not immune. But how does it affect our businesses, our products and ultimately our customers?

Big fish, little fish

Every industry has experienced waves of consolidation, depending on the economic environment, and some of it has been very good for the companies, their brands and the consumer (Disney/Pixar, Sirius/XM Radio). But not all consolidation has worked out (Sears/Kmart, AOL/Time Warner).

In the world of business, the life cycle of an industry is similar to the life cycle of a living thing—an industry is born, grows, matures, and eventually experiences decline and ultimately death. The distinct stages of an industry life cycle are referred to as: introduction/startup, growth, maturity and decline.

Consolidation is usually the result after a period of significant growth and occurs for different reasons:

• Growth slows, shifting the focus toward reducing costs

• Companies achieve "economies of scale"—as they expand, they're able to increase production faster and more efficiently, which also slows down the sustainability of smaller companies, many times pushing them out

• Barriers to entry become higher and the competition becomes more stabilized

By this time, the industry has entered its “maturity phase,” with the goal of those companies who survived the decline in sales to gain market share and increase cash flow. Price competition becomes much more relevant as product differentiation declines.

Compared to other industries, horticulture is a relatively young industry, but doesn’t that sound familiar? Is the recent wave of consolidations—especially at the grower and breeder level—the result of a “maturing” in horticulture that’s just going through a typical industry cycle? Todd Billings, who’s been in Ball Horticultural Company’s Finance Department for over 25 years (as CFO for 12 of them), thinks so.

“I think that it is [maturing] and big ag has gone through that,” he said. “I think vegetable companies have gone through that. I think cannabis will go through that; it’s in its infancy now. I think there is a certain amount of natural maturing life cycles of industries that go through consolidation.”

Each life cycle stage is introduced by a change in the market, customer or new innovations/technology and for three segments of the horticulture industry—grower, breeder and distributor/broker—they have all been affected in some aspect by these changes.

Growers

The 1970s and ’80s were good days for horticulture; the demand for plants was the highest it had ever been. There were no barriers to entry—anyone could build a greenhouse and sell everything they grew. And if a growing operation went out of business, it was soon replaced by another one.

By the 1990s, demand didn’t taper off, but growers were producing more than the market needed and it became saturated. Also during this time, the rise of the big box stores brought a wave of grower consolidation and a decline in the number of small operations—the big guys kept getting bigger and many small mom & pops couldn’t compete.

Abe VanWingerden, whose family-owned company, Metrolina, is a big box grower and has acquired a few growing operations in the last few years, said that “supply side correction” led to the influx of grower consolidations in the ’90s.

“We were producing too much for the demand out there,” he said. “Back in the day, if you needed product, you could find it even if it wasn’t ordered the previous year, as growers grew speculative product. If you don’t have a pre-order now as a wholesale grower, you’re much less likely to grow it like you might have in the 1990s.”

The pace of grower consolidation has slowed since the boom of grower consolidation in the 1990s and early 2000s. Todd said it’s because “the market is pretty well stabilized in terms of the influence of the mass marketers, the IGCs, landscapers and others. We’ve been talking about the same mix for 10 years now.”

Plus, these days, you need more money—in the ’80s, you could start a greenhouse business with $10,000 or get a third party to invest; today, significant innovations in state-of-the-art growing structures alone require a large capital investment, not to mention irrigation and climate control systems, transplanters and other automation.

“The buyers have become smarter and don’t just buy someone just because they’re available,” said Abe. “Additionally, the outside money isn’t as evident. Yes, we have Central Garden buying Bell and Scotts buying Bonnies, but many of the venture capital firms that got into our industry in the 1990s/early 2000s aren’t as quick to invest now due to the either lower returns on initial investments or the sheer complexity of our industry vs. other industries they can invest in.”

Abe also said that the other acquisitions that have been happening—like when Metrolina bought Stacy's—have been done mainly for strategic fill-in reasons; i.e., expanding lines within a retail customer, filling in geographies regionally, etc., but it's happening less often now.

Breeders

Recently, we've seen a lot of consolidation activity in the breeder segment and Anna Ball, President & CEO of Ball Horticultural Company, said one of the main reasons is because of developments in technology. Both Ball and Dümmen Orange, for example, are currently investing in and building advanced science research facilities, and both have acquired several different breeding companies during the past 10 years.

Although Ball has a dedicated staff of talented breeders, the company does partner with small, third-party breeders to find unique varieties and bring them to market. Anna said that consolidation has allowed them to build the new breeding facility that they feel will actually help small breeders by offering them access to new technologies and prevent even more consolidation.

Another reason there's been more consolidation at the breeder level is because, like with any business, you want to have as much market share as possible. As we've seen with recent breeder acquisitions, these companies have bought businesses that had a different product offering or filled a new niche. Like when Ball acquired Star Roses, for instance, which added woody ornamentals to the company's lineup or Darwin and Kieft Seed for a more robust perennial offering.

What's interesting is that, with all of Ball's recent breeder acquisitions, each of the companies approached them, not the other way around. "And the number one reason is that there's no successor," said Anna. The owners of these companies didn't have someone to take their place when they wanted to retire, so they asked Ball if they would be interested in making a deal.

