NEWSLETTER 2021
INTERNATIONAL AGRICULTURAL INVESTMENT

InvestAg

Introduction

The international food and agribusiness sectors are clearly undergoing significant pressures and changes across a number of fronts, which will shape how food is produced in the future. There is an undoubted need for farmers and agribusinesses globally to source capital in order to adapt, develop and successfully manage their changing businesses.

Confidence in the sector will no doubt be boosted by the recent increase in prices for a number of agricultural commodities. Soyabean oil prices having now doubled from the lows seen last May and being at their highest levels since 2013. Other vegetable oils such as palm have rallied as well, as have grain prices. This is buoyed by economic recovery and surging demand from China and other countries in south-east Asia.

Post pandemic opportunities seen across the world

As people always need to be fed, the agricultural industry has had an easier time than many during the seemingly never-ending Coronavirus pandemic. Having said that, producers whose focus is on supply to the hospitality sectors have had real challenges. The pandemic has however underlined the attractiveness of agriculture and farmland in particular as a safe haven in these uncertain economic times, being an asset uncorrelated to the financial markets. It has also shown up the weakness of the reliance of "just in time" imported food supply network and the importance of food security. Food prices have however remained relatively stable at a global level.

With many businesses and livelihoods around the world severely impacted, combined with international governments pumping in billions trying to prop up their economies, the economic impact of the pandemic will clearly be long-term. How world governments manage the situation going forward will impact on global trade, but the forecasts are positive. With a new US president now installed in the White House, Brexit completed, a roll out of the vaccine underway and better treatments for the virus, there is clearly light at the end of the tunnel. All of which should enable the global economy to start to grow again and present new opportunities in the agricultural sector.

Agriculture integral to fighting climate change

The world is finally waking to the need to do something to address climate change and the destruction of the natural environment as a result of a growing world population and ongoing urbanisation. The finger is often pointed at agribusiness as being part of the problem by degrading or destroying natural habitats in order to satisfy the demand for food. Whilst numerous farmers around the world are good custodians of the countryside, it has to be said that there is a huge amount of work to be done across the industry to help conquer these global problems, with agriculture being an integral part of the solution.

There are clearly challenges and trade-offs involved in redesigning food systems to restore biodiversity and/or prevent further biodiversity loss. A recent Chatham House paper recommends "three 'levers' for reducing pressures on land and creating a more sustainable food system.
The first is to change dietary patterns to more plant-based diets, due to the disproportionate impact of animal farming on biodiversity, land use and the environment. The second is to protect and set aside land for nature, whether through re-establishing native ecosystems on spared farmland or integrating pockets of natural habitat into farmland. The third is to shift to more sustainable farming." The paper says: "All three levers will be needed for food system redesign to succeed."

Agricultural revolution commencing

We are already seeing a quiet revolution commencing in the agricultural and food sector, which is in the early stages of a transition towards more sustainable/clean-label food production and consumption. For active investors this is creating compelling investment opportunities, be it in new technologies, or projects adopting transformational agricultural management practices.

Politicians are supporting and driving this change.

Governments are now putting in place policies and measures aiming to make food and agricultural production more sustainable. In the US, the environment appears to be a high priority for President Biden, with several executive orders having been signed in the early days of the new administration addressing climate change on multiple fronts. Biden has indicated a desire to improve federal programs to help boost the adoption of climate-smart agricultural practices. The EU's "Farm to Fork Strategy" is all about the environment and health; whilst aspirational at this stage, its aim is to meet the UN's sustainable development goals (SDGs).

The post-Brexit payment regime in the UK phases out food production subsidies and supports environmental initiatives instead, which is the biggest shake up in UK farming since it joined the then EEC in 1973.

