

# Research

Insights into Agriculture Investing

*Detlef Schön, CEO of Aquila Capital Green Assets*



Research

## INSIGHTS INTO AGRICULTURE INVESTING

The below paper provides insights by Detlef Schön, CEO of Aquila Capital Green Assets, on the outlook for prices of global food prices and their supply and gives an overview of the philosophy behind the AA GreenINVEST.

### DETLEF SCHÖN

CEO of Aquila Capital Green Assets and KlimalINVEST, responsible for portfolio management. Mr. Schön began his career with Cargill after completing a degree in agronomics. Having held a range of positions at the firm, including at its European headquarters, before long he was made Managing Director of the European Commodities Merchandizing Division. He also ran his own successful business for a time before returning to global agribusiness as Manager of International Grains for NIDERA in Rotterdam. Detlef has held several non-executive positions and supervisory board appointments. Furthermore he has run his own farm "Hof Peeneland" since 1991.



### THE OUTLOOK FOR GLOBAL FOOD PRICES AND SUPPLY

Food demand is following an exponential curve, driven both by the faster and faster increasing number of people needing to be fed – but (almost as importantly) by the fact that a higher and higher percentage of these people can actually afford to buy the food they need.

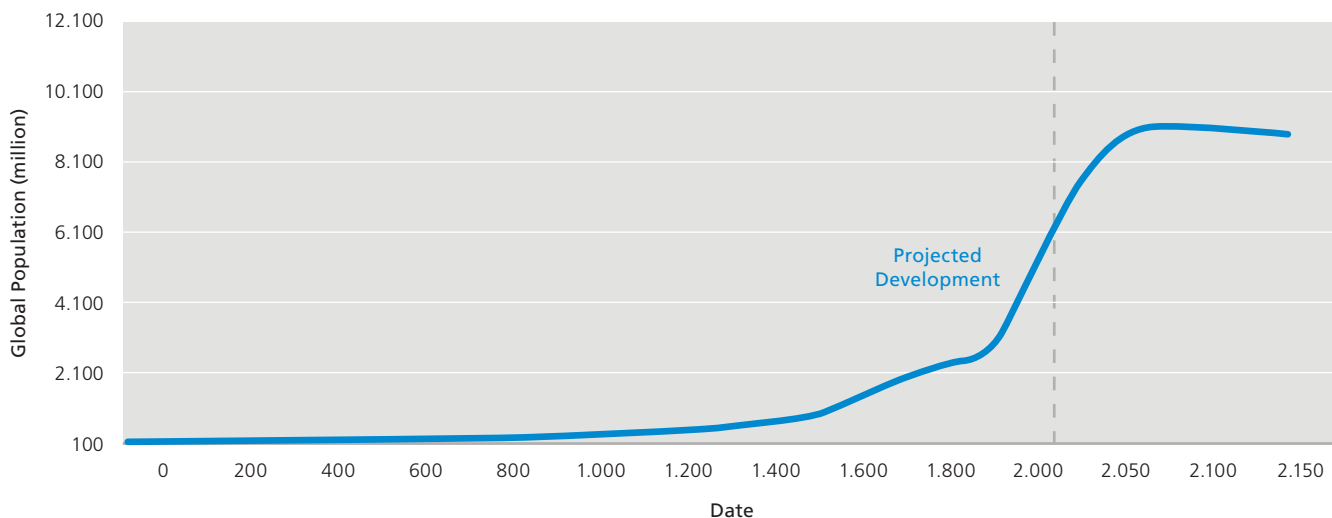
The key difference between linear developments (which the collective human experience is genetically programmed for) and those driven by exponential functions is the fact that by the time a problem resulting from an exponentially driven development becomes apparent, it is almost always too late for corrective measures to have a chance of preventing a further escalation.

The huge achievements of the "green revolution" (which generated mostly linear increases in food production) have created a mind-set of unjustified complacency.

This does not mean that food prices will go up in a straight line – in sectors and geographies without capacity constraints in infrastructure and processing capacity and with intensification reserves, there will be frequent and substantial supply responses.

