AGRICULTURAL INFRASTRUCTURE PROVIDES STRATEGIC INVESTMENT OPPORTUNITIES

By Brad Clark, Agspring

While investors have paid significant attention to land acquisition as a non-depleting commodity investment strategy for years, a potentially less risky and more attractive long-term opportunity has gone comparatively unnoticed. Agricultural infrastructure, represented by collection, storage, handling and shipping operations, remains a fragmented marketplace with the top five companies only representing roughly 30% of the U.S. market. Meanwhile, the multitude of other companies handling the remaining 70% of the market has been permanently stressed by steadily increasing global supply and demand for commodities.

The stress on the system for moving commodities has come in large part because global food consumption exceeds supply. Growing populations, increasing per capita incomes and the convergence of food and fuel markets have widened the distance between supply and demand. Even though more land is being utilized for crop production and yields are improving thanks to improved genetics and precision ag technologies, growing world population and livestock consumption promises to exacerbate the situation even further.

Against this backdrop, capital markets have consolidated and it is increasingly difficult for highly fragmented, small- to mid-sized companies to compete in an increasingly global market. Direct investment in the “midstream” gap of ag infrastructure networks would be a challenge on several levels; however, a new business model utilizing diversified management, local leadership and global resources promises benefits for investors as well as the upstream and downstream grain markets.

By combining entrepreneurial teams, essential agriculture supply chains and key capital partners, a new business model can set up investors and allied firms for long-term success. Partner companies in such a newly created structure gain access to elevators and rail, as well as trading and merchandising expertise, which improve overall network performance. With the ability to obtain equity and debt, expansions and combinations are now possible to increase market share and drive efficiencies.

Table 1: Fractured Mid-Size Market

Top 5 have 33% of off-farm storage space
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Need for capital is a driving force

Relative to other businesses, ag infrastructure requires a significant amount of working capital. As a result, companies that can afford a robust inventory and deep receivable financing capacity gain a competitive advantage. Unlike term debt, these near-cash items don’t reduce total enterprise value (TEV) when calculating equity values. The assets in the grains business are highly liquid and, therefore, not subtracted in equity value.

In addition, unlike many other types of industries, there is a significant amount of debt capacity in the ag sector. Private investors have not shown consistent interest in agriculture other than land acquisitions, and historically the storage and handling part of the industry has been viewed negatively due to unprofitability during the 1980s and 1990s. Infrastructure in the industry is highly fragmented with little equity in play making it a challenge to obtain the much-needed cash resources and leaving numerous projects unfinished. Simply put, local and regional cooperatives and ag-related businesses are growing out of their own balance sheets. However, it’s because of these reasons that latent growth and value creation opportunities exist for investors.

Reducing risk and improving margins

While exploring new investment opportunities, one must also assess risk and the degree to which risk can be managed is often a highly motivating factor for investors. There are many tools to shift commodity risk and price volatility, such as offsetting market positions with futures and options, which can improve margins for ag infrastructure businesses. Even so, another benefit for investors in infrastructure is the fact that there is not a strong correlation between fluctuating commodity prices and ag infrastructure.

Much of the business of moving grain is done using a basis trading structure, which is a notably more stable avenue relative to commodity trading in the futures markets. Grain merchandisers are trying to satisfy both ends of the market chain – sellers wanting the highest possible price and buyers wanting the lowest – which becomes a balancing act for merchandisers that would be nearly impossible if it wasn’t for basis and the stability it brings to conducting business.

Determine which efficiencies benefit both global and local markets

The fragmented market for ag infrastructure is made up of a large number of companies who know their local area inside and out, but may be lacking knowledge of, or access to, the global marketplace. On the other side are multinational players who fully understand the needs of the global markets, but have lost relationships and understanding at the local level. A network that values and utilizes experts at both these levels gains a significant competitive advantage.

With an understanding of the global marketplace, investments can be strategically matched with the needs of the local markets in mind. Meanwhile, centralizing functions that don’t impede the local nature of the relationship with producers and end customers creates the most value for shareholders. For example, capital can be put in place to enhance current facilities or create new barge or rail systems that would tie into larger networks. These upgrades and expansions enhance operations and provide efficiencies, such as improved grain delivery for farmers and expanded market access for their grain.

