2017 GLOBAL AGINVESTING CONFERENCE

Insights

BDO

"Australian companies did an excellent job articulating the investment thesis on why invest in Australian agriculture at Global AgInvesting 2017. The very professional discussion was backed up by an interesting case study presentation by Troy Setter, Managing Director of Consolidated Pastoral Company."

Margaux Beauchamp, Executive Director, BDO Corporate Finance

INTRODUCTION

As part of its commitment to the Food and Agribusiness industry, BDO continues to attend the Global AgInvesting Conference (GAI) in New York. In its ninth year, GAI is the world's premier agricultural investment conference series, attracting over 8,000 participants from more than 2,500 organisations worldwide to date.

The conference provides a comprehensive overview of agricultural investment opportunities across the globe, as well as the drivers for where the money is moving in the world's major production regions.

The 2017 conference had close to 700 participants and covered topics ranging from how the Food and Agribusiness industry is performing globally, the investment thesis, portfolio considerations, where to invest in the Food and Agribusiness industry and the effects of the Trump administration on the industry.

In addition to the main conference, BDO attended the short course looking at the *Fundamentals of Agriculture Investment*.

INSIGHTS FOR AUSTRALIA

- Australia was cited as a key agricultural investment geography, along with Brazil and North America
- Optimising investment strategies in agriculture requires consideration, in particular, of:
  - Changes in consumer behaviour which results in food trends
  - Changes in government policy including trade deals, import restrictions, and regulatory requirements including environmental considerations
  - Opportunities for changes in land and water use with more intensive land use and greater efficiencies, and land and water flowing to the highest and best use
  - Opportunities to adopt technology
  - Industry consolidation and shifts in the value chain.
- The most enthusiasm globally is for protein and permanent crops
- The Australian agricultural sectors with the most investment appeal are:
  - Protein: beef, lamb
  - Cotton
  - Permanent crops such as nuts, avocados, citrus, wine grapes and hops.
- Australia was not considered to have a strong competitive advantage in wheat production
- Investment attractiveness of aquaculture is limited by the perception that it does not have input supply constraints
- There were a number of American institutions looking for Australian investments in excess of $150 million
- There is a trend towards institutions wanting to invest directly into food and agriculture entities rather than investing via a fund
- There is an inclination towards investing along the supply chain in order to capture a higher margin and reduce variability
- A business model used by some investors in the Australian Food and Agribusiness industry is to build an investment that will be of a sufficient scale to on-sell to institutions and Asian investors.

AGRICULTURE INVESTMENT PERFORMANCE

The TIAA-CREF Center for Farmland Research conducts research, hosts academic symposiums, and works to inform policy on issues related to farmland prices and the financial aspects of farm management. The center is a specialised academic unit within the University of Illinois, USA. Bruce, J. Sherrick, Professor of Farmland Economics and Director of TIAA-CREF Center for Farmland Research gave a detailed presentation on agriculture investment performance and stated, "*No matter how you cut the data to examine different time periods, agricultural investment has outperformed all other asset classes.*". For example, US Farm Land returned 10.27% per annum in the period from 1970 to 2016 and 8.58% per annum in the period from 2000 to 2016. This compares with S&P500 index returns of 6.79% per annum and 2.48% per annum respectively for the same periods.

Table 1: Total return for different asset classes

Asset Class	Explanation	1970-2016	1980-2016	1990-2016	2000-2016
US Ave Farm (all)	United States farmland returns	10.27%	8.23%	8.84%	8.58%
S&P500	American stock market index based on market capitalisations of 500 large companies having common stock listed on NYSE or NASDAQ	6.79%	8.19%	6.84%	2.48%
NASDAQ	The Nasdaq Stock Market is an American stock exchange	9.63%	9.63%	9.15%	1.65%
EAFE	MSCI EAFE is a stock market index designed to measure equity market performance of developed markets outside the U.S & Canada	6.04%	6.11%	1.76%	-0.26%
TCMY10Y	Ten year treasury constant maturity	6.57%	6.32%	4.74%	3.60%
AAA	AAA rated US Corporate bond	7.70%	7.56%	6.15%	5.23%
All REITS	Real estate investment trusts	9.09%	10.29%	9.74%	10.88%
Gold	Return on the price of gold (USD/ounce)	7.41%	2.18%	3.91%	8.08%
CPI	Consumer price index	3.95%	3.10%	2.41%	2.12%

Source: TIAA-CREF Center for Farmland Research

INVESTMENT THESIS FOR FOOD & AGRICULTURE

Phillippe de Lapérouse, the Managing Director of HighQuest Partners, put forward a very strong investment thesis for investment in the Food and Agribusiness industry. Key supporting factors driving attractive investment returns were:

Population growth
Between now and 2050, the world's population is expected to increase from about 7 billion to almost 9.3 billion people, an increase of around 35%.

