“The Industry Has Changed, Have You?” The AGCO Story

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Introduction

The AGCO Corporation's story is truly a remarkable one. From its unorthodox beginning in 1990 as the ailing Deutz-Allis (formerly Allis-Chalmers) to its growth to over 18 internationally recognized name brands representing 14 product lines, AGCO corporation's success is attributed to its founder Robert Ratliff's vision and determination. In seven years, AGCO has emerged as the third largest farm equipment manufacturer (in terms of market share) in the world (21%, behind New Holland and John Deere) and also as third largest in the United States (15%, behind John Deere and Case with 50% and 20% respectively).

Entering an industry plagued by the agricultural crisis and recession of the 1980's, Robert Ratliff had 26 years experience with International Harvester Company and was (in 1988) the president and CEO of Deutz-Allis, then owned by Klockner-Humboldt-Deutz (KHD) of West Germany. With the falling of communism, KHD wanted to sell Deutz-Allis and focus on Eastern Europe's emerging market. This led to Ratliff's opportunity for his initial buy-out, which he negotiated by selling Deutz-Allis receivables to finance the purchase for 40 cents on the dollar. Nontraditional financing of over $186 million enabled Ratliff to acquire other struggling equipment manufacturers throughout the early 1990's. In 1992 AGCO went public, and in 1994 doubled its business through a $329 million purchase of Massey Ferguson, the most widely recognized tractor brand in the world, from Varity Corporation.

The Massey Ferguson deal made AGCO an overnight international force. The company's distribution network surged to 140 countries headquartered from Duluth, Georgia. International sales accounted for more than 70% of the company's 1997 revenue of $3.5 billion. AGCO has over 10,000 employees worldwide including a network of over 7,000 independent dealerships and numerous production facilities.

AGCO's real success lies not in focusing on operations management, as have its competitors, but in its financial stratagem for mergers and acquisitions which have enabled AGCO to succeed in today's leaner agricultural equipment industry. Robert Ratliff utilized financially ailing manufacturers' brand names and

distribution networks, then streamlined their marketing and credit operations. The result: profitable subsidiaries and rejuvenated brand names, and a corporation growing rapidly in a slow growth industry.

This case study focuses on AGCO's financial management, particularly the company's ability to finance its operations (sometimes through very unorthodox manners) in what many believed to be an unprofitable sector. Key acquisitions and a partnership (including the initial purchase of Deutz-Allis, the Massey Ferguson deal, and a joint venture with Rabobank Nederland) will be analyzed in detail. Each deal will be assessed in order to determine its profitability (thereby determining its effectiveness). Also, AGCO's strength relative to broader market measures (S&P 500) will be assessed.

From Worst to Third

In seven short years AGCO became the third largest farm equipment manufacturer in both the United States and the world. To appreciate the magnitude of such an accomplishment, an in-depth look at the emergence and growth of AGCO seems appropriate.

AGCO's lineage begins with Allis-Chalmers—an American agricultural equipment company that enjoyed success in the 1960's and early 1970's. However, Allis-Chalmers' success would be short-lived due to hard times experienced by the agricultural sector in the 1980's. Financial difficulties forced the sale of A-C's construction and farm equipment divisions in 1985. Fiat purchased the construction division while Klockner-Humboldt-Deutz (KHD) picked up Allis-Chalmers' farm equipment division (Vogt, 1994). Immediately after the acquisition, the Allis-Chalmers name was changed to Deutz-Allis, and the familiar orange colored, water-cooled tractors became green, air-cooled machines. Many farmers felt they had been betrayed, and as a result, sales decreased significantly.

KHD's marketing plans also added to Deutz-Allis' problems. Deutz-Allis engineers designed tractors that were too wide for standard row-crop dimensions, thus crushing crops. When informed of the oversight, executives at KHD suggested farmers change their cultivation methods--nothing was wrong with the tractor (Barry, 1997).

In 1988 KHD hired Ratliff (who left International Harvester position as president of its Export Company) to turn around its struggling Deutz-Allis division (Mallory, 1997). He caused an immediate stir. After a year of closing plants, cutting payroll, streamlining the dealership system, and reducing tractor retail prices, the Deutz-Allis division became profitable (Barry, 1997). By 1990, communism had fallen in most of Eastern Europe, and KHD set its sights on emerging opportunities. This provided KHD a convenient excuse for ridding itself of Deutz-Allis (and the American tractor market). A lack of interested parties opened the door for Ratliff and his group of investors (four other Deutz-Allis executives and Hamilton Robinson, Inc.—an equity partner) who bought the company in June of 1990 for $89.4 million, some 58% below the book value of the company (Quickel, 1994).

