

Investors confident about **healthy**

It is hard to remain ignorant of the increased interest in agriculture by institutional investors, often aiming for comparable rates of return (excluding capital appreciation) to other investment classes. Many family farmers must be scratching their heads as to how these returns shown in Table 1 and Figure 1, can be achieved.

In an article in *Stock & Land*, Ian Verrender encapsulates the problem: "The vagaries of the weather, and gyrating commodity prices have put broadacre dryland cropping and grazing beyond the acceptable risks that most corporations can bear. The corporate farm may be a sophisticated operation, highly mechanised and market-savvy. But a family will work for next to nothing when times are tough and accept dismal returns that a corporation simply cannot tolerate."

So why would institutional investors take on agriculture based on earnings potential? Bruce Bowen's presentation on farm performance, at this year's Australian Bureau of Agricultural Research and Economics (ABARE) Outlook conference, provides some insight.

He points out: "The top 25% of farms generated average rates of return excluding capital appreciation of 4% over the five years ending 2008-09 and rates of return including capital appreciation of 9%. These accounted for 55% of the gross value of broadacre farm production over the period and 85% of farm business profits."

Top farmers invest more

Bowen goes on to explain the top farms' superior performances: "Many of the ways to achieve productivity growth, such as purchasing more efficient equipment or accessing information about new processes or practices and responding to changing external conditions, are costly. In the three years ending 2008-09 the top 25% of farms also accounted for 55% of new investment for broadacre farms and the bottom 25% of farms accounted for 13% (and only 7% prior to the introduction of the investment allowance in 2007).

"Financial capability is also influenced by access to credit and other sources of income. Farms with access to many dimensions of finance are likely to be more resilient to external changes and better placed to improve productivity over time."

Top farms generated average annual total returns per hectare that were almost 11 times greater than the average for all other farms in these industries. Not only do these enterprises farm more hectares, they also achieve significantly higher returns per hectare. These higher returns per hectare along with 5% per annum capital appreciation present a less risky profile to lenders, so it is not surprising that over the last five years, the proportion of top 25% farmers acquiring additional land is running at 8% pa, just over double the proportion for other broadacre and dairy producers.

Herron Todd White's Roger Hill says the flat north Queensland property market reflects a re-alignment of land values per hectare with receipts per hectare. "In our view, cattle property prices have been flat to softening over the past three years as buyers (and their financiers) pay more attention to the income producing fundamentals of each property rather than its speculative capital gain."

Bowen warns "As the gap between land values and production



returns widens farmers' reliance on land ownership as part of their farming business may become an impediment to structural adjustment. This is because strong growth in land values could reduce the willingness of producers who are operating underperforming farms to sell their land. Likewise, the best performing producers' capacity to purchase land will be restricted by the high cost of buying land.

"In countries such as the United States and Great Britain, this barrier to structural adjustment has been to some extent addressed by land leasing rather than land purchase as the dominant method of farm expansion. In so doing, land resources can be reallocated to the more profitable farm businesses without land ownership having to change."

New lines of credit

A report on mixed farms (*The Land*) in February supports Bowen's warning - "The traditional, family-run mixed farm - once the 'bread and butter' of a country property agent's sales business - has become in today's market, one of the most difficult items to move. It's not because nobody wants them, but those who want them - namely,



returns from farming



ABOVE: Top 25% Farmers generate 55% of the gross value of broadacre farm production and 85% of farm business profit.

LEFT: Tony Eyre's business, Harvest Capital Partners, is promoting equity partnerships to larger cash strapped family farms where the next generation is looking to become involved and expand the business.

Figure 1: Research shows average rates of return excluding capital appreciation have been close to 1% since 2002 and are trending downward, partly as a consequence of rising land values.

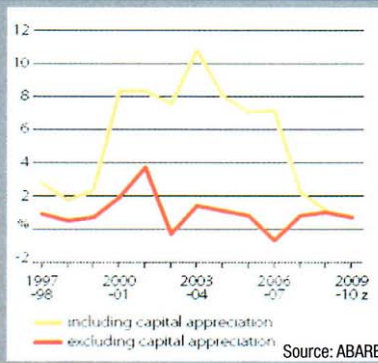


Figure 2: The ratio of average land price/ha to total cash receipts/ha has increased from around 5:1 prior to 2001-02 to around 7:1 in 2008-09 on broadacre farms. The increase in this ratio is relatively similar across all agricultural zones and industries.