Increased urbanisation and the rise of the middle class
As incomes rise and populations become more urbanised, there is a shift towards more protein-rich diets, placing upward pressure on demand for grain and eventually farmland pricing.

Constraints on supply
Factors driving constraints on supply include: water access, climate change, linkage to energy markets (biofuel mandates), deceleration of yield increases, and environmental regulations on production.

Reduced production costs from adoption of technology and new analytics-based efforts
Evolving technologies are expected to play a significant role in improving the performance of agriculture. Opportunities to use technology to increase efficiency and productivity will transform agricultural processes, allowing farmers to have better control over inputs and resultant quality of production. For example, innovations via robotics, precision agriculture and other automation techniques are likely to contribute to reduced volatility and improved efficiency at the field level.

INVESTMENT THESIS FOR FOOD & AGRICULTURE

Figure 1: Why Food and Agribusiness - Investment Thesis

Supply & Demand Imbalances	Demand for land & soft commodities is being driven by several strong macro trends
Inflation Hedge & Wealth Preservation	Historically a tested store of value in inflationary environments
Low Correlation to Other Asset Classes	Outperformed traditional asset classes long-term
Under-Owned by Institutional Investors	Farmland is an underinvested asset class because access and execution are difficult

Source: Philippe de Lapérouse, Managing Director, HighQuest Partners

In addition to favourable industry trends, low leverage, low turnover rates, and thin markets also support the positive investment thesis for agricultural investment. TIAA Center for Farmland Research estimates that in the USA the debt to equity ratio for the agricultural sector in 2016 was estimated to be 13.2% with real estate value of total assets being 83.7%. Furthermore, tax advantages (both income and capital related) and low interest rates compound the support for agricultural investment.

Within a portfolio, low correlation with financials and positive correlation with inflation make farmland a strong portfolio anchor asset.

Professor of Farmland Economics and Director of TIAA Center for Farmland Research, Bruce Sherrick, believes positive outcomes for capital providers to the Food and Agribusiness industry are likely and future trends will include 'financialisation', with equity and indexing vehicles to become more commonplace and complex.

Lower capitalisation rates are expected to be applied to agricultural assets. Historically in the USA, the lease rate to farmland value implied capitalisation rate has tracked the USA 10 year Treasury Constant Maturity Rate.

Despite the strong evidence to support food and agribusiness investment, an investors' bias as to what asset they would 'like to own' is expected to continue to be a key factor in determining agricultural investment decisions.

A PERFECT STORM OF OPPORTUNITY FOR FOOD & AGRIBUSINESS INVESTING

1

Strong and persistent secular tailwinds

- Population growth, coupled with increasing wealth and resulting animal protein consumption, creates multiplicative impacts on upstream production requirements
- Increasing supply constraints create long-term challenges, strengthening the need to produce more with less, increasing the need for investment.

2

Sector complexity reduces competition

- Multiple commodities and end products, complex value chains, and an evolving and expansive global footprint
- The investment market is inefficient which provides opportunities
- A sector specialist with a long-term focus can invest across the value chain and construct a diversified portfolio.

3

Industry consolidation creates opportunity

- Players looking upstream and downstream to gain tighter control of supply chain
- New entrants with disruptive aspirations
- Ongoing M&A consolidation will cause management distraction, talent migration, and asset sales
- Window to capture talent, acquire technologies and pursue development of opportunities while sector is 'sleeping'
- Distraction and reduced R&D spending.

4

Changing consumer behaviour

- Consumer desire for healthy, natural and organic foods coupled with traceability of the supply chain to ensure supplier accountability is increasing the requirement to understand the entire value chain, creating a need to leverage new technologies and business models
- Large consumer goods packaging players are experiencing erosion.

5

New technologies coming to agriculture

- Autonomous vehicles, advanced robotics and image analysis
- Precision agriculture
- Next generation genomics, biologicals and chemistry
- Increased farmer sophistication through consolidation and generational transition
- 'Internet of Things' and cloud architecture for connected farms.

6

Evolving regulations

- New food safety regulations and testing requirements
- Rising tension between urban and rural stakeholders
- Changes in the global regulatory environment including trade agreements.

7

Food and Agriculture is a new capital frontier and growth equity is white space

- Venture capital has identified food and agribusiness as a new vertical and has deployed capital to bring new technologies to the sector
- Companies are reaching commercialisation and are in need for growth equity to continue in their development
- Despite the need, there are few firms participating in food and agribusiness growth equity
- Limited competition affords an opportunity to invest into competing growth platforms.

