China's Next Steps - 1

China's Global Ag Conquest

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China and its corporations are on pace to blow out of the water last year's record Chinese foreign purchases, which reached $109 billion. (DTN photo by Nick Scalise)

OMAHA (DTN) -- The world's agriculture structure is changing quickly as Chinese companies, backed by the government, are on a commodity and technology buying binge that doesn't show any chance of slowing down.

Since the beginning of this year, China has spent about $84 billion in foreign mergers and acquisitions, though some estimates are even higher, according to Thomson Reuters. The country and its corporations are on pace to blow out of the water last year's record Chinese foreign purchases, which reached $109 billion.

China's recent economic plans include owning more ag and food companies. State-supported business interests are making the plan real. DTN's five-part series, "China's Next Steps," looks at what this means for U.S. farmers who have become more reliant on China as an export market.

One driving force behind larger Chinese purchases and mergers is the decline of Chinese currency, the renminbi, or yuan. The research firm KPMG cited last week that China's push in mergers and acquisitions was partly due to a declining domestic economy, coupled with a competitive desire by Chinese companies to increase international presence.

Business and ag leaders say China plays on an uneven field, given the country's advantage in foreign investment rules. While Chinese companies buy whole corporations, with the backing and support of the government, major U.S. agribusinesses with operations, licensing agreements and joint ventures in China can be only a minority shareholder in a Chinese company.

That's allowed government-controlled giant ChemChina to begin finalizing its deal to buy the Swiss-based Syngenta for $44 billion, making it the largest single purchase of a foreign company by a Chinese business. The deal could revolutionize grain production and biotechnology advances in China.

The unequal playing field has been a concern for some time, according to U.S. business and trade leaders. Every year, China and the U.S. meet at a Joint Commission on Trade and Commerce to talk about trade. Every year, China stonewalls on the topic of reciprocity in foreign investment.

"I can tell you it's brought up every single time we meet," said Agriculture Secretary Tom Vilsack in an interview with DTN.

The Obama administration is working on a bilateral investment deal to require China to open its market significantly to U.S. investors in a broader range of industries. China would lift restrictions on certain sectors currently on the so-called "negative list," meaning they are either closed or limited for U.S. investors.

"Right now, China has a very long list of sectors that are closed or restricted for foreign investment, including U.S. investment," said Jeremie Waterman, an analyst on China for the U.S. Chamber of Commerce. "In the agricultural area, currently biotech crop breeding or production, grain origination or storage and agricultural processing are all either in the restricted or prohibited sections of what's known as China's foreign investment catalogue.

"Currently, it's really unclear how far China would go in opening those sectors," Waterman said.

After 24 rounds of talks going back to 2008, China was supposed to offer a new proposal for opening up Chinese industries at the end of March, when Chinese President Xi Jinping met President Barack Obama in the U.S. China missed the deadline.

Vilsack has criticized the Syngenta purchase by claiming it would give Syngenta a "home field advantage" in biotech trait approvals. Rival biotech companies could be shut out when it comes to imports. Vilsack said Chinese officials haven't shown a willingness to embrace science when it comes to biotechnology trait approvals.

"I would say we have expressed some very serious disappointments with the Chinese on the GMO issue, for example, when they had 11 different traits that they could have approved for use within China and they saw fit to only approve three," Vilsack said. "They essentially asked the same questions on the other eight that they had asked before that had been fully answered. So I think they have got a ways to go."

Bob Young, chief economist for the American Farm Bureau Federation, said addressing biotech approvals in China often has to be done at the highest levels of government.

"Do you realize every new trait that we have gotten China to adopt or approve has required a meeting between our president and their premier?" Young said. "So now they are going to buy Syngenta. It would not surprise anyone if Syngenta got preferential treatment for the traits they want to introduce, and I'm not quite so sure how fair that is. That would be one of the concerns I would have going forward."

The country's latest five-year plan, rolled out last month, pushes for improved agricultural science and technology, a modern seed industry and increased agricultural productivity.

