By Hugh Dive 18th November 2016

Agricultural Investment in Australia

Over the last few weeks it appears that Gina Rinehart's Australian Outback Beef (67% Hancock Prospecting/33% China's Shanghai CRED) has won the bidding war for the Adelaide-based pastoral company S.Kidman & Co Ltd. If this $365 million deal is approved by the Foreign Investment Review Board (FIRB), the combined pastoral empire will own 11.9 million hectares or 1.5% of Australia. Food production/agriculture is an area in which Australia possesses a global comparative advantage in production, unlike car manufacturing where taxpayers may have trouble discerning the benefit they have received from the billions "co-invested" in the production of motor vehicles which will cease in 2017 with the closure of Holden's factory at Elizabeth in South Australia.

In this note we look at the extent to which opportunities for investors in getting exposure to listed agricultural companies has diminished over the last ten years by takeovers, and the depth of foreign interest in ASX-listed agricultural companies.

Time Horizons

We see that the biggest factor in the reduction in the number of listed agricultural companies is the mismatch in investment horizons between equity owners such as institutional fund managers and foreign buyers like sovereign wealth funds. Fund managers (*including the author of this piece*) spend too much energy focusing in on delivering quarterly returns ahead of their peers to retain funds under management, whereas foreign buyers can often take a longer view that the value of food or the supply of arable land servicing the growing urban populations of Asia will be worth more in coming decades.

Source:AFR

Contrary to what is implied by the above image; Australian agricultural companies are not being taken over by Asian companies, but rather most of the buying has come from North America. The common theme is that these companies are seeking to capitalise on both Australia's proximity to Asia, a stable investment régime and our low agricultural production costs. Further these companies appear to have longer investment horizons than Australian investors.

Graincorp

Graincorp controls seven terminals down the east coast that carry about 90% of Eastern Australia's grain exports. In October 2012, US grains trading giant Archer Daniels Midland (ADM) initially approached Graincorp with a bid of $11.75 per share; which was subsequently sweetened to $13.20 in return for board approval of the takeover. The purchase of Graincorp was designed to expand ADM's global reach and diversify their agricultural risks, but the $3 billion takeover was blocked in 2013 by the then Treasurer Joe Hockey.

However since 2013 we have seen a change of treasurer, a 35% decline Graincorp's share price and a 22% decline in the AUD/USD (which will reduce the price paid by a US-based acquirer). We would not be surprised if ADM returns with another bid for Graincorp given they still hold 19.9% of the company.

CSR (Colonial Sugar Refining)

CSR or Colonial Sugar Refineries was one of Australia's oldest companies, founded in 1855 and for over 150 years has dominated Australian sugar refining and exporting. In December 2010 the conglomerate's sugar business was sold to Singapore's Wilmar for $1.8 billion, after they outbid China's Bright Food Group. Whilst ***CSR*** is still listed on the ASX (and has performed well over the past year), this performance is from the remaining building products, glass and aluminium businesses. In addition to controlling more than half of Australia's raw sugar output, the acquisition has allowed Wilmar to become one of the top 10 global raw sugar producers.

ABB (Australian Barley Board)

ABB Grain or formerly Australian Barley Board was taken over by Canada's largest grain handler Viterrra (*née Saskatchewan Wheat Pool*) in 2009 for $1.6 billion. In our view this was Australia's most efficiently run agricultural business, which included the Southern Hemisphere's largest beer malt house. The combination of these businesses gave Viterra approximately 36% of globally traded barley, canola and wheat. Viterra itself was taken over in 2012 for US$6.1 by Glencore; this saw assets such as Australia's largest malt maker Joe White Maltings on-sold to another large US-based agribusiness Cargill.

AWB (Australian Wheat Board)

The Australian Wheat Board or AWB had suffered after the controversial Iraqi oil for wheat scandal of 2005. AWB was taken over by the Canadian agri-business giant Agrium in 2010 of $1.2 billion, who then on-sold it to an even larger agri-business US-based Cargill in 2011. The rationale for this takeover quite similar to the above acquisitions; that is allowing the company to spread agricultural risks and also gain exposure to the Australian market that is well placed to serve the rising Asian food consumption.

Australian Beer Companies

The magical combination of water, hops and malted barley has also been the target of foreign companies. Lion Nathan the maker of Tooheys, XXXX, Steinlager and Hahn was taken over by Japan's Kirin in 2009 for $3.4 billion. Similarly Fosters the brewer of VB, Carlton and Crown was acquired by the US/South African company SAB Miller in 2011 for $12.3 billion. Outside of Coopers, the major Australian beer brands are now owned by foreign companies.

Whilst jingoistic beer drinkers might bemoan foreign ownership of major Australian beer brands, the stagnation of domestic beer consumption and the significant inroads that small craft brewers have made in capturing market share clearly indicates that the foreigners wildly overpaid for these assets. In 2015 Lion Nathan's Australian beer, wine and spirits volumes were down 3%, which followed a 2.7% decline in 2014.

What's Left ????

Over the last five years we have seen a "hollowing out" of the listed agricultural sector, so as an investor the obvious question is "*What is Left to Invest in*?" When looking at the large agriculturally-exposed companies we are left with ***Graincorp***, crop protection (herbicides, insecticides and fungicides) company ***Nufarm***, beef producer ***Australian Agricultural Company***, ***Treasury Wine Estates*** the owner of iconic wineries Penfolds and Wolf Blass and Australia's largest producer of fertilizers ***Incitec Pivot***. The Dividend Income Fund owns a position in Incitec Pivot as the first two smaller companies are outside our investment mandate. Whilst Treasury Wine has performed well over the past year, through the cycle, the wine industry is a very hard business. A position that is reinforced several times every year over a glass of sparking shiraz in conversations with the owner of a very fine South Coast winery.

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