Source: Summary of Speaker and Panelists comments at Global AgInvesting 2017

AGRIBUSINESS AS AN ASSET CLASS

HighQuest Partners LLC highlighted that over the past three decades, farmland investing has grown exponentially from a 'niche' investment dominated by a few large pension plans and insurance companies to a mainstream institutional real asset class that increasingly can be accessed by retail-oriented investors.

However whilst now growing by 8-10% per annum, HighQuest Partners LLC assess that institutional investment in farmland still represents less than 0.5% of the total global farmland investment and is significantly less than institutional investment in timber. Yet farmland is more than 3 times the investable universe of timber.

Table 2: Global Investment in Farmland

	Total Global Farmland US$ Billion	Total Global Timber US$ Billion
Total land	8,300*	425*
Investable universe	1,000*	300*
Institutional investment	45*	60*

*** Estimates**

Source: HighQuest Partners LLC

Mark White, Head of Real Assets, Albourne Partners, gave a presentation at Global AgInvest on agriculture as an asset class. His principal point was that agriculture is an emerging and structurally developing asset class for institutions that provides multiple opportunities for portfolio enhancement.

Benefits include:

- Diversification
- Return enhancement
- Structural improvements and cost reduction of return profiles
- Inflation participation and forward beta profiles.

As an asset class, agriculture has unique social objectives (Environmental, Social and Corporate Governance 'ESG', Socially Responsible Investing 'SRI' or Economically Targeted Investment 'ETI'), which must be understood and interpreted before investing.

Mark believes the best ways to build an agricultural investment strategy are through governance, strategic placement, sustainable strategy, sustainable firm and partnership.

He also cited the key reasons an agricultural investment may fail which included:

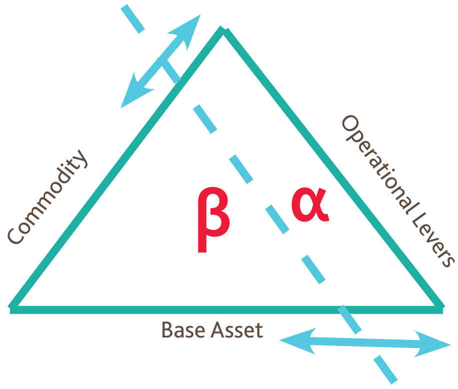
- Poor transparency
- Irrelevant background
- Conflict of interest
- Hidden/high fees
- Span of control
- Key person
- Scale – works both ways
- Regulation
- Strategic drift
- Legal upset
- Poor succession.

Due to the unique characteristics of agriculture, the Chief Investment Officer of an institution may examine the three aspects of performance drivers (commodity, base asset and operational land) and identify the Key Success Factors ('KSFs') necessary to execute on each of these drivers before the Investment Committee makes a decision on investment.

Figure 1.3: Key Success Factors

Strategic Due Diligence and KSF.s Analysis

The Commodity Driver
- Supply and demand
- Cyclical
- Macro
- Beta
- Uncontrollable



Operational Levers
- Dependent on the base asset and commodity driver
- Requires varying degrees of operating expertise
- Contractual experience and regulatory drivers
- Strategic, but also prone to disruption
- Encompasses ESG

The Base Asset Analysis
- Tangible
- Value-based
- Beta
- Limited to no control after acquisition

Source: Albourne Partners

Successful investment structures have centred around direct investment with local management left in place. This has driven a recent trend for institutions to bring sector expertise in-house to pursue direct investment, as opposed to investing via a fund.

Permanent crops and situations involving a mix of real assets with exposure to operating risks along the supply chain have also been gaining popularity. These direct investments are seen to be a natural progression as investors look to change their risk profile and look for higher returns.

The current landscape for investment in agriculture structured as a fund is shown in Table 3. Sustainability and consumer concerns regarding quality (providence of food) are becoming the drivers for the adoption of new technologies and business models, for example, indoor farming of leafy vegetables adjacent to large consumption markets.

Table 3: Agricultural Fund Investment Landscape

Metric	Range	Average
Fund Life (Years)	4-21	11
Investment Period (Years)	2-10	5
Management Fee of Committed Funds (%)	0.5-2.5	1.7
Carry to GP (%)	0-20	12.4
Preferred Return (%)	0-8.5	5.3

Source: Albert Partners

WHICH SECTORS ARE BEST FOR INVESTMENT

In his presentation, Philippe de Lapérouse, Managing Director, HighQuest Partners emphasised that because of agriculture's complex market structure, there needs to be an understanding of how margins are shared at different points along the supply chain. Ejnar Knuden, Chief Executive, AGR Partners, advised that the best returns will be available to those that predict future trends in agriculture, as by the time consensus is reached the assets will be fully priced.