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Monetising Natural Capital

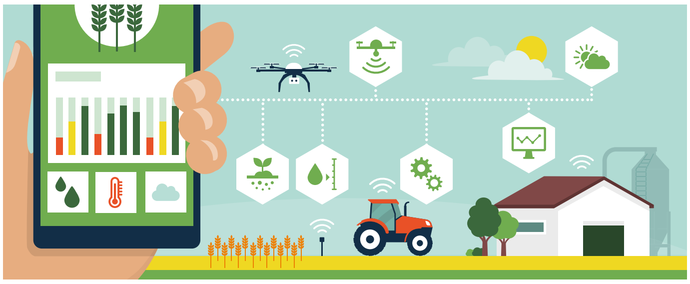
The agricultural community is also starting to look how it can monetise its Natural Capital. The US has led the way, with farmers able to monetise carbon sequestration and sale of conservation easements. Whilst returns are currently quite modest at US$10-15/t of carbon sequestrated, world emission targets suggest prices of $40-80/t are needed in the long term if we are to reach the Paris Agreement goal of limiting global warming to 2 degrees Celsius above pre-Industrial levels.

We are also seeing the emergence of programmes in Europe in France and Belgium, which are paying more than in the US at Euro 40/t of carbon sequestrated on arable farms. A similar programme is about to commence in the UK shortly too. The British government has set a £22/t floor price when it begins auctioning permits under its domestic Emissions Trading System (ETS) this year, which is 50% higher than originally announced.

How valuable this market will become to the farming community, time will tell, but there will be ample opportunity for the agile minded to gain much higher prices, if they don't settle for being just price takers. What we do however know is that topsoil is the largest natural carbon sink available on Earth, which means that the way we farm will play a big role in our ability to fight climate change.

We are already seeing the start of the drive towards lower input farming and regenerative agriculture regardless of carbon credit programmes. The latter involves planting of perennial grasses, no till farming methods, planting of cover crops between cropping, increasing organic matter in the soil and improvement of water retention preventing soil erosion; all resulting in carbon sequestration. The rationale behind such approaches has always been good stewardship of the land asset. With financial incentives now increasingly in place, we expect regenerative farming methods to become increasingly mainstream over the next few years, particularly as the financial incentives to farm in this way increase.

Re-wilding is clearly another area of wildlife conservation gaining momentum. Whilst having huge benefits for the natural environment, to be able to afford to go down this route most landowners and farmers will need to secure alternative income from their holdings e.g. conservation grants and subsidies, carbon credits, hunting, converting farm buildings to alternative uses and tourism etc. Whilst re-wilding has garnered a lot of support from conservation bodies, the emergence of scrub rather than the more manicured look of the managed countryside many people have grown up with in developed countries, has resulted in initial public resistance to the idea in some quarters.



Ag Tech innovation is booming

The last two or three decades have seen considerable improvement in crop and livestock yields, due to the growth in research and development. However within the last five years or so we have seen ag and food tech innovation boom, with big data and precision agriculture leading the way.

There are many new exciting products being developed and adopted, be it using robotics, artificial intelligence and big data to increase productivity and reduce chemical usage and costs.

From very poor levels of investment historically, we saw Euro 2.8bn of investment in food and ag tech in Europe in 2019 alone, but there is still a lack of seed capital in the region, with the majority of investment being made in up and running revenue producing companies.

Vertical farms are also attracting the headlines. The food retailers are excited by the opportunity to secure a consistent supply of local produce with little or no chemical usage, twelve months of the year. The UK's biggest online grocer Ocado has recently invested in one.

Despite the considerable start-up costs, the potential financial returns for investors are exciting. The largest European vertical farm to date (7,000 sqm over 14 storeys) has just been completed in Copenhagen in Denmark, but even bigger operations are planned to be built in the UK, with roll outs of multiple farms across the country. With countries like the UK importing half their herbs and leafy greens, there is huge market potential for vertical farm operators if they can get their business models correct.

Protein demand shifting

The global consumption per-capita of animal-based protein has increased modestly over the last 50 years. However, there has been a recent surge in supply and demand for alternative proteins in North America and Europe. Western wealthy middleclass health and environmentally aware consumers make up 85% of global consumption. The rise in vegans, vegetarians and flexitarians is driving this growth.

Alternative dairy products currently make up the biggest share of this sector (28%). However, alternative meat has seen the biggest growth, with retailing in the US having grown at 6% per annum (2016-2019). Higher prices compared to meat currently limit demand. Uptake will no doubt increase as taste, smell and textures improve, if combined with price reductions. As prices become more competitive, the huge Asian market is one to watch.

