

## Panel 13: Political Economy - Finance

### Farmland as an Asset Class: The Focus of Private Equity Firms in Africa



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March, 2011.

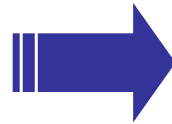
# Items to cover

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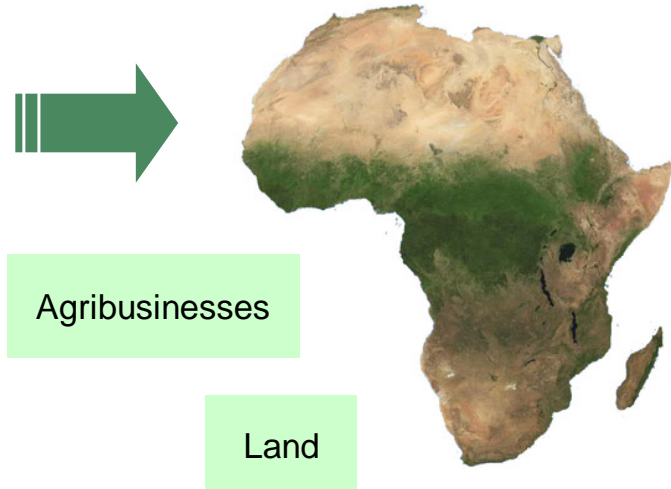
1. Flow of Private Sector Capital: Private Equity in African Agriculture
2. Private Equity Overview
3. Global Agriculture: The importance of Africa
4. How PE firms gain exposure: Farmland vs. Agribusiness investments
5. Altima's approach to farmland investing
6. Alternative business opportunities
7. Smallholder production challenges & the potential of Commercial-Smallholder Hybrids
8. Points to Note

The Wall Street Journal identified 45 private equity groups looking to deploy over \$2bn into African agriculture over the next 2-4 years.

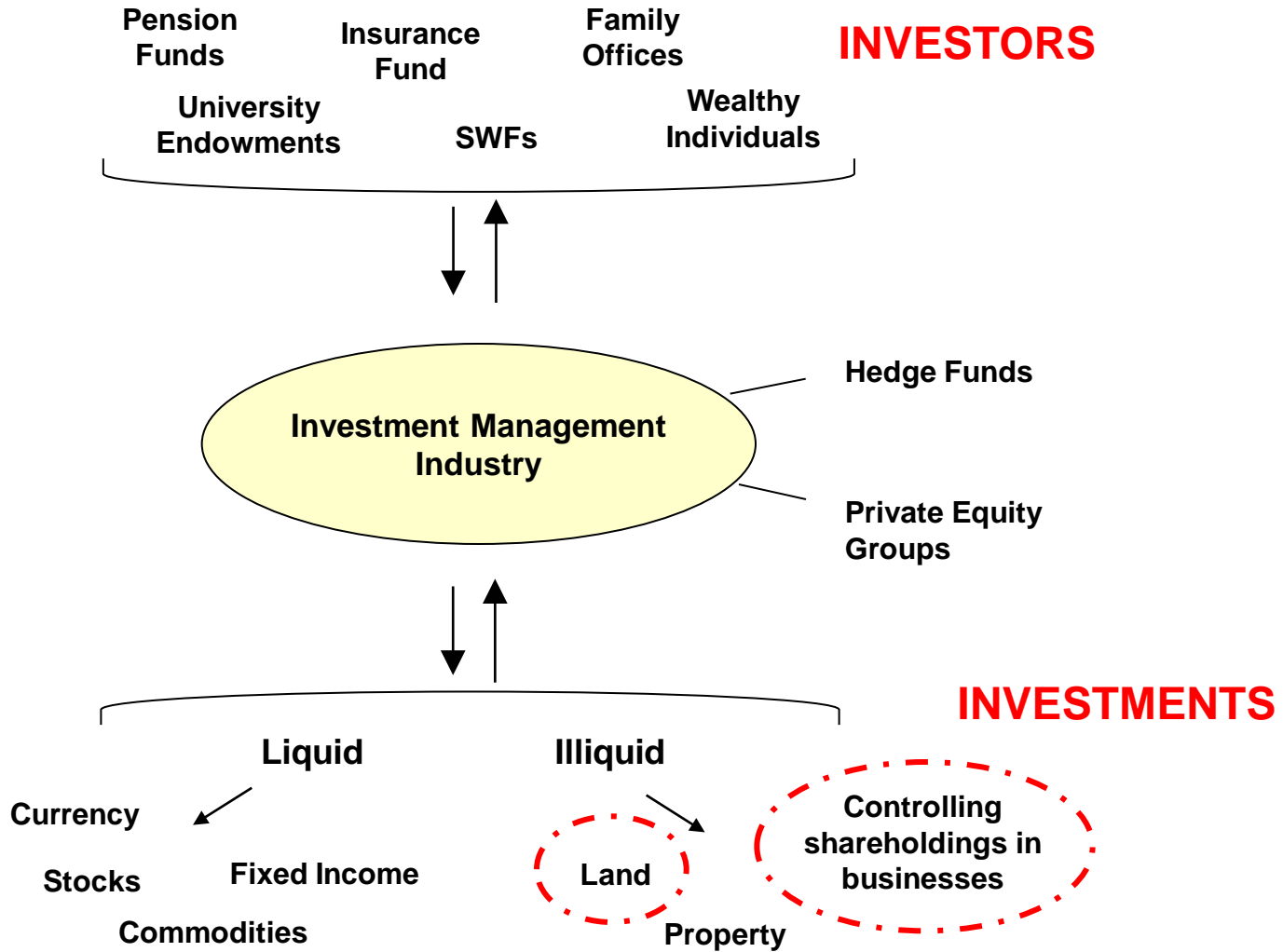
Source: WSJ (2010)