"(Biotechnology) is an industry that they have strategically earmarked and they want a national champion," said Usha Haley, a business professor at West Virginia University who studies Chinese business strategies. "What happens when

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they have a national champion in this industry? That means the decisions are made directly from Beijing." She added, "It's not a secret that's the industry they want to dominate, and I underscore dominate."

THREE SEED COMPANIES INSTEAD OF TWO

Richard Brock, president and CEO of commodity broker Brock Associates, said in an interview that the ChemChina-Syngenta deal likely means more global corn production because Chinese farmers will have access to better genetics.

That may mean less opportunities in the future for American farmers to export corn to China. Still, Brock noted that the Syngenta sale to ChemChina offers a positive point for U.S. agriculture: The ChemChina deal may have staved off more industry consolidation. With the pending Dow-DuPont merger, farmers will be down to three major seed players (Dow-DuPont, Monsanto and Syngenta-ChemChina). That could have dropped to two if Monsanto had purchased Syngenta.

ChemChina already does about $3 billion in business in the U.S. under subsidiaries such as China National BlueStar that include research and development facilities in the U.S. in both agricultural and industrial sectors. BlueStar sells a number of different chemicals and products ranging from animal supplements to a wide range of silicone products. BlueStar has operations in California, Georgia, New Jersey, Pennsylvania and South Carolina and has overseen some of them since at least 2004 when BlueStar became a ChemChina subsidiary.

The Israeli crop chemical company ADAMA Agricultural Solutions, which does just under 20% of its business in the U.S., is 60% owned by ChemChina. ADAMA did $573 million in sales last year in North America, up 5.1% from 2014.

Syngenta is the leading provider of crop chemicals at roughly 20% of the global market. Combining ADAMA and Syngenta's market share, ChemChina would be the largest global supplier of crop-protection chemicals, beating out the Dow-DuPont combination.

SMITHFIELD SALE, THREE YEARS LATER

Some American farmers and groups experienced a lot of angst in 2013 when then-Shuanghui paid $7.1 billion to buy Smithfield Foods, which was then the largest purchase of a U.S. company by a Chinese suitor. Shuanghui, now called WH Group, got $4 billion in financing from the Bank of China, which touted in its 2013 annual report that backing the Smithfield purchase was part of the national drive to help companies "Going Global." The Bank of China stated at the time it "spares no efforts to support Chinese enterprises in their international competition" and expected to increasingly support "Going Global" enterprises.

Senators in 2013 raised concerns that Smithfield could come to dominate exports to China. U.S. pork exports there stagnated in 2014 and 2015. Pork exports to China were down roughly $200 million from 2013 levels because China delisted several U.S. packing plants accepting hogs fed ractopamine, which is banned in China. Other major meatpackers JBS Swift and Tyson declined to talk to DTN about the prospects of pork exports to China, though neither referenced any pork exports to the country in their 2015 annual reports.

In its 2015 annual report, WH Group reported that Smithfield Foods was responsible for 97% of all pork exports to China from the U.S. in 2015. Smithfield reported that its pork exports to China, while only roughly 5% of its total volume, were up 50% in 2015 "as we continue to leverage our WH platform," Smithfield CEO Ken Sullivan said on an earnings call in March. Sullivan added he expected Smithfield's pork exports to increase significantly.

"We do have ambitious goals in terms of our export volumes to China," Sullivan said.

China agreed to start accepting pork from 14 more U.S. facilities last October, including plants owned by Tyson, JBS Swift, Seaboard Foods, Hormel Foods, and Triumph Foods. Hog prices went up roughly $22 per hundredweight, and the U.S. Meat Export Federation said pork exports to China were up 86% in volume and up 50% in value for the first two months of 2016.

With five new packing plants potentially coming on-line in the U.S., the Chinese market will be critical, said Will Sawyer, executive director of protein research for Rabobank in the U.S. Sawyer said Smithfield positioned itself to serve China's demands for ractopamine-free product and others are going to have to do the same.

He noted that Smithfield in Virginia is sending its product to just one customer, and the pricing mechanism is set up between Smithfield and WH Group.

In December, WH Group rolled out the Smithfield brand in Zhengzhou, China, with a $123.5 million processing plant taking imported Smithfield pork bellies to sell "American-style packaged meats" to Chinese consumers. Smithfield supported the construction of the new plant with engineering, food safety, marketing and operational support.