Ratliff felt the name Allis-Gleaner would suit the company (both trustworthy agricultural equipment names combined to appeal to farmers), but legal issues prevented that selection. Side-stepping the legal roadblocks, AGCO Corporation, a variation of the Allis-Gleaner Corporation, was chosen (Vogt, 1994). AGCO soon entered the unsuspecting agricultural equipment sector by marketing AGCO-Allis tractors and Gleaner combines.

Acquiring Deutz-Allis was only the beginning of Ratliff's plan. He wanted to increase AGCO's profits by expanding its product line thereby offering dealers more options. But the farm equipment industry was geared for slow growth. A new approach was taken through mergers and acquisitions. The depressed condition of the agricultural sector enabled AGCO to purchase brand name companies at rock-bottom prices. Once a company was acquired, AGCO would retain the name (thus insuring a loyal customer base) and distribution network. Next, marketing and credit operations were streamlined. Ratliff's plan quickly turned each acquisition into a profitable subsidiary.

By March 1991, AGCO's growth plan was in full swing. The company acquired Hesston Corporation (for $26.0 million, some 35% less than book value), makers of hay and forage equipment from Fiat GeoTech S.p.A. of Italy (Quickel, 1994). Later that year AGCO purchased White-New Idea's tractor

division (for $10.1 million, 24% below book value) (Quickel, 1994). The SAME brand of specialty tractors entered AGCO's sights in 1992 as AGCO purchased the North American distribution rights. In 1993, AGCO acquired the distribution rights to Massey Ferguson products and a one-half interest in the company's credit service Agricredit Acceptance Corporation from Varity Corporation. In a move designed to broaden AGCO's product line, the remaining portion of White-New Idea was purchased. Products gained included planters, spreaders, and other implements. Each acquisition appeared an appropriate move, for sales increased by $600 million at a cost of $280 million.

Financing became easier to obtain as the company grew. By 1992, financing through receivables was no longer necessary. ITT Commercial Finance Corporation extended AGCO an adequate line of credit at reasonable terms. AGCO also made its initial public offering in April of 1992 which raised $62 million and was applied to rising levels of debt. An additional $88 million was raised through a preferred convertible offering in May of 1992 (Quickel, 1994).

AGCO became a global force with its 1994 acquisition of the worldwide holdings of Massey Ferguson and the remaining portion of Agricredit Acceptance Corporation. McConnell tractors and Black Machine also joined AGCO that same year. McConnell gave rise to AGCOSTAR, a new, articulated line of tractors, while Black Machine provided unique technology for crop planters. In 1995, AGCO purchased the North American distribution rights to the Italian made Landini tractors along with the Ag Equipment Group, makers of Glencoe tillage equipment, Tye no-till grain drills, and Farmhand equipment.

Acquisitions of Iochpe-Maxion of Brazil and Western Combine Corporation and Portage Manufacturing, Inc. of Canada (both in 1996) expanded AGCO's position in the Western Hemisphere. AGCO also entered a joint-venture in 1996 with Rabobank Nederland in forming AGRICREDIT, a North American finance subsidiary. In 1997, Deutz-Argentina, S.A. and Fendt of Germany were added to AGCO's expansive listing of subsidiaries. Deutz-Argentina solidified AGCO's presence in South America while Fendt, renown for tractor innovations, gave the company a technological edge. A portion of Fendt's cutting-

edge technology helped to create Fieldstar, precision farming equipment designed for use with both Massey Ferguson tractors and Gleaner combines (precision farming utilizes yield monitoring and global positioning systems, giving farmers the ability to boost yields).

Doing Business the AGCO Way

Agco's success stems not only from Ratliff's vast knowledge of the farm machinery industry, but also his willingness to part from the accepted way of doing things. Overcapacity had long been the biggest problem in the business. Manufacturers would forecast demand, overstate existing inventory, and then burden dealers with more equipment than they could possibly sell. As a result, both manufacturers and dealers suffered lengthy downturns, especially in the 1980's. By contrast, AGCO gained flexibility by outsourcing much of the manufacturing (nearly 50% of goods sold), focusing instead on developing its dealer network and the AGCO team. Also, dealer operating margins exceed those of AGCO's major competitors thanks to an emphasis on cross-over selling (a dealer selling more then one brand of equipment) from a full line of products.