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Food and agriculture as an asset class continues to grow

The food and agriculture sector as an asset class continues to grow and according to High Quest Partners accounted for a minimum of US$131 billion assets under management (AUM) around the world in 2019, with 469 asset managers (compared to 38 asset managers in 2005). Following the financial crisis in 2008 we saw a sea change, with a huge new interest in the sector, with investors looking for investments uncorrelated to traditional asset classes.

Investment managers have deployed and continue to raise investment vehicles for a range of international strategies including: field scale agriculture and farmland, controlled environment agriculture, vertically integrated agribusinesses, ag tech and inputs. In the last year we have seen particular interest in the sector from venture capitalist firms attracted to alternative proteins and controlled environment agriculture.

Over half of the total investment AUM in global food and agricultural asset class is invested in the USA, with the US asset managers the biggest hitters. Farmland takes the lion share (almost 40%) of the total global AUM by value in the food and agriculture sector. Institutional investment in farmland has more than doubled over the last ten years. According to High Quest, 138 asset managers are globally pursuing farmland strategies whereas fifteen years ago there were only 22.

The ongoing consolidation across the global agribusiness sector, makes it a more attractive environment for the institutions and large corporates. Investors who have targeted farmland investments, continue to look to diversify their portfolios away from pure arable/row crop farmland portfolios, after commodities prices such as soya fell during Trump's trade war with China. Some investment managers aim to have an allocation of one third of their agricultural AUM in permanent cropping and other higher value agricultural investments.

Family offices also continue to see farmland as a great store of wealth for the next generation, some with a diversified portfolio of holdings. For example Bill Gates is now leading the way as the largest private landowner in the USA.

European High Value Farming and Agribusiness

As an investment advisor, InvestAg is involved in private equity, venture capital and farmland investing. We are currently seeing exciting investment opportunities in high value UK and European fresh produce integrated agricultural businesses. We see the fresh produce sector now has a particularly good opportunity to align with customers post Covid-19, following the disruptions highlighting significant fragility in the supply chain.

European agribusiness is dominated by privately owned producers. The big European retailers work directly with a limited number of large growers with integrated packhouses, or via the wholesalers/packers. As we emerge from the pandemic, they are looking to work with well-financed producers with realistic growth ambitions to give assured and substantial supply of produce. This combined with ongoing consolidation of producers, gives opportunities for investors to partner with top quality growers, by giving them the financial clout they need. Partnership can come in several forms, be it as a private equity investor directly involved in the business, sale and lease back deals with investors of farmland and other assets, or debt provision.

Portugal and Spain attracting international investors in permanent cropping

In recent years Portugal and Spain have become a target for international investors looking for permanent cropping investments, previously the preserve of local private families and companies in the region. These countries are able to produce crops earlier than in Northern/Central Europe, securing high prices for products during the pre- season e.g. tree and berry fruits, vegetables and salads etc. Their production of Mediterranean permanent crops such as almonds, olives, citrus, peaches, is also attracting strong international investor interest.

Portugal has built Europe's largest artificial lake, the Alqueva Dam, which has already opened up 120,000 ha of new areas of irrigated farmland in the Alentejo Region (170,000 ha when finally complete). This has put Portugal on the map as a destination for agri-investment, perhaps rivalling Australia as an alternative to the USA. Investors see considerable value in Portugal compared to say California, which despite its water issues has attracted considerable institutional investment over the last few years, driving up land prices.

UK – Post-Brexit offers investment opportunities in high-value agriculture

Post-Brexit we see interesting consolidation potential of high-value agricultural producers, complimented by increasing consumer demand for sustainably produced local food. We see this to be the case particularly in vegetable, herb/leafy green and fruit production. We are also seeing new greenfield developments of protected agricultural projects (glass house, vertical farms etc) being funded from a range of sources.

For traditional UK arable and livestock farming businesses to be profitable in the short to medium term, they will have to adapt to the removal of EU production subsidies, by embracing the new UK environmental payments and also diversifying their businesses even further. However, we believe UK farmland will be a proven as a solid long-term investment.

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For further information please contact:

Henry Wilkes
Tel: +44 (0) 1245 361266
hwilkes@investag.co.uk
www.investag.co.uk

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