INVESTMENT OPPORTUNITIES IN GLOBAL AGRIBUSINESS

A Global Megatrend—The Business of Feeding the World

By Michael Underhill

Surgling economies such as those in China and India are generating higher incomes, demographic changes, improved infrastructure, and greater consumer quality awareness, all of which will influence global eating habits. As people become wealthier, they tend to demand higher-protein foods. The United Nations estimates that by 2030 the demand for agricultural products will be about 60 percent higher than today.

Protein intake in developing markets is growing by 11–15 percent annually, for an estimated growth of 75 percent total by 2050. By 2030, China’s annual meat consumption will be more than double the 1997 levels, which were 41 kilograms per person.

We now have about half the arable land per person that we had 40 years ago. By 2025, it’s estimated that between 600 million and 986 million people will be living in countries where cultivated land is critically scarce (FAO 2011).

All these factors contribute to the enormous potential of the global agribusiness industry.

Institutional Appetite for International Agribusiness Grows

With more than 9 billion mouths to feed on the planet by 2050, food security is increasingly dominating the international agenda. The UN Food and Agriculture Organization estimates that global food production will need to increase by 70 percent over the next four decades.

As a result, international agribusiness is becoming an increasingly sought-after investment. Institutions with a thirst for alternative investments are attracted to this asset class due to its stability, lack of correlation with other asset classes, anti-inflationary tendencies, and past performance.

Until relatively recently, agriculture and farmland have not had a place in the investment portfolios of the mainstream institutions/pension funds. Indeed, the majority of the world’s farmland is owned by private families. Even in the United States, which likely has the greatest penetration into the sector, institutional ownership is less than 0.5 percent of the entire farmland market. This is beginning to change.

Global pension funds manage approximately US$32 trillion of assets, of which US$150 billion are believed to be invested in commodities; of that amount, US$7 billion–$15 billion is estimated to be invested directly in farmland. Institutional exposure to commodities and farmland is expected to double by 2017 (Africa Progress Panel 2014). Some institutions will be looking for investment products that give them liquidity. Others will be nervous about exposure to the volatility of farm returns and may prefer to own land leased to farm operators, either directly or via investment funds. Agriculture does not fit easily into institutions’ real estate portfolios. Nor does it necessarily fit into their alternative asset portfolios, where they demand returns in excess of what agriculture normally can produce. Institutions therefore are starting to create new specific asset allocations. To warrant this, they need to satisfy themselves that they can invest significant amounts of money, via direct or indirect investments.

Ten years ago publicly marketed international farming investments available to third-party investors were particularly rare. But according to OECD/Food and Agriculture Organization of the United Nations (2014), within the past five years 54 international publicly marketed agricultural farming investments have successfully raised subscriptions around the world, with a total current market capitalization of approximately US$7.4 billion. This trend is expected to continue with the corporatization of agriculture and an increasing number of new agricultural investment funds typically targeting internal rates of return of 9–18 percent.

Institutions will find it challenging to work with a new asset class that has a majority of first-time asset managers. Historically, access and execution to this relatively illiquid asset class has been difficult, and specialist skills have been required to make and manage investments.

What Is Agribusiness?

The agribusiness sector includes, but is not limited to, companies involved in the production, processing, transporting, trading, and marketing of soft commodities such as grains, meat, fish, and forestry products, as well as those that supply products and services including seeds, fertilizers, crop nutrients, agricultural equipment, and water to the agricultural/forestry industry (see figure 1).
Why Invest in Agribusiness?
The agribusiness sector is showing signs of a long-term, demand-driven trend similar to that experienced by hard commodities and the energy sectors during the past decade. A number of factors are driving demand and constraining supply, leading to investment opportunities (see figure 2). Investing in global agribusiness companies can provide investors with sector diversification for a portfolio of traditional equity investments as well as exposure to a long-term growth trend supported by strong fundamentals.

Growing Demand
The three main drivers of increased demand for soft commodities over time are:

Population growth. According to the United Nations, the global population is set to grow 40 percent by 2050 to 9 billion, compared to 6.5 billion today. The world’s farmers need to continue to become more efficient to satisfy growing demand for food.

