

Strategic Initiatives

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Discover.

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Strategize.

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The Arrival of South American Agriculture

Now Is the Time for the US to Capitalize

“... previous estimates of the scope for possible agricultural expansion (in Brazil) have been grossly under-estimated.”

– USDA, January 2003

Volumes have been written about the prospects for South America’s potential as a major force in global agriculture and related food systems. For the past twenty years, competitive advantages in costs of production and abundance of resources were analyzed and reported. South American “watchers” projected dramatic increases in output and the gradual shift from production to commodity processing. At the core of these predictions was the enormous potential for South America to become a significant agricultural commodity supplier and the implications for global markets and market dynamics.

Well, just about everyone predicted correctly. The projections are now realities; South America is proving to be a formidable supplier and competitor in global commodity and food markets. *continued on page 2*

Selected Raw Materials Export Growth Rates in South American Countries

Country	Commodity / Ingredient	% Growth, Exports, 1991-2001
Chile	Fresh / frozen salmon	106%
Brazil	Soybean oil	150
Brazil	Frozen / chilled chicken	300
Peru	Fresh asparagus	275
Chile	Fresh table grapes	35
Argentina	Wheat	86

Source: United States Department of Agriculture - Foreign Agricultural Service

The Hale Group is among those observing the gradual rise in importance of South American agriculture. We believe the time is right for US agriculture and agribusiness to take a more active role in this important region of the world. The US needs to view South America not only as a competitor, but also as a potential customer, supplier and / or investment partner.

Despite current uncertain economic conditions in South America, attractive long-term opportunities exist in nearly every agricultural and related commodity-processing sector including input supplies, processing, and food production. The basis for this belief and our recommendations for exploiting these opportunities are outlined below.

The South American Experience

In 25 short years, South America (Brazil, Argentina, and Chile, in particular) has emerged as a major global supplier of agricultural raw materials, semi-processed commodities and, in some cases, high value finished products. The rapid development of the countries in South America was due, in part, to leveraging the region's core strategic advantages including abundant production resources, ideal growing conditions, and lower input and manufacturing costs. In addition, a concerted effort was made to change the internal policies of these countries so long term economic growth and attractive returns could be achieved.

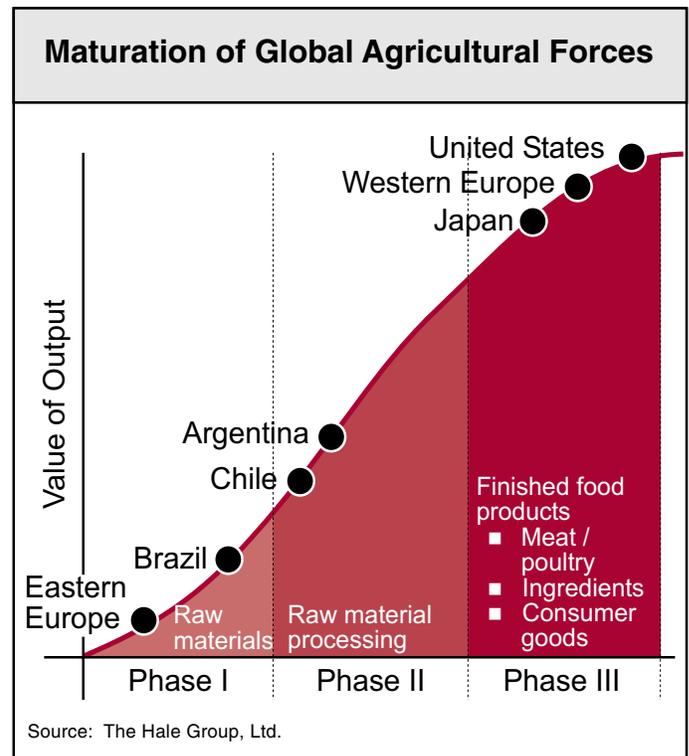
Argentina, Brazil and Chile are successful global suppliers across multiple raw material and food ingredient categories. For example, Brazil and Argentina combined now control 50% of soybeans traded in the world, surpassing the US share of approximately 35%. Chile accounts for nearly 25% of the global farmed salmon market, and sales are growing by more than 20% annually.

Within the meat sector, Brazil is the fourth largest pork exporter in the world. 2002 exports were estimated to be 350,000 tons, with Russia taking one-third of this output. In addition, Argentina is the world's

fifth largest exporter of beef and Brazil is emerging as a significant player in this sector with a 59% increase in beef exports during the past two years.

The table on page 1 provides selected examples of key raw materials growth in the three primary countries over the last 10 years.

Many believe these achievements in raw material production are only the first stage in the development of the region's role as food supplier. Substantial growth opportunities will exist as South American countries move along the growth cycle (see chart below) into raw material processing (Phase II) and the production of finished food products (Phase III).



Brazil, for example, is in the first phase of becoming a global presence in food and agricultural commodities with the production of soybeans. Brazil will transition into the second phase by transforming soybeans and other agricultural commodities into primary processed products such as soybean oil. In the third phase of this development, Brazil will utilize these commodities in feed ingredients to produce animal proteins such as chicken or pork, or some other value-added food product.