Optimising investment strategies in agriculture requires consideration, in particular, of:

- Changes in consumer behaviour which results in food trends
- Changes in government policy including trade deals, import restrictions, and regulatory requirements including environmental regulations
- Opportunities for changes in land and water use with more intensive land use and greater efficiencies, with land and water flowing to the highest and best use
- Opportunities to adopt technology
- Industry consolidation and shifts in the value chain.

The Agriculture Private Equity Panel members were:

- Rich Gammill, Managing Partner at Proterra Investment Partners
- Alejandro Quentin, Founder and CEO, Pampa Capital
- Jason Silm, Head of Agriculture at ADM Capital
- Hunt Stookey, Director of Research & Investment Strategy at Ceres Partners, LLC

The panel conveyed the view that protein and permanent crops are currently the highest in value and best use of land and water. They also mentioned one of the common themes of the conference is that people are eating better and want to know where their food comes from. A lot of best practices and technology are slow to be adopted due to a lack of knowledge and capital. Vertical integration and leveraging contracts to build bigger deals were highlighted as key performance predictors.

Kevin Schwartz, CEO, Paine Schwartz Partners, said they had achieved an IRR of 90% on their agribusiness post farm-gate private equity fund. He cited industry relationships as the key to success and using partners and directors with significant industry expertise. Kevin also said success requires extensive primary research.

The key risks to investment performance were considered to be poor execution and commodity exposure.

TRUMP ADMINISTRATION IMPACT ON THE INDUSTRY

David Gray, the Senior Advisor of Altima Partners, talked about the effects of the Trump administration on US agriculture and global trade. He expects bilateral negotiations to become more difficult. However, the Trans-Pacific Partnership being scrapped increases opportunity for other exporters, especially Australia and South America.

Trump's general pro-business philosophy, coupled with that of the Republican Party, is seen as beneficial for the Food and Agriculture industry at large. Confidence is high in the agricultural sector, with some economists citing optimism among farmers following Trump's election.

David believes that despite Trump's rhetoric, global supply chains are unlikely to be materially modified.

WHY AUSTRALIA FOR FOOD & AGRIBUSINESS INVESTMENT?

Panelists in the discussion of Agribusiness opportunities in Australia included:

- Michael Blakeney, Investment Director, Blue Sky Alternative Investments Limited
- Richard Kriedemann, Partner, Allens
- Tim Biggs, Chief Investment Officer, Laguna Bay
- Elizabeth O'Leary, Head of Agriculture, Macquarie Infrastructure & Real Assets.

Key reasons cited by the panel as to why Australia represents such a strong investment opportunity were:

- Attractive investment risk/reward returns
- Exposure to high growth, emerging Asian markets as a result of around two thirds of production being exported
- Well established and understood laws and government.

Traceability is another competitive advantage for Australia, with consumers demanding to know what they are eating and where it came from. In order to exploit this, the panel believes Australian firms need to do a better job at marketing their clean, green and quality food brands.

Strong deal flow exists across all asset sectors in Australia (not just beef) with further consolidation of the industry required. Investors are adopting a range of investment models: direct invest and operate, purchase and lease, asset management and agricultural fund. There has been a dramatic shift in the supply chain with a shift away from the spot market. Businesses need to be of scale to fully capitalise on the opportunities available.

The panelists agreed that, although water is the most limiting factor to Australian agriculture (as it is worldwide), the developed water market in Australia means water flows to the highest and best use.

When choosing which Australian agricultural sectors to invest in, the panelists recommended that investors consider:

- What products is Australia competitive in supplying?
- Which products are likely to be consumed in Asia?
- What products benefit from consumer desires for clean, green and traceable foods?

The following sectors were considered by the panel to have the greatest potential in Australia:

- Protein: beef, lamb
- Cotton
- Permanent crops such as nuts, avocados, citrus, wine grapes and hops.

Looking to the future, Tim Biggs, the Chief Investment Officer of Laguna Bay, is of the view that Australian farmland growth rates are likely to be one of the highest in the world. Australian rural land values are expected to increase at CPI plus 7-8% which is the growth rate of Australia's major Asian market, or as a minimum at least two thirds of the high growth rates of Asia plus Australia's GNP.

Investors were advised by the panel to be sensible when setting time frames and not to expect a quick return. Further, they should conduct bottom up business valuations and not just rely on third party property valuations.

"Foreign investment is very important for Australian agriculture. Since European colonisation, there has always been foreign investment. Our first company in Australia was the Australian Agricultural Company. There has always been wavesof capital from different sources over the years."

Michael Blakeney, Investment Director, Blue Sky Alternative Investments Ltd

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