It is just the 'Tip of the Iceberg'.



# Private Equity Overview



# Private Equity Overview

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## The PE business model



2 & 20

- **Management Fee**

Annual fee based on the amount committed

E.g. \$100m committed = \$2m per year over fund life

- **Performance Fee**

Cut of the profits (if any) at exit above target rate

E.g. \$100m invested with \$140m realised (\$40m profit)

Note: Increasing pressure on these figures from investors has seen moves down towards 1.5 & 15

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### Characteristics:

- 5-7 year timeframe (med / long-term finance)
- Controlling stake in businesses / projects
- Highly incentivised management teams

### What are PE firms good at?

- Viability of business models
- Assessing the scalability of opportunities
- Moving quickly, with authority
- Working closely with management teams to set direction

# Global Agriculture - The importance of Africa

## DEMAND

Globally, many countries are finding it increasingly difficult to meet the rapidly rising demand for food resources:

- Drivers:
- Global population is expected to reach 9 billion by 2050,
  - Increasing income levels (as a result of economic growth), and
  - Extensive rural-urban migration.

## SUPPLY

- Productive arable land is widely considered to be at its maximum balance.
- Diversion of food crops into biofuel production e.g. rape seed and soyabeans.
- Impact of climate change
- Substantial yield gaps (between the developed and developing world)



Sub-Saharan Africa and Latin America are the only regions with significant areas of land available for an expansion of agricultural production.



The considerable yield gap that exists between Sub-Saharan Africa and other regions provides an opportunity for investment.

African governments have put an increasing emphasis on enhancing agricultural productivity, and expanding land under production.

**... Africa to play a key role moving forwards ...**

# How PE firms gain exposure

... Two different ways to play the same macro trends ...