Rising living standards. Strong economic growth in developing economies is leading to a rapid rise in the living standards of many people. As income per person increases, particularly for people with very low incomes, a larger proportion of income is spent on improving nutrition and general well-being. This involves consuming more food, as well as introducing protein such as chicken, pork, beef, and dairy products, and reducing consumption of starches such as rice. This increase in demand for protein leads to greater demand for grains as animal feed. As a rule of thumb, 1 kg of chicken requires 2 kg of grain, 1 kg of pork requires 4 kg of grain, and 1 kg of beef requires 7 kg of grain (see figures 3 and 4).
Slowing Productivity Gains

World cereal yields have increased on average by 1.9 percent per annum over the past 47 years. However, over the past 20 years the growth in yield has slowed to 1.4 percent per annum.3

Water Shortages and Pollution

Only 3 percent of the world’s water is fresh and agriculture is a key user. The demand pressures on water are rising as population grows and industrial use rises, and both compete with agriculture for water. Although water is arguably the most important resource on the planet, many people are unaware of how it is actually allocated. The vast majority of global water withdrawals (about 74 percent) are for agricultural use, compared with domestic purposes (8 percent) and industry (18 percent) (World Water Forum 2008). The damage of a water shortage is incredibly widespread. More than 2.8 billion people in 48 countries will face water stress or scarcity conditions by 2025 (UNEP 2002). By the middle of this century, 7 billion people in 60 countries could be facing water scarcity (UNDESA 2003). All three areas (agriculture, domestic, and industry) are suffering and stand to deteriorate rapidly over the coming years.

In agriculture and industry, water is a key determinant of a country’s output and trading power. Deficiencies in the traditional water withdrawal process in most water-scarce countries means that roughly 50 percent of withdrawn water evaporates or is otherwise lost (World Economic Forum 2008). The same study estimates that 55 percent of the world’s population will be dependent on food imports by 2030 as a result of insufficient domestic water. By importing cereal, meat, and other food products, countries can reduce their direct agricultural water use. But three of the top-10 food exporters are water-scarce countries and three of the top-10 food importers are water-rich countries. If water scarcity remains unaddressed, these import and export practices are unsustainable. The agricultural industry will require a difficult

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Biofuels. Although not as strong a driver as the first two factors, the growth in consumption for biofuels such as ethanol is increasing demand for agricultural products. Around the world, governments have mandated use of renewable fuels for blending with gasoline and diesel. Concerns about energy security and carbon emissions have led to such policies.

Constrained Supply

The demand for soft commodities is increasing, but the pressure on supply factors also is increasing. During 2012, drought conditions across the central United States drove corn and soybean yields to their lowest levels in nine years.

Supply has been impacted as well in other regions such as Asia, where wheat stem rust is depleting crops.

Falling Arable Acreage per Person

Global cultivated area has grown 13 percent since 1961.2 Over the same period, global population has grown from 3 billion to 6.5 billion—a rise of 115 percent. With 2.5 billion additional people expected on the planet by 2050, the amount of arable land per person is likely to continue declining. There is also pressure on agricultural land from competing uses such as urban sprawl, industrial complexes, and forestry.
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c更改 in the list of net exporters and net importers. Agricultural trade, which has declined over the past 20 years as a result of food price volatility and more competitive, dynamic global trading markets, will need to improve and increase in order to accommodate the demand created by the water crisis. With more people reliant on food imports, the water-rich, water-poor divide will become a key differentiator in global agricultural production and pricing.

Climate Change
Climate change has serious ramifications for food production. Scientists estimate that a 1-degree Celsius increase in the optimal temperature during the growing season may reduce yields in wheat, corn, and rice by 10 percent. We believe that investing in companies involved in helping to produce more food will deliver strong returns for this sector over the medium to long term. Soft commodity companies are generally capital-intensive businesses that have a far greater sensitivity to volume than to price. These companies reduce their cost per unit by increasing volume and thus increasing profitability.

Agribusiness Investing Value Proposition
Investors typically have been told that investing in raw commodities is the appropriate strategy for gaining exposure to the agriculture asset class. In direct contrast, institutional investors now are turning their attention to global agribusiness investment strategies that invest in the stocks of these commodity-focused companies, which provides exposure to commodities as well as an enhanced element of managerial oversight through the lens of a professional asset manager. 

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Endnotes
2. Source: Food and Agriculture Organization of the United Nations
3. Source: Food and Agriculture Organization of the United Nations

References