"That is an exciting thing in terms of expansion -- global expansion of the brand," Sullivan said. "I'm told that sales are better than they anticipated coming right out of the box with a brand new plant."

BUY THE COMPANY, NOT THE COMMODITY

China's strategy when it comes to commodities -- be it pork, grain, coal or steel -- is increasingly to find a way to buy a company rather than buy the commodity, said Dan Slane, an Ohio businessman.

"They figured out with coal and iron ore that it was better for them to buy the coal mine than to buy the coal on the commodities market," Slane said. "They have applied that to Smithfield. They would rather buy a company that creates some value and dominates the market."

Until the end of last year, Slane was a member of the U.S.-China Economic and Security Review Commission, a group set up by Congress specifically to study national security issues regarding trade and economic ties between the U.S. and China. The group is separate from the more clandestine Committee on Foreign Investment in the U.S. (CFIUS), which only analyzes possible national security implications of foreign purchases.

Slane told senators at the time that if the Smithfield deal was approved it would help start a wave of other Chinese firms or investors buying U.S. and other foreign food and agribusiness companies.

"I just think we're asleep at the switch and we're going to wake up one day and the Chinese are going to own a bunch of our companies, and then a different problem arises," Slane told DTN.

A handful of senators wrote a letter last month to the Treasury Department calling on USDA and FDA to have some say in the Syngenta deal under CFIUS. Slane said he told members of the Senate Agriculture Committee multiple times during his tenure on the China commission that the CFIUS law needed to be changed to include agriculture as a national security issue.

"I said to these senators -- because I brief them all the time -- the wave is coming. They are going to be buying American food companies because they need to protect their food supply and that's the way they are going to do it."

No action was ever taken.

A spokeswoman stated Treasury Department officials have nothing to share about the senators' letter or the internal workings of CFIUS.

GREATER CHINESE EXPECTATIONS

Another state-owned agricultural company growing rapidly oversees is the China National Cereals, Oils and Foodstuffs Corp. Known as COFCO, it's a global grain buyer, processor and overall food distributor. Earlier this year, COFCO completed a $750 million buyout of the grain-trading assets from the Hong Kong-based commodity trader, Noble Group Ltd. COFCO and Noble had started a joint venture in 2014 that helped COFCO build more international expertise in buying almost every major agricultural commodity. COFCO also took a controlling interest in Dutch grain trader Nidera at the same time.

COFCO did not respond to emails about its operations, but in a news release last year the company stated it has invested nearly $5 billion in Brazil agribusinesses. COFCO owns two soybean oil pressing mills, four sugar mills, one transit station, two export terminals and 12 silos. Last year, the company moved 8 million metric tons of grains and oilseeds out of Brazil alone.

COFCO has been looking for ways to buy into U.S. agribusinesses. "We want to get more involved in other parts of the world, especially in the Americas, where a lot of the grain is grown, shipped and exported to other markets like China," Paul Liu, COFCO's head of North America, told the Wall Street Journal in 2015.

Nicholas Lardy, a senior fellow at the Peterson Institute for International Economics, noted early on that the Syngenta transaction would get a lot of regulatory attention due to the size of the purchase. CFIUS can't disclose most information provided to it by companies, but Lardy doubts arguments about national security interests.

"It's hard to think fertilizer can be a national security issue," Lardy told DTN.

Investing in better crops follows a major Chinese push to overhaul its pork and poultry sectors. This modernization was partially driven by greater consumer expectations for higher food standards.

"China is now at a level of per-capita income that people are moving up to a higher quality of food," Lardy said.

China now wants to improve its grains and oilseed production. Syngenta helps fill that need, as does the recently announced deal between DuPont Pioneer and the Chinese seed company Origin Agritech.

"I think they want to have the technology for GMOs, they want to have the know-how, the management and the production side," Lardy said.

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Editor's Note: This is the first of five articles looking at the growing influence of China on American agriculture. Wednesday's articles will look at what inroads U.S. businesses are making into China.

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