As part of Ratliff's plan to keep costs low, outsourcing major components seems a perfect fit. Research and development costs AGCO only 1.7% ($54.1 million for 1997) of net sales (AGCO, 1997). A great portion of AGCO's product (axles, engines, transmissions) is built by an outside party. By outsourcing, the builder is forced to pay for research and development. Even though outsourcing reduces costs, it does have some disadvantages. If suppliers' capacity tightens, product availability, quality, pricing could eat away at any advantages gained through outsourcing. AGCO addressed these problems with its 1994 acquisition of Massey Ferguson and later acquisitions (thereby increasing manufacturing capacity to thus aiding in hedging this risk).

Ratliff realizes that AGCO's dealers are its greatest asset. It seems brand loyalty is becoming a thing of the past. Farmers now buy from a dealer they feel comfortable doing business with. To better serve dealers (and customers), AGCO has developed an intricate dealer support line which includes a hot line

directly connected to company headquarters in Duluth. With each new acquisition, parts and product distribution lines are reevaluated to ensure the best support possible. Ratliff also feels that dealers require some business training to increase profits. Dealers already know the technical aspects of each product, but they must also have the ability to analyze the profitability of their business. Business training sessions are provided for AGCO dealers, teaching them about financial statements and profitability measures.

AGCO utilizes a closely knit sales team to distribute its products to dealers. In fact, only three levels of management separate the field representative (the dealer's direct interface with the company) and Ratliff. Field representatives act more like manufacturer representatives in that they prospect for business and put together sales proposals. They work closely with dealers to insure end users get the equipment they require. This is done by analyzing farmers' needs and selling products farmers will utilize. Compensation for field representatives is directly linked to the end sale of products. Half of a representative's commission hinges on the final sale of a product. By doing so, everyone involved in the sales process has a unified goal—get the product in the hands of the farmer.

Crossover selling has provided AGCO with an additional resource few of its competitors possess. Once convinced of the benefits of selling the company's full line of products, AGCO dealers soon realize the advantages of crossover selling (AGCO, 1994). A company study shows that each brand added to a dealer's showroom generates an additional $150,000 in crossover sales. However, care must be taken to insure that market territories are preserved for each line; cannibalism of sales does nothing for a company's bottom line. As of December 1996, AGCO dealers are involved in over 2,400 crossover contracts, thus accounting for one-third of total dealer contracts.

Key Acquisitions and Partnerships

Over its brief history, two acquisitions and a partnership stand out as milestones for the AGCO Corporation. These key deals founded AGCO, made the company a world leader in agricultural equipment,

and teamed them with the world's largest agricultural lender. They include the Deutz-Allis deal, AGCO's purchase of Massey Ferguson, and the 1996 joint venture with Rabobank. An evaluation of AGCO's financial position will be provided for each acquisition thus determining the deal's effectiveness in adding value (in the form of stock appreciation) to the company.

Deutz-Allis

Robert Ratliff attributes much of his success with AGCO to being at the right place at the right time. The Deutz-Allis purchase is no exception. Upon learning of KHD's plans to sell Deutz-Allis, Ratliff recruited a group of five equity investors and planned to make a bid for the company. However, he faced one major problem—no one would finance the venture because of agriculture's depressed condition. Since conventional means would not work, Ratliff resorted to selling Deutz-Allis' receivables at a discount (equipment dealers typically have large amounts of receivables outstanding since most credit terms specify yearly or seasonal payments). Ratliff figured he could convince Deutz-Allis' debt holders that selling receivables was the only way any they would be repaid.