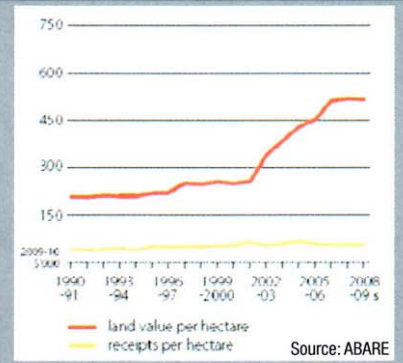


Table 1: Rates of return for different broadacre farming enterprises since 2007/08

	Rate of return excluding capital appreciation		
	2007-08 %	2008-09 %	2009-10 %
Wheat and other crops	1.9	2.9	1.7
Mixed livestock crops	0.9	1.0	0.4
Beef industry	0.3	0.4	-0.2
Sheep	0.5	0.0	0.8
Sheep beef	0.3	0.6	0.4
All broadacre industries	0.8		
Dairy	3.7	1.9	0.4

Source: ABARE

other farmers wanting to expand, or set up a family member - are often unable to raise the necessary finance. The banks, with an eye on their farmer client's none-too-healthy equity levels, aren't keen to lend for new farm purchases until they see a return to pre-drought cash flows.

"Meanwhile, the off-farm investors and corporate players who do have bank or institutional funds at their disposal aren't interested in the traditional mixed farm. They mostly want the specialised broad-acre cropping or grazing property, preferably a big one, and one that will complement their existing holdings within a region."

Companies such as publicly listed AACL Holdings and equity partnership firm Harvest Capital Partners are examples of enterprises responding to the unmet demand for access to credit and other sources of finance.

AACL Holdings pays growers to sow crops and markets the grain on their behalf at harvest, relying on a managed investment scheme for financing its activities - an unpopular funding vehicle for many investors, following the collapse of Great Southern and Timbercorp in 2008. The company advanced \$100 million in

investors' funds for co-production of grain in the first half of this year. AACL currently share farms 365,000 hectares across 300 farms ranging from WA to NSW. (See *Australian Farm Journal*, July 2010)

Tony Eyres' business, Harvest Capital Partners, is promoting equity partnerships to large cash strapped professional farmers. He says the business "looks after large scale family operations that are often four and five generations old - family businesses that have amassed a lot of wealth and success through being good asset managers and being good farmers. They have a desire to continue to grow and they've got a strategy to achieve that growth, but there's one thing missing which is capital".

Eyres says equity capital from investors sits alongside family equity and bank debt. "That gives you capital to either buy assets or fix up existing assets, change the management practices on a farm, or buy more cattle, invest further down the value chain by putting a feedlot in place, or a feed mill - it's all about participating at different parts of the value chain as an extension to their production. Ultimately it's capital for growth."



David Sackett, chief executive officer of Growth Farms Australia says partnerships are much more mature in the dairy sector, with more share farming and equity capital investment via ownership of cows versus land.

The *Land* reported Eyres has a select client base; raising \$400 million for five clients.

David Sackett, chief executive officer of Growth Farms Australia, a contract farm management business with some involvement with equity partnerships, agrees with Eyres that equity partnerships are usually not available to smaller family farm businesses.

"The reality is the size of most family farm businesses and the size of the institutional investors is just grossly mismatched. Institutional investors aren't interested in putting half a million dollars here, \$2 million there. They're interested in putting large amounts - tens to hundreds of millions - into a small number of large investments, not a large number of small investments."

Sackett says in most cases, farmers looking for an equity partner needed to find somebody who was prepared to put in smaller amounts of money, which was not easy. "Our experience is these partnerships are much more mature in the dairy sector, with more share farming, ownership of cows versus land, so I can see it's easier to do in the dairy sector. In mainstream broadacre agriculture I think it's uncommon."