1 Farmland (Real Estate)	2 Agribusiness *
<p><b>Buy land and rent to an established high quality operator</b></p> <div style="display: flex; justify-content: space-around; align-items: center;"> <div style="text-align: center;">  <p>(a) Capital Appreciation</p> </div> <div style="text-align: center;">  <p>(b) Rental Income</p> </div> </div> <p><b>Attractive investment features</b></p> <ul style="list-style-type: none"> <li>- Relatively low risk and low volatility</li> <li>- Store of value in times of inflation and recession</li> <li>- Annual cash return</li> <li>- Consistent long-term asset appreciation<sup>+</sup></li> </ul> <p><b>Less attractive</b></p> <ul style="list-style-type: none"> <li>- Liquidity</li> </ul> <p style="text-align: right;"><b>Targeted Returns</b> <b>12-14%</b></p>	<p><b>Buy controlling stake in an agricultural company and seeking to increase its value</b></p> <p><b>Attractive investment features</b></p> <ul style="list-style-type: none"> <li>- Relatively high risk and higher volatility</li> <li>- Potentially unlimited upside</li> <li>- Control over the direction the company takes</li> </ul> <p><b>Less attractive</b></p> <ul style="list-style-type: none"> <li>- Liquidity</li> </ul> <p style="text-align: right;"><b>Targeted Returns</b> <b>20% +</b></p>

... Altima are engaged in both areas (both in Africa and at a Global level)...

\* Agribusiness investments can, and do, involve the acquisition of land resources.

<sup>+</sup>Based on NCEIF data of US Farmland appreciation over the long-term.



# Investment Process: Responsible Investing

A socially and environmentally responsible approach to investing is a core element of our strategy.

**Reputation is key.**

## Principles:



**General Ethical, Environmental and Social Responsibility:** Altima will not engage in the farming of environmentally sensitive areas, or the clearing of primary rainforest, or in the acquisition of contested farmland or farms where land titles may be under dispute, or where land acquisition may be controversial.



**Promote Community Development:** Agriculture is the core industry in many developing countries and has considerable impact on local rural populations. Through local employment, through skills transfer, and through outgrower schemes, we aim to encourage integrated development within, and alongside our businesses, particularly in Africa.



**Proactive Soil Management:** Organic matter and a healthy soil structure are key ingredients for optimal production of crops at low cost. Our operators are recognized industry leaders in soil management and minimum tillage techniques. For example, El Tejar are among the pioneers and key promoters of “Zero-Till” in Latin America.



**Sustainable Water Use:** We believe that fresh water will be the critically constrained natural resource in the coming decades and that a sustainable approach to water management is crucial. Our operators are users of precision technology which minimizes the risk of polluting water systems with chemicals and fertilizers, and in the case of irrigated cropping, reduces the risk of wastage.

# Viable investment opportunities are possible without taking control of land

50-60 million small farms in sub-Saharan Africa produce 80% of agricultural goods.

(IFAD - Nwanze 2010).

## Characteristics:

- highly fragmented,
- land rights are largely informal,
- focused on subsistence (low crop yields),
- inadequately linked into formal markets, and
- poorly supported by gov<sup>t</sup> extension services.



**The vast proportion of PE investments are focused on Commercial 'Western' agriculture, largely ignoring the Smallholder.**