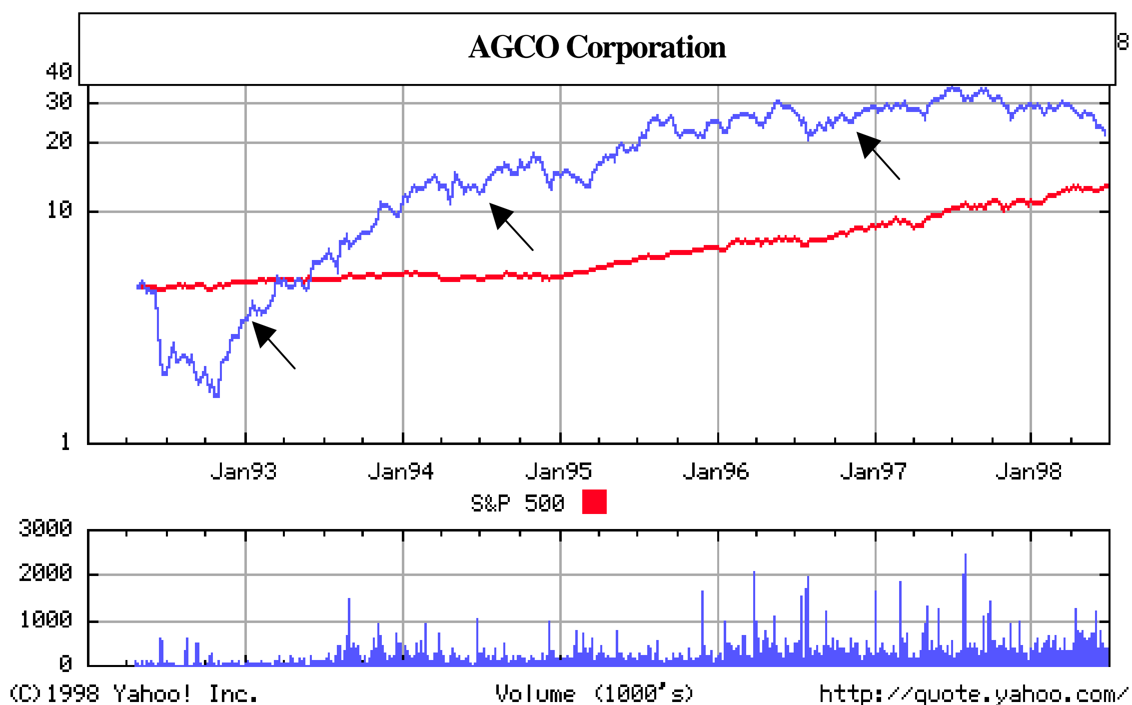
In June of 1990, the Whirlpool Financial Corporation bought Deutz-Allis' accounts receivable (money owed to the company by dealers of Deutz-Allis equipment) at a 40% discount, supplying Ratliff with the $89.4 million needed for the buyout (Mallery, 1994). In other words, Whirlpool obtained approximately $149 million in receivables for only $89.4 million and took on default risk. The process was very expensive but proved to be worthwhile. Besides, the purchase price of $89.4 million was 58% below the company's book value.

Massey Ferguson

Even though the Massey Ferguson deal doubled AGCO's size and made the corporation worldwide player, Ratliff did not set out to buy the company. Instead, he sought Agricredit Acceptance Company, Massey's North American equipment finance subsidiary (Walker, 1996). Lean times left the Varity

Corporation cash poor (probably because of outstanding receivables). In January of 1993, AGCO walked away from the negotiating table with the North American distribution rights to Massey Ferguson equipment and tractors and a 50% stake in Agricredit Acceptance (costing $94.8 million and $19.9 million respectively). The move added nearly 1,100 dealers across the United States and Canada and increased the company's revenue base by over 65% (AGCO, 1993). Substantial improvements in expense ratios also were achieved by combining operations and eliminating duplicate facilities, personnel, and other costs.

Figure 1: Historical Stock Prices for AGCO Corporation versus the Standard & Poors 500 Index



The Massey Ferguson purchase marked a new beginning for AGCO. After funding six acquisitions through dealer receivables, a conventional loan secured through ITT Commercial Finance funded the company's latest acquisition. ITT extended a $220 million revolving credit line priced at prime plus 125 basis points (Quickel, 1994). Compared to earlier financing costs exceeding four times this amount, ITT's deal was a bargain.

AGCO acquired the remaining portion of Massey Ferguson in June of 1994 for $500 million--a bold move which more that doubled the size of the company. Revenues increased 128% to $1.4 billion and more than 4,000 dealers were added worldwide. Through the acquisition, AGCO became an agricultural equipment giant (AGCO, 1994).

