

CSFI

CENTRE FOR THE STUDY OF FINANCIAL INNOVATION

5 DERBY STREET
LONDON W1J 7AB

TEL: 020 7493 0173
FAX: 020 7493 0190

Food for thought: Investing in agriculture. A round-table discussion with Nicola Horlick (Bramdean), Rod Evison (CDC), James Paget (UBS) and David Stevenson (FT) held on Thursday, November 13, 2008, at Watermen's Hall, 18 St-Mary-at-Hill, London, EC3R 8EF, from 12:30-2:15pm.

There is a convincing narrative behind investing in agriculture, the first speaker said. The world's population is set to rise 50% to 9 billion by 2050. These people have to be fed, something we are failing to do already. There is a strong need for a large scale commercial farming operations in developing countries and pension funds should think about investing in it.

The speaker highlighted South America, and Brazil in particular, as places with plentiful water and vast tracts of uncultivated land and a recent record of political stability. Sugar cane, ethanol, eucalyptus – which provides biomass for steel production – coffee and soya were all grown there. Some members were worried that investing in farming production might involve uprooting peasants. The speaker cited one project where the land was wholly uncultivated apart from a sliver that had been ring fenced to protect peasant farmers.

The second speaker focused on Africa, where the need for food was greatest but the supply poorest. A key constraint for inward investors was a lack of management skill right through the value chain. However the decades-long bad news on Africa trend had started to wane and there were clear signs of progress. Looking forward there were several challenges. The first was a need to build large-scale production capacity. The second was a lack of infrastructure essential for farming. Third were natural hazards common to all farmers and lastly was the unfair playing field of world trade that farmers in poor countries faced.

The third speaker said European investors were increasingly interested in the real asset space in the wake of the crash of structured, derivative products. This includes forestry as well as soft commodities. Prices have fallen recently but this seems to be a cyclical downturn within a longer upward trend. Agriculture also has the advantage of not being closely correlated with traditional assets, especially forestry, which has its own biological cycle. The speaker agreed about the long term supply and demand drivers of a growing population of a shortage of water. However he railed against the "obscene" subsidies handed out to farmers by the US and EU that, together with tariffs on imports, made it impossible for developing country farmers to compete either in foreign markets or even in their own.

In terms of investment the speaker suggested following the water, which was essential to farming. While Australia had suffered successive droughts, Latin America had the water, land area and security of tenure that made it suitable for investors. There are risks, notably political instability, financial crisis and currency swings but investors can diversify and hedge those risks. The speaker said an investors might look for returns in the high-teens or

low-20s over an eight-year period. Those come from a mix of trading profits over the course of the investment and a capital gain on exit, whether via a flotation as a real estate investment trust or a trade sale. This latter element underlines the need for investors to improve the value of the land during their ownership.

The fourth speaker drew on his own knowledge of family farmers who were farmers in the UK and Africa to make four key points. Farming is hard work and requires an emotional input. Investors need to think about the practicalities of what the farm they have bought must do to turn a profit. It is unwise to think one can spread money across a number of different projects in different countries. On the other hand land itself is a good investment, although one could get a better return by buying farmland in developed economies. Lastly the statistics show that over time commodities have not been a good investment and therefore companies involved in it are unlikely to do well either. He compared agriculture with technology where the “megatrend” narrative pointed to a secular shift but in fact the gains mostly went to consumers with little going to investors.

One member asked whether agriculture was something that should or could be sold to retail investors? The first speaker was strongly against that, as these projects required very long-term commitment that might suit pension funds but not individuals. Saying that pension funds currently only held 2% of assets in alternative investments compared with 20%-plus in conservative Switzerland, so there was room for those institutions to raise their investment. The third speaker agreed it was a medium-term investment and one that pensions funds should be in because of its non-correlation, intrinsic hedge against inflation, the fact it is based on real assets and the merits of diversification.