Continued Growth Expected

We believe that both regional stability and South America's natural and economic advantages will be sustained over the long term. South America (Brazil, Argentina and Chile, in particular) and the outside investment community will continue to invest capital in infrastructure, technology and other resources to strengthen their position with key markets and customers and exploit the growing need for lower cost commodities and ingredients.

One of the best indicators of the anticipated long-term viability of the region's strength can be measured in foreign investment levels. For example, Brazil's Net Foreign Direct Investment (NFDI) across all industries increased from \$11 billion to \$30 billion between 1996 and 2001. Brazil's NFDI in production agriculture alone rose from \$176 million to \$660 million over the same period.

US public policy is also expected to help the future of South American Agriculture. In December of 2002, the US and Chile reached agreement on a free trade agreement similar to the North American Free Trade Agreement that will gradually phase out any tariffs, duties and other trade barriers now in place. If approved by Congress, the agreement will phase out tariffs on farm goods in four years and all tariffs and quotas within twelve years.

The Options for US Agriculture

As South America develops into a major further processing source, as we expect it to do, US firms need to be thinking about the following key issues.

South America as a Competitor

Consider viewing South America as a major **competitor** that will continue to grab market share in the US, Canada and across other traditional export markets. How can market positions be protected?

The Hale Group believes there will be some sectors in which US agriculture will not be able to compete long-term, assuming continued liberalization of markets. These include soybeans, sugar, rice and even chicken. The US will have to evaluate which sectors can hold long-term competitive advantages, least cost disadvantages, or can be differentiated

Recent US Investment in South American Agribusiness

- In January of this year, ADM announced it was doubling its soybean crushing capacity at its largest of 6 processing operations in Brazil. In the announcement it stated that "South America soybean production is constantly increasing and as a global processor and supplier, participation in this growth is a critical element of our strategy."
- Perdigao announced in December of 2002 that it plans to add 1,600 new jobs in 2003 and an investment of \$30 million to be used to expand, modernize and increase productivity in all company units located in the south of Brazil. It saw an 18% increase in revenue in 2002 and projects 8% growth for 2003.
- In January of this year, Harvest States announced it would open a grain trading office in Brazil.
- Bunge announced in November of 2002, a lease agreement on a 1,200 MT crushing and refining plant in Brazil, adding to its position as the largest processor of soybeans in Brazil and the largest supplier of bottled vegetable oils to the domestic market.
- Cargill has announced investment plans in Brazil by investing \$20 million in an export port and contributing to a \$425 million rail project with the government.

based on particular quality traits. But to view South America as only a competitor is not enough.

South America as a Supplier

Consider South America as a low price **supplier** of reliable, high quality further processed food products. Should alliances or other strategic partnerships be formed to ensure access to key products?

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The Options for US Agriculture continued from page 3

The Hale Group believes that forming strategic partnerships with South American firms will have significant advantages. Both sourcing opportunities and alliances should be pursued. Some US firms have already embarked on this strategy and more are expected to follow soon.

South America as an Investment Opportunity

Consider making an **investment** in South America should it be determined that further processed and value-added products can become the next core manufacturing competency for this region. If direct investment makes sense, in which input, production and processing sectors should a firm invest, and at what levels?

The Hale Group believes that direct investments in South America make sense given the outlook for continued expansion. We have already seen major agricultural and food processing firms ratchet up their investments in key segments. We have also seen the dramatic increase in investments in the poultry-processing sector by domestic companies such as Perdigao and Sadia. Determining the specifics regarding which sector and commodity category offer the optimal mix of opportunities requires additional due diligence.

The Right Time Is Now

We believe the growth of agriculture in South America will be sustained and will take on multiple forms over the next 20 years. As Thomas L. Friedman stated in his book *The Lexus and the Olive Tree*, "Globalization isn't a choice, it's a reality." In the near-term, we will see uncertain economic conditions, market disruptions, gains and losses, spurts of liberalization and protectionism, and new players emerging; however, there will be ample opportunities over the long term.

We believe that US agriculture and agribusiness should view South America as a long-term investment opportunity. By partnering with South America, US companies can utilize their position as global leaders in food and agricultural technology and processing to achieve growth and profitability objectives for both their organization and their South American counterparts. Key strategic and tactical questions remain prior to actual investment, but the place is South America and the right time to invest is now.

About The Hale Group

The Hale Group is a consulting and advisory partner assisting companies develop fact-based strategies to contend with an evolving landscape. The underlying philosophy of the firm's efforts on behalf of its clients, and in collaboration with them, is to formulate strategies that enable clients to break through the market clutter and identify platforms for growth.

The Hale Group has developed proven processes and tools to help organizations gain perspective on the opportunities and challenges within an industry. The level of The Hale Group's participation can take many forms from addressing the overall process or an individual part of the process. However, in whatever capacity we participate, the desired outcome is for our clients to be successful.

Our products and services include:

- *Strategy*
- *Organizational Effectiveness*
- *Market Research*
- *Operating Efficiencies*
- *Opportunity Analysis*
- *Mergers & Acquisitions*

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