The underlying trend however – around which food commodity prices will oscillate with increasing volatility and in shortening cycles – is following an increasingly steep curve.

### GLOBAL POPULATION GROWTH



Source: United Nations, World Population Prospects

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## INSTITUTIONAL INVESTOR APPETITE FOR EXPOSURE TO AGRICULTURE

All major institutional investors are in a process of readjusting their portfolio parameters to the “post-GFC” world.

As a result, there is a sharply increasing weight of investments in the “real asset” space across the board – i. e. tangible assets with a robust investment case involving scarcity of physical supplies in combination with accelerating demand and increasing purchasing power.

Energy and food (and thus implicitly the combination of land, climate and water) are the sectors with the most compelling investment cases. The Aquila Capital Green Assets Farm Portfolio is the result of a rigorous analysis, first looking at the alternative strategies available to investors and ranking them with regard to what they offer in terms of:

- liquidity
- volatility
- operational return potential
- capital gains potential
- inflation protection
- insulation from (lack of correlation to) equities / bonds

Our conclusion is that only direct farm investments (or at least such investments that directly track the same drivers) truly serve the purpose of allocating assets in the sector.

Contrary to energy, food is a relatively new asset class with a severe shortage not only of countries where investments are advisable in terms of risk free rate of returns but more importantly of asset managers that are able to handle large sums of money – the limiting factor being not a lack of administrative capacity but simply the ability of transforming a business that is traditionally modular and driven by private entrepreneurs into scalable, corporate investment vehicles. Good farmers that “speak finance” are hard to find – and to take a financial institution onto a farm (the standard approach) quite often is a recipe for disaster.

## WHICH CROPS AND COUNTRIES OFFER THE BEST RETURN AND INVESTMENT INCENTIVES

For the Aquila Capital Green Assets Farm Portfolio we are continuously reappraising sectors with regard to their ability to generate:

- cash flows,
- capital gains and
- „alpha” in both.

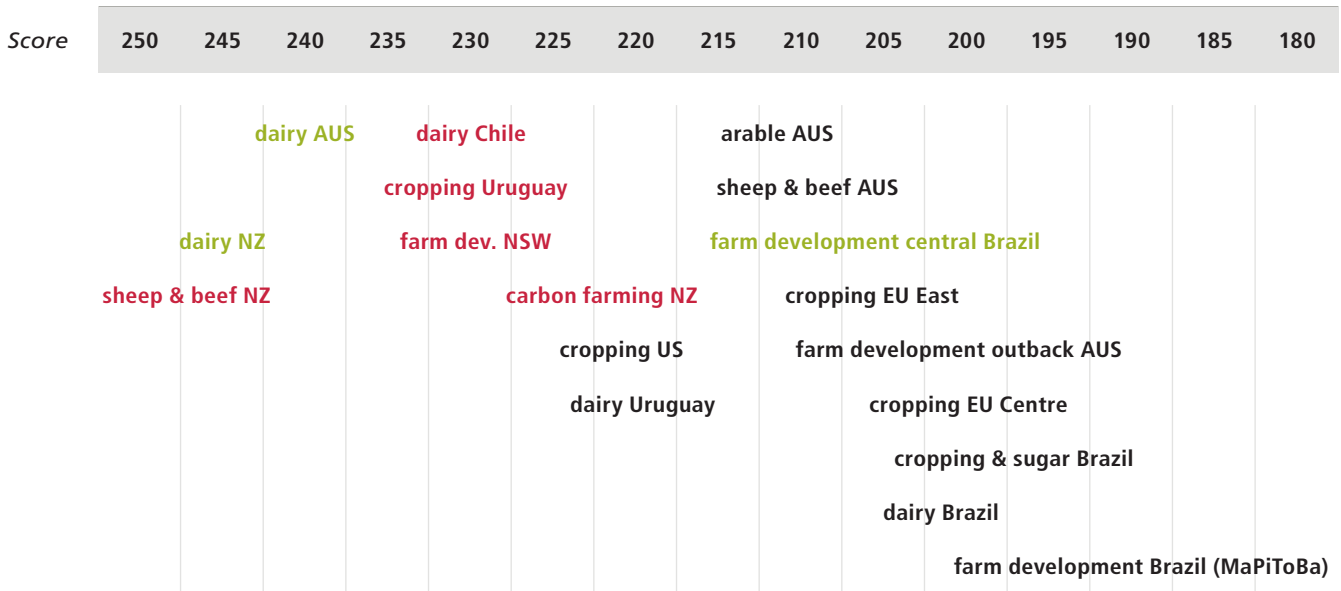
This is then complemented by the evaluation of:

- country risk
- implementation risk
- liquidity and
- volatility (stability) criteria

The results are weighed („factors”) in such a way that they reflect the individual investor’s risk profile. One possible result is on the following page (left = best):

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## POSSIBLE RANKING

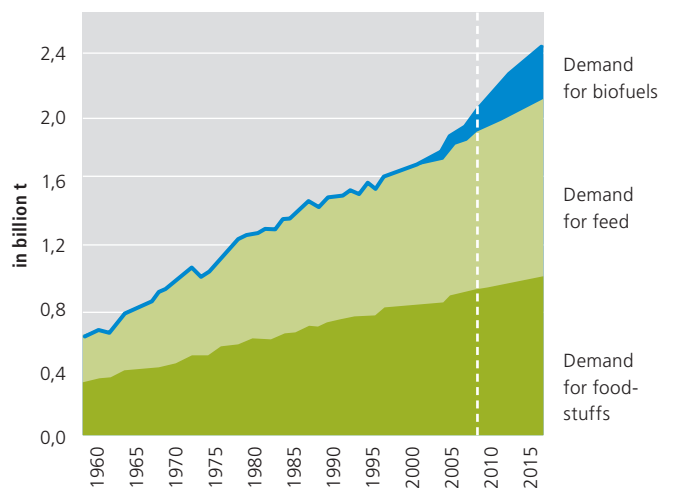


Source: Aquila Capital

Obviously, there is a fair amount of intellectual property behind these numbers – and they assume factors and weights that will differ from investor to investor; we pride ourselves on being able to customize investment vehicles according to investor requirements.

At this stage however I want to make one strong point – and that is my firm belief in the renaissance of **pastoral farming**. As demonstrated by the graph on the right hand side, it is absolutely obvious that the production of milk and meat from grass is the only way to prevent a protein crisis:

## GROWING DEMAND FOR BIOFUELS, FEED AND FOODSTUFFS



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Bearing in mind that feed conversion, i.e. the amount of grain required to produce 1 kg of meat, ranges from 2.5 (poultry) to 7.5 (beef), and realizing that there is more farm produce being fed to animals than to humans, it immediately becomes clear that here is an enormous reserve of calories that can – and will have to ! – be freed up through a shift from grain-based to pastoral farming for meat and milk:

- More than two thirds of global farming acreage is pasture land;
- There are significantly more production and productivity reserves in pasture than in arable land;
- Grasses (including sugar cane) use increasingly scarce water supplies more efficiently than grains and oilseeds;
- Feeding grains or grain substitutes to cattle results in an unsustainable competition between humans and animals for increasingly scarce arable land;
- Cattle is genetically designed to eat grass not grain, with corresponding health / mortality issues in a high-intensity grain-feed system
- the production of milk and meat from grass is therefore economically more viable than and ethically superior to cattle eating grain that would otherwise feed humans.

The increasingly adverse feed / milk ratio in the US – and the fact that New Zealand is producing milk as much as 40 % cheaper than its main competitor in the world market, the EU – are evidence of the increasing competitive advantage of grass based systems.

It is for this reason that Aquila Capital Green Assets and AGInvest have formed a pastoral farm investment management company AA GreenINVEST based in New Zealand, the heartland of pastoral farming and the country where between them the partners are currently managing assets worth more than 400m NZ\$. AA GreenINVEST focuses on investments in New Zealand and Australia but is in a position to replicate the New Zealand production system in all countries with similar climate and vegetation potential.