'Vertical integration' creates new class of sugar traders

Sugar industry observers have been watching the trend of "vertical integration" in the market for some time, seeing the development of global sugar traders and sugar producers, each pinning its hopes for survival on "vertical growth" up and down the value chain.

The trend began years ago, when traders began buying sugar companies, including:

- Louis Dreyfus's establishment of sugar/ethanol producer Biosev in 2009;
- ED&F Man's purchase of producers in Chile (2004), Mexico (2007) and in the Ukraine and Russia;
- Wilmar's acquisition of Australia's CSR Sugar (Sucrogen) and a 27% holding in Indian refiner Shree Renuka Sugars and Morroco's Cosumar;
- Bunge's entry into sugar trading by its 2008 acquisition of the trading arm of Tate & Lyle and the subsequent acquisition of sugar factories in Brazil.

At the same time, sugar companies began investing "upward" into the trading sphere. A few examples include:

- Germany-based Südzucker's 2011 purchase of 25% of ED&F Man;
- UK-based AB Sugar's 40% participation in commodities house Czarnikow;
- The recent participation of Germany's Nordzucker in the sugar arm of German sugar trader August Töpfer & Co (ATCO);
- US trader and sugar refiner Cargill has combined with the large Brazilian sugar producer Copersucar to establish a new global sugar trading operation, Alvean, put into operation in October 2014;
- Tereos that year also said it is establishing its own white sugar trading unit, in anticipation of the end of EU sugar quotas in 2017.

Clearly, the storm of trading-level acquisitions and mergers is due, in part, to faster global communications systems. The high-speed flow of information has accelerated the necessary work of the trading houses, now operating 24/7 to communicate prices, identify market changes and risks, make good "bets," and move sugar, according to trader Jonathan Drake, of the Netherlands-based RCMA Group.

Global sugar traders and sugar producers are pinning their hopes on "vertical growth" up and down the value chain. (Photo illustration: Nordzucker)

Addressing the annual meeting of the International Sugar Organization (ISO) in 2012, Drake said the trade houses began acquiring sugar-production facilities, moved by an original desire to streamline distribution systems.

"The needs of the sugar economy have not changed," said Drake, who heads a team of RCMA Sugar traders in Asia. "But the trade houses have had to change to meet these needs more efficiently."

Of course, greater vertical integration means that the lines between traditional sugar producers and sugar traders are becoming less clear.

"Profitability analysis gets blurred," said Drake, pointing out that it is easier for producers to "integrate forward" (or upward, toward traders), than it is for traders to integrate "backward," toward producers.

"Tying up with a trade house makes sense for an exposed producer," said Drake, citing the example of Südzucker's purchase of 25% of EDF Man in 2011.

Similarly, banks trying to better understand their investments in the sector may try to "integrate" with traders, as was the case in which Australian bank Macquarie bought a 42% stake in London-based sugar merchant Czarnikow, in 2012.

These trends have been most observable as agribusiness giants with sugar and bioethanol assets seek to acquire more strategic partners along the supply chain – from farm lots to factories, rail and shipping terminals and more – both inside producing nations and within certain regions of the trade.

Today's faster, screen-based trading may be a challenge to the "human element" in the futures markets. Some 90% of daily sugar volumes are moved by high-frequency traders and black-box algorithmic models, said Drake, adding that such trades dominate the process of determining spot prices. Tighter networks of traders, sellers, and buyers are transmitting commodities reports more quickly. Any shocks to the sugar economy move through the system faster and farther than ever before. The resulting data are becoming more challenging to understand and analyze, the trader said.

The result of all the activity is that fewer traders are moving larger volumes of sugar, creating a more concentrated – and, perhaps, more transparent – global marketplace, but one in which all the players, from top to bottom, are seeing ever-tighter margins. Large agro-industrial organizations have entered the ring for a bigger share of the value chain.

That means getting tied-up in domestic production and supply chains. And, as Jonathan Drake put it, "the mindset of a producer is different from that of a trader."

Nowhere is this conflict more apparent than in Australia, where Singapore-based agribusiness and sugar trader Wilmar Sugar International finds itself opposing Australian government proposals to regulate the sugar industry. The Australian Senate is responding to calls by traditional marketer Queensland Sugar Ltd (QSL), seeking government recognition of the long-held convention that Australian farmers have ownership of close to two-thirds of the raw sugar produced by milling companies.

A huge player in Asia, Wilmar's partners include Malaysia-based Kuok Group and US-based agribusiness giant Archer Daniels Midland Company (ADM). Established in 1991, Wilmar trades in a wide range of agricultural products and was founded on "an integrated business model which encompasses the entire value chain," according to its website. Aside from its agricultural production and food-processing businesses, the company operates a fleet of shipping vessels which make calls at ports in more than 50 countries. Today, Wilmar owns and operates eight sugar mills in North and Central Queensland which make more than half of Australia's raw sugar – crushing about 15 mn t/year of cane to produce 2 mn t.

At the same time, market competition seems to be thriving "down under."

"The needs of the sugar economy have not changed, but the trade houses have had to change to meet these needs more efficiently."
– Jonathan Drake

Like Wilmar, the China Oil and Food Company (COFCo) also began expanding its assets by acquiring Tully Sugar Ltd in Australia in 2011. In April 2014, COFCo agreed to pay US$1.5bn for just over half of the trading unit of Hong Kong-based Noble Group Ltd, Asia's biggest commodities trader. It was COFCo's second purchase in 2014, after it agreed to buy a majority stake in Dutch grain trader Nidera BV in February, Bloomberg reported. Also that year, Brazil's Copersucar became the exclusive marketer for Australia's Mackay Sugar, replacing QSL.

For its part, Wilmar Sugar signed an agreement with Germany's Nordzucker in 2012 to cooperate in the sourcing of raw sugar for the European market and on the marketing of exported EU sugar. Since that time, Nordzucker has acquired 25% of the sugar trading unit of the August Töpfer & Co. (ATCO), according to a joint company press statement.

Also in Europe, French sugar maker Tereos unveiled its global sugar trading arm, Tereos Commodities, in November 2014. At that time, Tereos said it hoped to control 15% of the world's current 10 mn t/year white sugar trade by 2020.

The newest European sugar-market player, however, is Alvean, which began trading in raw and white sugar in October 2014. A Switzerland-based joint venture between Brazil's Copersucar and US-based Cargill, Alvean trades globally through at least ten branch offices located in Thailand, Spain, India, Dubai, Hong Kong, Indonesia, Miami, Moscow, Brazil and Shanghai, according to the company website.

Boasting "a strong combined global supply chain, a worldwide presence and excellent logistics management," Alvean is only the latest sugar-marketing operation to grow out of a struggling sugar sector. Before founding Alvean with Copersucar, Cargill had posted significant losses to its sugar sector in 2012, a year in which the company also invested a record US$4bn (€3.2bn) in acquisitions, joint ventures, expansions, and improvements.

Similarly, Copersucar also has taken its own hit from falling prices, with a 16% drop in net income from the previous year, to BRL86.3mn (€25mn), according to the *Financial Times*. In 2011, the company announced it would reduce its workforce by 2,000 or about 1.5% within six months, citing "changing economic conditions."

Some industry critics suggest that vertical integration reflects market desperation, describing one joint venture as "two people lost in the woods," the *Financial Times* reported.

Along with the rest of the industry, Alvean, the new Swiss trader, faces an unpromising market, the newspaper said. All along the sugar supply chain, farmers, refiners and traders are feeling the pain.

"The integrated model will probably be the only model that will be left, as companies search for financial strength and synergies," one longtime trader told the *Times*.