Once a local business has access to equity and debt, other areas of the business can also be addressed. For local and regional cooperatives, for example, the need for cash may include “patron equity redemption.” The aging of rural America is not only impacting farmers, but a cooperative system that involves paying out large sums of patronage funds when farmers “cash out.” Family-run, local businesses also are running into financial roadblocks as they transition to the next generation, if indeed there is a next generation to lead these tightly-held companies. Many times these are the very factors that are keeping cooperatives and companies from growing, or in some cases even causing their demise.

Scale in the network also enhances investor returns. These larger networks have an increased capacity to trade in previously untapped markets in the current system. A way to manage the risk of increasing the scale of the network is through direct investment using holding companies. A larger holding company has a greater diversity of assets than an individual company, making raising capital easier. The holding company can set corporate policies over all subsidiaries and help manage growth without interfering with the individual local management.

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Geographic diversity is another risk management tool as well as a key to success. By spreading out locations and operating in multiple trade areas, potential risks can be minimized that are brought on by weather, crop disease and even trade-impacting political situations worldwide. The goal is to enter a trade area and move into a lead position in that particular market. This is done by assessing local needs, enhancing existing facilities, building out new infrastructure and working with the local leadership to become not only a stronger competitor in that particular marketplace but to command the lead position.

Owners who are able to buy and build a diverse set of essential supply chains may combine regional operating companies into a larger mosaic that creates a significant value add. In essence, owners earn the economic benefit of a bigger multiple for national or even multinational scale in addition to lowering unit costs and creating synergies between operation companies.

As with all investments, one must look at an exit strategy. The revitalization of an existing system, as well as creation of new trading areas, makes for a strong exit strategy. Capital investors will have opportunity to recapitalize with long-term private capital, public offerings or the potential to sell to strategic buyers. There will be opportunities to sell either all or part of the platform. With this new business model, investors can expect strong and predictable cash flows that are also consistently superior to land investments.

**Investments that make a difference**

Agricultural infrastructure is an investment that not only provides the returns investors seek, but it also makes a sustainable difference in feeding a growing world population. While it’s important to place investment capital with strategically selected companies and regions, each segment of infrastructure eventually leads to moving the necessary grain and food ingredients to the larger global market. This relies on knowing which targets are in a position of growing if better supported financially and logistically.

Against this reality is the growing understanding that global hunger will likely not be solved by donations and taxes. In fact, it will require sustainable business models to tackle the problem on an ongoing basis.
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and a major component will be upgrading ag infrastructure. This is an investment opportunity that might simply have been overlooked to this point. Experts predict that world population will reach more than nine billion by 2050 meaning there will be two billion more people to feed in roughly 35 years. It’s estimated that this will require nearly doubling the amount of food that is currently produced. This need for more food has been recognized by the investment community in rising values for farmland. But improvements in production that attain higher yields through precision farming and other best practices will be irrelevant if not also be accompanied by improvements in the infrastructure to move an increasing supply of grain, oilseeds and other foodstuffs.

With nearly three-fourths of the market being handled by a multitude of fractured networks and individual companies, flexibility and efficiency in handling, storing and moving grain and food ingredients stand as key components to reach this goal. And unlike the production side of agriculture, investing in ag infrastructure is somewhat insulated from the rise and fall of commodity markets, farmland values and the unpredictable nature of government programs. As long as world demand for grain continues to rise, it will take additional investment to close the gaps throughout the system. This makes ag infrastructure investments not only profitable and sustainable, but also vital to meeting the future needs of our changing world.

About Agspring

Agspring combines entrepreneurial teams, essential agriculture supply chains, and superior capital partners for global success feeding our changing world. Deep equity and credit relationships provide Agspring a solid platform for capital improvement and expansion. Agspring maintains decentralized operations and puts leadership teams in place who desire to grow into new markets including grains and oilseeds; livestock feed ingredients; and consumer food ingredients.

“I enjoyed all aspects of the conference and especially the singular opportunity to meet some really great people in agriculture. I have to say that I have never been so busy meeting people in such a concentrated period of time.”

Robert Cowan, Utah Retirement Systems

Since 2009, GAI has hosted nearly 6,000 attendees worldwide to discuss agriculture as an asset class, including investment opportunities in global farmland and agribusiness operations, ag private equity and agriculture technology.

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