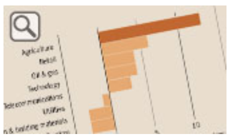
FINANCIAL TIMES

January 27, 2013 6:55 pm

# Investors wary of going back to the land

By Louise Lucas

©Getty



It sounds like an investors' nirvana: an industry, worth an estimated tenth of global economic output, with demand to drive a projected 70 per cent increase in production by 2050.

Yet agriculture – the starting point in a food chain that will have to feed 9bn people by the middle of the century – has scarred some big hitters in the investment world. Many are now wary of a sector that is at the mercy of fickle weather, political risk and quixotic governments.

This marks a turnround from the few years before the 2008 financial crisis, when Morgan Stanley was buying swaths of farming land in Ukraine, Altima Partners wanted to create "the first ExxonMobil of the farming sector" and Crispin Odey, manager of London-based hedge fund Odey Asset Management, was advocating "sell banks, buy cheese".

Today, appetite to tap into the sector remains strong – but couched in caveats informed by dud deals of those riskier years. That restraint is in turn a brake on many of those who need funding the most: 85 per cent of production comes from smallholders, many of whom need to expand and improve technology.

"Farmers are struggling to gain finance from banks and [are] looking to alternative sources," says Ashley Clarkson, associate director at Grant Thornton, the business adviser.

Richard Ferguson, director of Masdar Farming, calls agriculture "the last big industrialisation". It is, he says, a process that will take 20-30 years to play out, much as the oil sector did over a century: with smaller farms joining forces and becoming corporate entities.

Russia and Ukraine illustrate the process. Under the reforms after the collapse of the Soviet Union, collectives passed into the hands of hundreds of individuals; as a result, a third of land went out of production.

Corporate acquisitions began in 2002 in earnest. Mr Ferguson recalls one agricultural enterprise that boasted 70 lawyers among its 1,600-strong workforce, whose time was spent buying individual shares of blocks of land from hundreds of peasants – including many who had since died. These formed the basis of some of today's big listed groups such as Cherkizovo and Black Earth Farming.

Yet the mismatch between the expectations of those seeking capital and those supplying it is putting a brake of investment flows. One consultant illustrates the yawning funding gap that exists with a New York-based hedge fund that ran due diligence on a big Brazilian farm project.

The fund rejected the deal on realising it would only gain good positive cash flow "one month a year". It did not understand at the outset that farming, with one harvest a year, does not represent steady cash flow.

Other issues give investors pause for thought. Agriculture is fragmented, small-scale and localised, and single projects are deemed too risky.

Instead, investors are tapping agricultural growth via equipment and technology, buying shares in the likes of tractor maker John Deere or seed supplier Syngenta – companies that in the words of one analyst are "just selling western technology into emerging markets and making quite a bit of money of the back of it".

The scarcity of such listed groups also explains the runaway multiples of those that do exist – UK-listed animal genetics group Genus trades on 26 times forecast earnings. Equally, there is a fair-sized graveyard of agricultural shares that plummeted, such as Asian Citrus and Asian Bamboo.

So new opportunities are being sought and investors are exploring ways of making farming more investable, such as by increasing scale or diversity to mitigate risk.

Models include banding farmers into co-operatives, a trend under way as farmers seek their own economies of scale and better bargaining power when they deal with buyers, such as food and drink companies or retailers.

The model is also useful for fundraising. Farming co-ops can band together to invest in processing or refining, in turn producing more profitable goods. Examples abound, from cassava processing plants in Mozambique to a grainstore and processing centre in the English Midlands. At the opposite side of the world Fonterra, the New Zealand dairy co-op, late last year raised NZ$525m with a new fund tracking its financial performance.

The listing turned Fonterra, which last year collected 17bn litres of milk and employs more than 17,000 people, into New Zealand's biggest company.

Yet other analysts list counterpoints to these success stories, such as Landkom, Asian Citrus and Black Earth Farming. The latter was set up to invest in Russian grain production and boasts a land bank bigger than Luxembourg. But equally, earnings have shrunk in each of the past five years in what the company terms a “disappointing” performance.

Landkom, which joined London’s junior market Aim in 2007, was swiftly forced to slash its land bank expansion ambitions by the financial crisis; it then bought wrong machinery and suffered a poor rapeseed harvest – and was taken over for a song.

Grant Thornton’s Mr Clarke sees more attractions in other parts of Europe. There, investors can gain returns on capital of 1-2 per cent with land appreciation on top. Given land prices in the UK have doubled in the past five years, and have been strong in other parts of Europe too, “that is attractive for pension funds and educational establishments”, he says.

Jürgen Siemer, senior analyst at Sustainable Asset Management concurs. “Prices for land are going up, so investment in agriculture and the value chain is becoming more attractive and there is much more profit to be made.”

And even the stretched timeframe for returns is not so unusual, says Mr Ferguson, drawing on his previous career as a telecoms analyst.

In 1993 when Orange, the mobile operator, appeared it did not expect to make a profit for six years (in the event, it produced a tiny profit one year out of seven). In 2000, it was among five UK groups forking out $22bn-plus for 3G licences – setting the goalposts back further.

Farming may have a longer horizon still. Kim Wagner, partner at Boston Consulting Group, says farmers measure in generations. Colleague Decker Walker adds: “The value creation in this industry has been absolutely spectacular.”

Not something investors were saying said about telecoms companies in 2000.

**RELATED TOPICS** United Kingdom