Ratliff and his management team eagerly took on the daunting task of absorbing a company that was larger than AGCO. Armed with a $550 million revolving line of credit (issued by Rabobank, Trust Company of Georgia, and ITT Commercial Finance) AGCO purchased Massey's world wide holdings for a cash price of $310 million and 500,000 shares of common stock (worth about $19 million at closing) (AGCO, 1994). An additional public offering of common stock funded the remainder of the balance.

Even though AGCO incurred a massive amount of debt through the Massey acquisition, the management team worked at cutting costs as a means of reducing the company's debt to total capitalization ratio. The elimination of Massey's business structure and the consolidation of various operations enabled the reduction of AGCO's debt to total capital ratio by 12% (to 44%) in first six months (AGCO, 1994). Increasing the company's top line and improving margins (again through cost cutting) also provided additional cash for debt repayment.

Ratliff notes that shareholder value ranks as the most important measure of AGCO's profitability. Figure 2 reflects this notion by plotting AGCO's stock price relative to the Standard & Poors 500 index. The initial Massey purchase (point A) produced an immediate surge in AGCO's stock price, which was followed by a four week holding pattern, indicating a "wait and see" attitude by investors. Assured that AGCO had made a profitable decision, confidence in the security grew (indicated by March the rebound) As the first quarter ended, AGCO had increased its performance to the level experienced by the S&P 500.

Investors embraced the acquisition of Massey's remaining holdings with open arms, as shown by the increase in AGCO's stock price (point B). By now, the company was easily outpacing the S&P 500 which attributed greatly to increased earnings through acquisitions.

Joint Venture with Rabobank

In November of 1996, AGCO entered into a joint venture with Rabobank Nederland, extending AGCO's global financial capabilities. Rabobank purchased a 51% stake in AGRICREDIT, AGCO's North American retail finance subsidiary, for $44 million (AGCO, 1996). AGCO posted much more than a capital gain for selling only *half* of its subsidiary (total cost was $42.9 million—$19.9 in 1993 and $23 million in 1994). Other benefits included de-leveraging of AGCO's consolidated balance sheet by about $550 million, the redeployment of $44.3 million in capital, and an opportunity to participate in additional business with Rabobank (AGCO, 1996).

The venture also produced the backing of a Triple-A rated agricultural lender, reason enough for the alliance. AGCO gained a tremendous financial resource for expansion of its operations—both equipment manufacturing and retail financing, yet another shrewd decision on the part of the AGCO management team. AGCO's joint venture with Rabobank was also a hit with equity markets. Just as AGCO's stock seemed positioned to pull back, the news triggered an up-tick in price (point C), and the company lost little momentum. Because investors' approval of AGCO's actions (and general confidence in the sector), its stock continued to outperform broader market measures (the S&P 500). Although the successive period's (first quarter 1997) price appreciation was somewhat flat, the Rabobank venture had nothing to do with it. This stagnation reflected investor's uneasiness about AGCO's president and CEO J-P Richard's leadership of the company. In the second quarter of 1997, Ratliff (serving his second stint) replaced Richard as president and CEO.

Observations and Implications

"'A World of Solutions' for your growing needs"—the mission statement for AGCO—truly epitomizes the global influence AGCO now exerts in the agricultural machinery and equipment industry. Acquisitions of full-line and short-line manufacturers and their distribution networks have given AGCO a presence on six continents, a remarkable feat in less than a decade.

The marketing strategies of multiple brands from an AGCO dealership, a parts network that encompasses over a dozen separate but identifiable companies (and their brands), innovative technologies (precision farming, hydraulics, transmissions/gear boxes, tillage methods, etc.), and an in-house financial institution for access to credit by customers and the corporation alike are all worthy of further review. However, it is the growth of the company, from a financially ailing Deutz-Allis to the third largest farm machinery and equipment firm in the United States and globally via various financial paradigms and acquisition strategies that are unique.

And given the AGCO management team's vision and knowledge of the agricultural machinery and equipment industry, additional growth, including more acquisitions, by AGCO is likely. "The industry has changed, have you?" is a statement on Robert Ratliff's desk that summarizes AGCO's management philosophy. High growth in a no- or low-growth industry through joint ventures and acquisitions has been the success by-line for AGCO. This financial paradox occurred as AGCO eliminated duplicity of operations through branded dealerships and a global parts and sales distribution network to prove that cutting costs will enhance net income, in spite of being in a low-growth industry.

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