

# Institutions Are Blazing a Trail in CIS Farming

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In most parts of the world, farming has traditionally been the domain of families and vertically integrated agro-processors. But the food price spikes in 2007-08 highlighted imbalances in the global supply and demand of food commodities, and doubled the price of wheat. Since then, interest in farming from a new class of institutional investors — including hedge, endowment, pension, private equity and sovereign wealth funds — has surged.

Two factors are driving investments: potential gains from rising farmland values and potentially attractive operating returns. Underpinning the investment case is the view that commodity markets are in the early stages of a super-cycle of higher prices. This in turn is being driven by rising demand for food from a global population forecast to grow from 7 billion to 9 billion by 2050, as well as by changing dietary trends in emerging markets, driven by a middle class estimated to increase from 400 million to 1.2 billion over the next 20 years. Institutions also view farmland as a distinct asset class and a means of diversifying risk

by using real assets as a hedge against inflation, as well as having a low correlation to traditional asset classes.

A recent study by the United Nations' Food and Agriculture Organization and the European Bank for Reconstruction and Development estimates institutional investment in primary agriculture worldwide at about \$24 billion. This represents a fragment of the value of farmland globally, which TIAA-CREF, a large U.S. pension manager and leading institutional investor in farmland, estimates at some \$8 trillion.

Institutions have focused mostly on four regions: the U.S.; Canada; Australia and New Zealand; and Brazil and Argentina. These regions account for about 84 percent of the investments made to date. Five key features define their attractiveness: strong agricultural potential, well-developed farmland markets, significant depth in farming expertise, effective legal and contractual processes, and developed supply chain infrastructure.

Russia, Ukraine and Kazakhstan have also attracted institutional interest, although they represent only 10 percent of such investments globally. While the Commonwealth of Independent States offers some of the most potential for institutional-scale investment, country risk perceptions, complexities in doing business and the lack of high-quality opportunities have limited actual commitments.

The remaining 6 percent of institutional investment in primary agriculture has been in Africa, where fragmented land rights, weak infrastructure and governance issues have held back investments. But the continent offers vast potential to increase agricultural production and, along with Brazil, is perceived as having the most scope to open new areas of arable farmland.

While the investment model in the U.S. and Canada generally consists of owning and leasing farmland, the lack of independent players with the requisite operational expertise has compelled investors in Russia and Ukraine to manage farms themselves. Lower land costs continue to be the competitive advantage for CIS countries. Farmland in Russia costs about 10 percent of that in North and South America, but the need to manage operations has increased the complexity of investments.

Since 2006, foreign institutions and private companies have invested an estimated \$2.9 billion in farming in Russia, and they control some 1.7 million hectares, or 1.4 percent, of its 120 million hectares of arable farmland. Foreign capital has also dominated the institutional investor landscape in the country. While local agro-holdings continue to invest widely, there are just two major commitments by domestic, nonfarming institutions in Russia's primary agriculture: Finam's Capital Investments Fund and VTB Capital's Irrico development.

There has been similar interest in Ukraine, where foreign players have invested some \$2.8 billion and control about 1.5 million hectares, or 4.5 percent, of the 33 million hectares of arable farmland. In Kazakhstan, there has been just one major institutional investment in farming so far. In 2012, the European Bank for Reconstruction and Development made its first-ever equity investment in primary agriculture, buying a \$45 million stake in KazExportAstyk, which controls almost 1 million hectares in northern Kazakhstan.

Many new investors in Russian farming envisaged relatively short payback periods, expected land values to converge rapidly with those in comparable locations like Brazil and forecast

that crop yields would increase quickly with modern management. The reality has been different. Land values have risen only slightly or stagnated, and crop yields have improved relatively modestly compared with long-term historical averages. A sequence of climatic misfortunes, including Russia's worst drought yet in 2010, has added to operational woes and resulted in a costly learning curve for many investors. Few of the publicly reported investments have performed as expected. Indeed, many have seen their market values plummet.

Farming in Russia has vast potential, but crop production on a very large scale is yet to be proven as a business model that delivers consistent profitability. While the basic investment premise to capitalize on long-term supply and demand fundamentals remains sound, new capital is likely to tread cautiously until performance is more consistent and convincing. But there are star performers among the eight publicly listed pure-play farming companies that invest in the CIS, one example being Ukraine's IMC, which has a record of consistent growth and profitability.

The brief experience of these new farmers has shown that smart strategic planning, including scaling up operations within manageable limits and better initial selection of farmland assets, has been as critical to success as competent operational management skills. The most important lesson is that farming is a business that needs long-term capital to cope with the sector's inherent volatility. Institutional investors are one of few, possibly the only, sources of such funding.

These early pioneers are blazing a trail for potentially major sources of capital that could unlock much of the promise embedded in the region's agriculture. Their success in managing the volatility of the business will decide the value of this asset class and its appeal to future investors.

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*The views expressed in opinion pieces do not necessarily reflect the position of The Moscow Times.*

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