## Why?

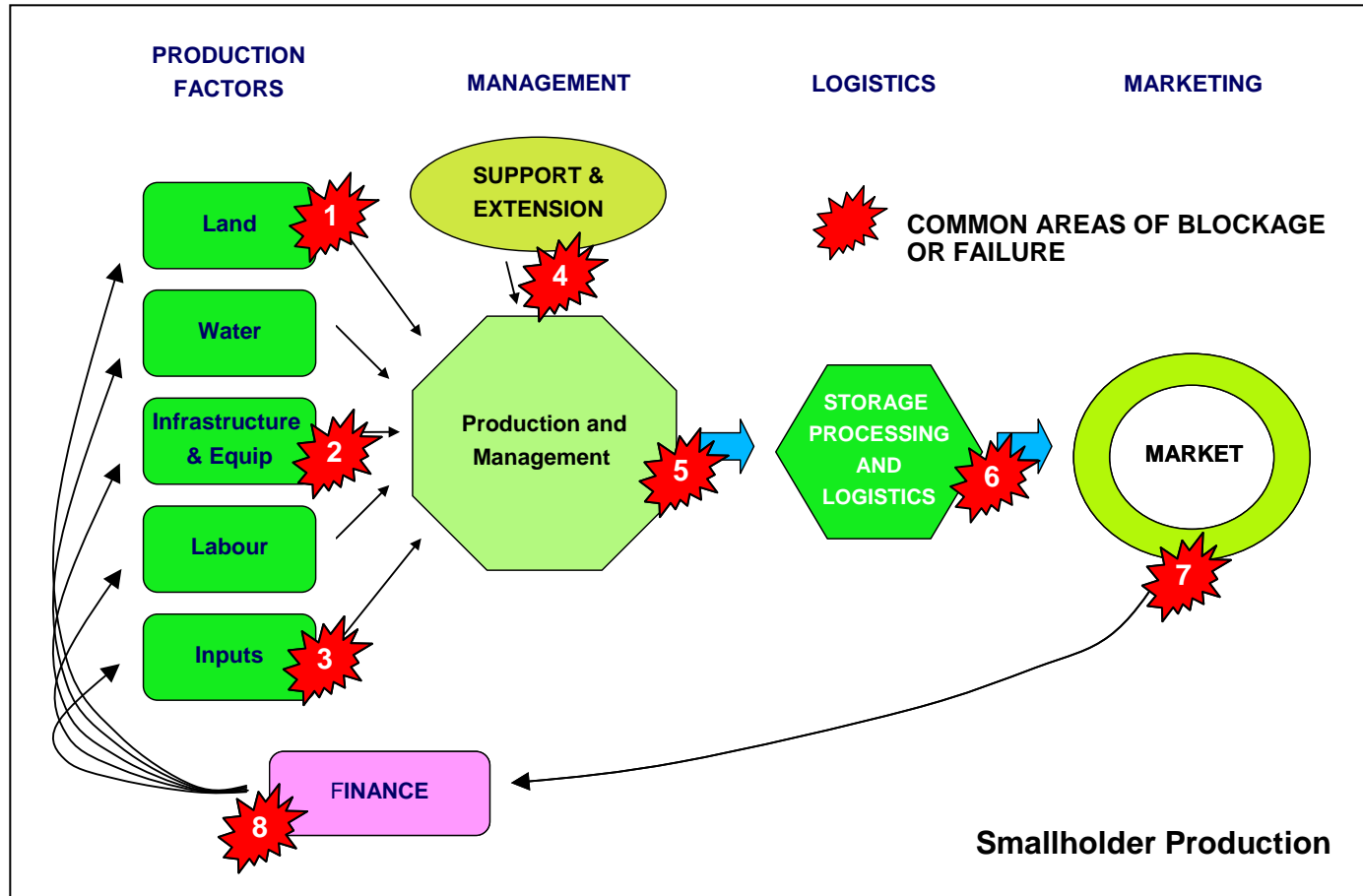
- Western investors (majority of PE funds) have knowledge and experience of large-scale commercial agriculture;
- Business models for commercial agri-production projects are proven;