Anna feels Ball's reputation for its friendly, family-focused culture is the reason why these companies are interested in putting their business and employees under the Ball umbrella. And on the flipside, company culture is what the Ball leaders look at when deciding on an acquisition.

"Culture is a big thing," said Anna. "One of the reasons that consolidation fails is because people try to buy companies where the culture doesn't match."

Other questions they ask: Is it a strategic fit with what they're trying to achieve? What's the financial return on investment? How do they add value? Can they make it a better company if they own it? All of this plays into the decision.

Ultimately, it comes down to better serving their grower customers by offering the most and best choices.

"It gives them cooler product that they can make more money on," Anna said. "Less risk, less disease, higher margins.

"I always say that we're [investing in new breeding technology] for the growers because we are. We need plants that perform for the consumer no matter what they do to them. In other words, tougher plants with a shorter crop time that they can make more money on. That's why any of the breeders do it."

Distributors/brokers

This segment of our industry is different depending on how you look at the distribution business as a whole. Craig Hyslip, COO of Griffin, said that 30 years ago, what he calls "traditional distributors" only supplied hardgoods products—everything from containers and greenhouses to soil and chemicals. Brokers, on the other hand, were the ones you went to for plants. Now, they're interchangeable, with almost all distributors selling some live goods—whether vegetative, seed or both—and brokers dabbling in hardgoods.

But if you look at consolidation, the two halves are very different. From the early 1990s into the 2000s, there were quite a few mergers and acquisitions happening on the distribution side. Griffin alone bought 13 distribution companies during that time. And as with the growers, the box stores played a large part in that activity.

"They changed how we went to market. The big growers got bigger, so the smaller distributors ran into financial situations," said Craig. "They couldn't be competitive with medium to large growers. That affected their service levels and when your service levels go down, we all know what happens. Consolidation among distributors allowed them to scale up, to keep pace with what was happening in the grower segment."

As the smaller distributors were looking to leave the industry, larger ones like Griffin saw the chance to expand from a local business to more regional, and eventually, national. They were able to improve on their logistics and the level of purchases increased, said Craig. Then they expanded into live goods, which had been unheard of before.

"We looked at it as though we should not be selling live goods because it's competitive against our customer and that was just ingrained in us," said Craig. "But the industry, quite frankly, is not growing. So we looked at the plant side, being able to sell that product along with the hardgoods. To sustain your own business, you've got to bring on additional products, services or a combination of both, or attract a new customer."

Conversely, on the broker side, there has been little to no consolidation and no one knows why (Dümmen Orange's acquisition of Vaughn's and McHutchison has been the most recent and really the only one in a while).

"I'm dumbfounded that there hasn't been consolidation [on the broker side]," admitted Craig. "I do not feel as though the market requires as many brokers as there are and there's a tremendous amount. But we're all doing it and we're all staying in it year in and year out."

"It's kind of funny because everyone has said, 'Oh, the distribution level is going to be irrelevant and we won't need it.' It's the one level that people say is not going to be around and it's the strongest," said Anna, (broker Ball Seed is included under the Ball Horticultural umbrella). "It's kind of nice, though. Everyone's got their place and we all compete."

Just keep swimming

Looking back at the last 30 years of our industry shows that it's followed the appropriate course to the mature stage, with the key being significant growth during a period of time. And we've seen quite a bit of consolidation in various segments as a result of both sales increases and declines.

But consolidation is like walking a tightrope—the middle is where you want to be. Too much leaning to one side isn't good: not enough, means the industry isn't experiencing any growth; too much means all the power is in the hands of fewer people.

When I asked Anna if she would be willing to sit down with me for this article, I was pleasantly surprised to see that she did some homework, writing down the positives and negatives of consolidation relating to our industry.

Positives:

• It can bring in outside ideas from other industries.

• It provides an option to those who don't have a succession plan in place.

• Economies of scale—Some business experts say that this is the number one advantage of consolidation, but Anna disagrees because you never get the economies of scale that you think you're going to get. It's not necessarily a gain when you buy a company with the same type of products.

• Product consistency for the growers—fewer suppliers means more reliable, consistent product.

• Opportunity for innovation—with some scale, you can invest in more R&D/technology.

Negatives:

• We still need independent breeders. Consolidation reduces competition, innovation and choice. “I want a really strong world of independent breeders because that makes us a better company,” said Anna.

• Culture—it can affect the friendly, trusting nature of our industry.

• Riskier—a high percentage of your business is only with one customer.

If you look at the current landscape of companies in all three segments, there’s not much room left for consolidation. All of the people I spoke with speculated that we’ve surfed over the wave of consolidation and will now see another wave of businesses not necessarily selling, but completely leaving the industry—whether it’s through bankruptcy, retirement or lack of succession.

Again, the market will dictate when and how that wave will affect all of the fish in the hort sea, little and big. Plant genetics have come such a long way that growers expect little to no disease issues or crop failures. And with the ease of how you can order almost any hardgoods product online from anywhere in the world and get it within days, growers’ expectations for service and product quality are extremely high because that’s what their customers are expecting.

“Now it’s about efficiencies,” said Craig. “There’s very little room for error, so growers really need to be able to count on that genetic to come through. They can’t afford for you to put your problem on their bench space. In the ’80s when prices were high, everybody was making money in spite of themselves. Now it just doesn’t work that way.” **GT**