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Opportunities for the Asian investor in Agriculture - slowly slowly catchy monkey

Apr 15, 2015

The old idiom is about right for agricultural investment. If there's a monkey in a tree, and his tail is hanging down, you have to move very ***slowly*** to catch him. In other words, patience and steadiness will accomplish your goal. If you think of the current generation of billionaires in Asia, many of the these great fortunes were originally made not from telecoms, or property or shipping but from growing rubber, pineapples or palm trees - names that include Singapore's Lee family, the Kwoks of Malaysia and the Salim Family of Indonesia. Temasek, the Singapore Sovereign Wealth Fund recent bailed out the over-extended Olam empire, built by immigrant Indian families who started their endeavours in Nigeria but we're invited to relocate their business to Singapore. Peter Lim, the Singaporean businessman, made his fortune from a judicious 10 million dollar investment in Wilmar, now valued at in excess of 700 million dollars. Patience and timing has been essential and with falling oil prices, weaker commodity prices and a funding gap that has been left by the demise of the big banking groups, the timing may just be propitious for exploring this asset class again.

Today, the imperative to invest into efficient large-scale food production has never been more pressing. This past year saw the birth of the 7 billionth person on the planet and the global population is generally expected to exceed 9 billion people from 2050. According to the scientists, the world is currently sustainable with a population of somewhere between 300 million and 2 billion, depending on whose numbers you use. However, what is patently clear from all the scientific analysis is that the growth rate of the world's population needs to radically decrease, as the planet simply cannot support the 7 billion people who currently inhabit it.

How can private individuals invest in and diversify their exposure to agricultural land?

One of the greatest challenges for private investors who want to participate in the revaluation of farmland as an asset class, and benefit from the hedge against inflation that land based investments offer, is that there are very few quoted farming companies. Most of these are operating businesses which have very little true exposure to the land itself. The ETFS in the agricultural space are also devoid of adequate land exposure. Consequently, one has two choices. Either one buys a farm, an investment that brings with it the lifestyle option of being able to spend time in the countryside. Realistically however, for financial return, one would look to one of the few private equity firms that offer investors a diversified exposure to climate, crops and geography.

Are there particular exit strategies that need to be planned?

At Milltrust, we have entered into a 10 year commitment to develop a billion dollar program, diversified across farms in the southern hemisphere which will produce rice, wheat, corn and barley, as well as new cash crops that will provide feedstock for animals, as protein consumption in the developing world balloons. We will farm cotton for clothing, and sugar cane for the cost-efficient production of green energy in the form of bio-fuel. Finally, we will produce grassfed beef and lamb, and grass-fed dairy cattle to produce protein that can go directly to the markets of North Asia from the rain-fed pasture-lands of Autralasia.

Our commitment is to develop marginal land into higher grade farmland, enhancing yields and productivity through top grade agronomy and farming techniques, and to sell these assets for full value within this defined timeframe. Only if we list the company as a REIT is there likely to be liquidity but we are making a commitment to pay out all income and capital gains over the life of the investment.

What proportion of an investor's portfolio should be allocated to agricultural land?

The world is in a very precarious place. There is more sovereign, bank and household debt today in aggregate that there was before the Global Financial Crash in 2008. The Eurozone is schlerotic, the US is recovering too slowly, the world is gripped with more military conflict than at any time since the second world war. Real Assets have become a part of the investment management vernacular, and investors who are worried about inflation eating into their hard earned wealth are increasingly looking to keep a significant portion of it in real, and tangible investments. Farmland, like real estate and infrastructure projects, is an asset class than can deliver a reasonable cash dividend, and in many parts of the world has been starved of institutional capital. As the giant pension funds and endowments deploy more and more money into farmland, creating bigger and more powerful farming enterprises, so profitability will improve, and values will increase.

How has agricultural land performed as an asset class?

One reason for interest in agricultural land as an asset class is the significant increase in food prices over the past decade, driven by the commodity supercycle. Unlike hard commodities which have without exception tumbled from their historic highs as China's urbanisation has slowed, food consumption continues to increase with alacrity. China now accounts for the largest share of soft commodity imports with respect to 14 softs, including powdered milk, soya, sorghum, cotton, barley, wheat corn, rice, and canola. Yet, whilst soft commodity prices have increased dramatically and will continue to do so as more of more of the developing world's population shifts to a more western diet, the productive assets, where these commodities are cultivated, have been a disappointing investment for decades.

This however is set to change. Land is a real assets, and agricultural land offers income combined with deep value that institutional money is now seeking out. Traditional sources of funding have dried up in the post crisis era, but this funding gap is today being filled by endowments and pension funds, who recognise the long term value on offer, and the inflation hedge that land will inevitably provide should interest rates spike in the coming years.

What are the main drivers of agricultural land prices?

Investors are looking to agricultural land to respond in the event that inflation manifests itself, and food commodity prices remain firm, but speculative assumptions aside, the real drivers of agricultural land prices historically have been improved yields or change of use. In the first instance, there is significant evidence that points to better farmers delivering substantially yields. The difference between the top decile of farmers and the next decile can be as much as 50 percent higher productivity in Australia for example. So the best farmers will deliver the best value in terms of value creation.

The other key component of value creation is the capital uplift that comes from moving unproductive or poorly farmed land into more profitable agricultural production. Typically, this involves preparing the land, introducing irrigation, building storage facilities for the crop, and focusing on the most lucrative crop for the region, and given market conditions. The gain in value can be measured by looking at comparable land prices in areas which enjoy similar yields for the same crop.

What type of agricultural land – arable, permanent cropland, pasture – offers investors the best opportunities?

Experienced Ag investor usually liken pastoral farming to something akin to a bond like investment, reasonably reliable but unexciting returns. Conversely, cropping is seen as more volatile with potentially higher equity like returns, in the order of 8 percent year on year.

We believe that median returns are probably inadequate alone to attract the institutional capital that is needed to plug the gap in the farming world, given the uncertainty of weather and water related risks and commodity price volatility, so often outside the control of the farmers. Increasingly, the adoption of buy to lease models with crop insurance to mitigate the risk of failure will encourage investors to invest, but improved asset values as profitability from better agronomy, effective water management, and a more strategic approach to crop planting is also going to be an important driver of returns, independent of favourable tail wind.

Which Asia-Pacific countries offer the best opportunities and what are the ownership restrictions?

Asia is a huge challenge for land investors as there are foreign ownership restrictions in many countries, and little large scale agricultural land that hasn't already been planted. Malaysia and Indonesia have sacrificed large areas of their native vegetation to the palm oil boom of the past couple of decades during which palm oil prices rose from 185 USD in 2001 to a peak of 1248 in 2011 (albeit back down to 621 today). This has often been at the expense of traditional commodities like rubber, as well as the rainforest. Today, it is almost impossible to find a piece of land suitable for palm production in Malaysia, and the foreign ownership restrictions in Indonesia make owing land for a foreigner very cumbersome. However, there are some interesting regional developments like the shift to stevia cultivation, a natural low calorie sweetener which appears to be the next big thing.

With much of the output of Australia and New Zealand set to find its way into the Chinese marketplace, these two countries remain our preferred destinations, given the rule of law and the clearly defined ownership regime. However, we are looking at opportunities right across the value chain for the savvy entrepreneur, including cold chain facilities, supply chain logistics providers, and branded food manufacturers.

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