By contrast,

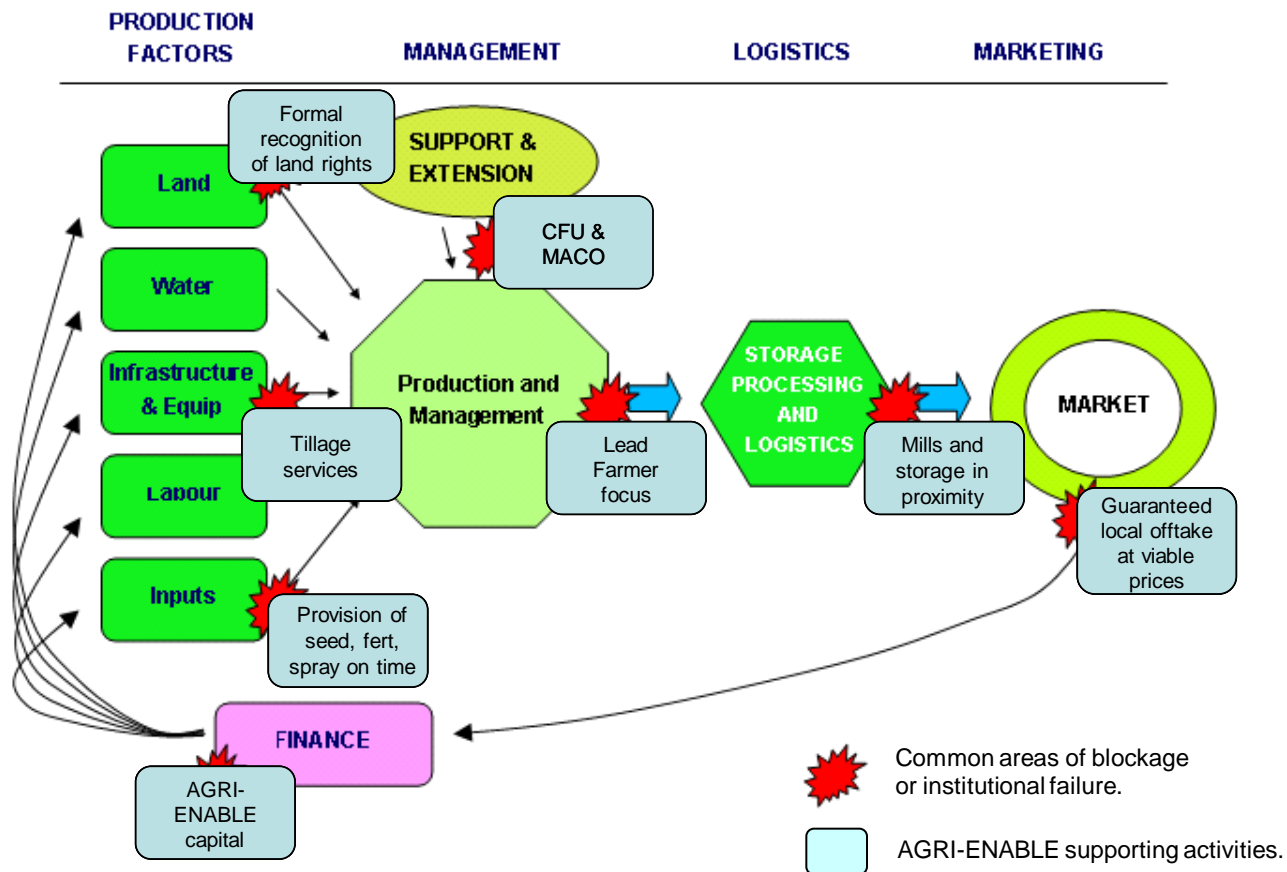
- Smallholder agriculture is less well understood and considered to be focused purely on subsistence; and
- There are few proven business models.

**... So what are the challenges with Smallholder agriculture? ...**

- 1** Land rights are often ill-defined and insecure.
- 2** Equipment is often unavailable or expensive.
- 3** Inputs are often late and expensive.
- 4** Farmer support is often unreliable and misleading.
- 5** Production techniques are often sub-optimal and inefficient.
- 6** Storage often lacking. Processing opportunities limited. Transport often expensive.
- 7** Markets are often distant and unpredictable.
- 8** Pre-season finance is often unavailable to smallholders, or late, and expensive.



... Unless the finance cycle is viable and complete Smallholder initiatives are doomed to fail ...



... A commercial hub can bridge the common areas of failure or blockage and complete the cycle ...

# Points to Note

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- Private sector (and more specifically Hedge Funds / Private Equity Orgs) need to be more transparent.
  - Work going on amongst leading players in the industry to establish a mechanism through which ACCURATE information enters the public domain (late April - Washington DC).
  - Principles for Responsible Agricultural Investing (RAI).
- Two sides to the transaction (and a set of intermediaries).
  - The role and motivations of national governments need to be considered.