While equity partnerships could still be seen as one way of bringing further investment to agriculture, Sackett believes over time many different sorts of investment and farm management models will emerge.

Another way of obtaining capital is by pooling resources and there have been an increasing number of reports of such arrangements this past 12 months. Recent examples include Kalabity Station and Dunglear. Local farmers combined to buy Kalabity, one of South Australia's premier sheep grazing properties for a figure somewhere between \$5 million and \$6 million. Dunglear, a 14,363ha Walgett property was reported as selling to the local Zell and Hindle families of Taroo and Clydesbrae respectively, who will divide the property between them.

Superannuation funds diversify into agriculture

An understanding of the disparity in farm performance and the scope for addressing risks is increasingly attracting institutional investors to agriculture. The Sustainable Agriculture Fund (SAF) is one such fund and caught the rural media's attention late last year with the \$30 million purchase of four Moree district properties; Calrossie, Gil Gil, Glenesk and Kirewa, totalling about 7500ha.

In February, SAF was again in the headlines with the *Australian Financial Review* (AFR) reporting the fund had purchased failed Great Southern company's King Island cattle farms in the Bass Strait. SAF paid \$27 million for the four properties - Reekara, Boongarra Dinibili and Longford - totalling 16,700ha. The deal included 6200 head of Angus cattle.

By April reports of SAF taking delivery of 2204ha Marlow, were

in the rural press. The property, which is near Calrossie, was purchased for an undisclosed figure from the Coggan family late last year. The Coggans bought Marlow at auction for \$5.5 million in 2005.

With \$2.84 billion under management, West Australian-based superannuation fund Westscheme became a minor shareholder in RM Williams Agricultural Holdings after one of its agricultural investments was folded into the company.

Howard Rosario, Westscheme's chief executive, told AFR: "Westscheme does not have an agricultural focus but is open to further investment in the sector. We do not have an allocation approach to agriculture; this investment is only based on opportunity."

Overseas superannuation funds also have a stake in Australian agriculture with US based Westchester continuing to look out for suitable farms. Via two Australian entities this business now owns 120,000ha of which it farms 17,000ha itself and leases the remainder to family farm entities. According to Steve Jarrott managing director, The Westchester Group of Australia Pty Ltd, the business has "a mandate which allows us to continue making high quality grain and oilseed production investments in Australia for the near future at least."

Wealthy individual investors

High wealth individuals, such as Michael Hintze are also assessing opportunities within the sector. AFR reports the Michael Hintze Pension Fund (MHPF) has spent almost \$80 million since late 2007 on cropping and livestock property in NSW. MHPF purchased Suffolk Vale and Springfield, the Boorowa mixed farming properties of Australian Agricultural Company board member, Nick Burton Taylor. Both properties, involving a total of 4588ha, were sold separately for undisclosed prices after being passed in at auction in October 2009 for \$7 million and \$8 million respectively.

Hintze is quick to dispel any sentimental attachment to his new land holdings. The properties, including flagship holdings Marshmead at Walgett, and the \$22 million Warrane west of Armidale are run chiefly by Growth Farms Australia's Richard Taylor.

"I'm not a farmer, but I do the numbers. It's got to make money," Hintze says. "Why Australia? I know people in Australia but I want to make sure that we don't start running the risk of this land being taken away from us - it's the sovereign risk issue," he says. "I feel pretty comfortable with the property rights in this country."

Hintze is not just looking for capital gain from the properties; he demands solid returns on production. "Some people are buying for 3 or 4% return and they would be right from the capital appreciation of the land but that's not why I'm buying it up," he says "I'm buying it for the return [on production]. My view is that [commodities] are going to keep going up and land, well they are not making any more land."

His thoughts echo those of many others, with BHP Billiton's hostile takeover bid for Potash Corporation of Saskatchewan, Canada, being described as "a vote of confidence in the promise of a multi-year, if not multi-decade, rise in the price of grains, sugar and other crops" (AFR). Based on ABARE's calculation that average rates of return excluding capital appreciation have been close to 1% since 2002, it is difficult to argue against the need for such price rises.

On the AFJ web

Harvest Capital Partners equity partnership case study

