KEYNOTE INTERVIEW

Sustainable agriculture investment rises to the fore



Today, it is more important than ever to build resilience into agricultural investment strategies, say Brad Mytton, Frank Barillaro and Anthony Abraham of Roc Partners

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Q How has investment in agriculture evolved to cope with worsening economic conditions?

Brad Mytton: Investment in agriculture over the past decade has shown its resilience to economic conditions, providing relatively steady and consistent returns. For example, the labor shortages over the past few years have been used as an opportunity to invest in automation and ultimately deliver greater efficiencies. However, all this investment to date has been carried out in an environment of low interest rates and relatively cheap access to capital. Clearly, the picture has now changed, with high inflation and normalizing interest rates.

Because of this, investors are demanding higher yields and better returns, which makes investment selection more challenging. This can't just happen automatically. Investment managers need to consider areas in which there can be some added value to drive better returns. In this respect, food producers risk being caught in the middle of inflation increasing their costs and higher interest rates limiting consumers spending power. Producers have to be cognizant of this risk and find a way to pass on these costs to avoid being squeezed.

This is where a private equity model can prove effective, as we are focusing on customer trends first and then looking at how these trends flow through to demand for food, following the supply chain from there to invest where we can add the most value. This lens allows us to identify projects where consumer demand remains more resilient.

This economic environment clearly presents challenges, but there are opportunities too. The market disruption won't last forever. Investment managers who think about how they can do better in the current environment will find that they have created a new way of outperforming in other times.

Q So this earnings squeeze hasn't really changed how you run your business?

Frank Barillaro: As Brad said, we believe these cost pressures present an opportunity. They force firms to find ways to become leaner and more efficient, and think more carefully about cost management. In many cases, these operational efficiencies become permanent, so when things return to normal and margins start to expand again, you're left in a better position than before the disruption began.

A number of our investment entities are thinking at the moment: "Where can we be more efficient? Where can we cut costs? How can we do things differently?"

Getting to the bottom of these key questions is a really good opportunity for the Australian farmer and the Australian agricultural industry as a whole to become better, leaner, faster. As a result, if we can carefully navigate the next 12 to 24 months of uncertainty, we'll come out of the other side in a really good position.

Anthony Abraham: As part of managing costs and operations more generally, we look for businesses that allow us to control as much as possible – what we call 'investments with a roof'. Businesses such as chicken farms and glasshouses are good examples. Agriculture is an industry which faces into climatic volatility. By putting a roof on things, you can expand the number of elements that you can control, which helps drive productivity. You can increase the heat if the temperature becomes too cold or cool things when the weather is too hot. You can also turn the water on at just the right time. While putting a roof on things is the ultimate form of control, there are other ways of reducing uncertainty, for example, introducing clever irrigation systems into farmland.

Q What parts of the agriculture sector are most appealing at present?

Brad Mytton: The world has changed dramatically in the past 12 to 18 months, not just in agriculture but in all sorts of other areas. That said, private equity offers a way of looking at the world that starts with the consumer and then continues wherever the consumer trend leads. We have taken this approach and adapted it for agriculture. So rather than a traditional approach – where you just grow and you sell produce – we look at where the trend is heading, and how we can best take advantage of these trends.

We tend to buy operational food and agri-production businesses that are clear market leaders with very defined barriers to entry. These are asset-backed businesses with high-quality assets that are run on an owner-operator model. This strategy has served us well for the past eight or nine years and our view hasn't changed in the current environment.

By bringing a private equity approach to operational assets, we have been able to avoid the earnings squeeze that I mentioned. We partner with exceptional management teams and then work towards setting the firm on a strong growth trajectory – this has been the key driver of our returns.

Anthony Abraham: In a world where future asset price increases aren't guaranteed, you need to buy value, and you can't buy value unless you have a really clear-headed and critical view of your investments. Once you have this in place, you need to maximize value. An important factor in this is your ability to manage operations and achieve operational efficiencies – and that's right across the sector.

FB: One of the biggest challenges with agricultural investment is the weather. If you reduce exposure to these elements, you can go a long way to eliminating risk. Obviously, you will never get rid of risk entirely, but you can minimize it to quite a significant degree. For the things that we are in control of, we make sure we are doing the absolute best job that we possibly can to manage them effectively. For the things that we can't control, such as weather, we do the most to invest into businesses or systems that help mitigate our risk exposure.

BM: This also plays to our strengths. We are not here to compete with the family farmer. We are here to provide capital for large corporate-scale food production assets. The idea is to focus on more capital-intensive assets, such as intensive horticulture or grass-fed beef, that can afford to pay for the best management teams in the country to really drive returns.

In summary, our approach is all about providing a bit more resilience on the downside with the potential for further upside in a good market.

Q How does ESG impact agriculture investment?

FB: ESG is ramping up. More definitive actions are coming out now, and investors are holding companies to higher standards. One of the great things about Australian agriculture is that we are custodians of very large tracts of land, water resources and food production assets in general. This provides a wonderful opportunity to make a positive impact on ESG.

Animal welfare is a good example of this, and some sectors have done a great job of improving their practices in that regard. Good governance has also been a big part of our investments. For example, stepping into a family-run business and introducing corporate standards.

Climate is another important element that feeds into our investment decision-making. Before making an investment, we will assess what the outlook for things like climate look like in 30 years' time. For example, this has led us to investing into glasshouses where we can grow produce all year round.

These investments can be quite capital intensive, so they lend themselves well to institutional investment. While some of these assets require more investment on a dollar-per-hectare basis than traditional methods, it provides us with year-round productivity and significant protection against adverse weather conditions.

There are also some areas and sectors we will avoid because the outlook on climate is not as attractive. For example, when it comes to wine production, we think that the cooler climate areas such as Tasmania will do better, while on the other hand there are certain regions that are more exposed to climate risk which we will seek to avoid. Paying close attention to environmental factors is a big part of what we do.

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>
> **BRAD MYTTON**

BM: Since the focus on ESG is only going to increase over time, it would be irresponsible to invest in anything where we could not see a clear path towards ESG best practice. While we will consider projects with areas of concern from an ESG perspective, we will only invest on the basis that we can implement a very clear plan to address these shortcomings. If we came across a project that was high risk from an ESG standpoint and where we also had zero or little ability to improve things, then this would be no-go territory.

AA: There are a couple of specific examples that we can point to here. We introduced solar panels into our chicken businesses in order to reduce our environmental footprint since this segment of the market uses a lot of energy. This has insulated us to an extent from rising energy prices.

In the chicken industry, we believe our animal welfare work is among the best in the industry. We have purchased a number of operators who have not been very good in this respect, and we have improved things. Pleasingly, this has resulted in better animal welfare standards as well as much better feed conversion ratios, resulting in better returns.

In the stone fruit business, we are using microbial fertilizers, which feed the soil with bacteria that promote growth. This is fantastic because it reduces the amount of inorganic fertilizer that we need to put into the soil and insulates us from higher input costs by providing greater productivity for less.

We see the focus on ESG to not only drive better environmental, social or governance outcomes, but also as an opportunity to create better efficiencies and higher returns.

Q You make a compelling argument for investing in Australian agriculture. So who has been investing in this space?

BM: Within North America, investors have had a strong domestic focus on agriculture for some time, providing them with solid returns over the years and a good level of understanding of the value in agriculture investing. Over time, these investors have shifted some focus to investing in Australia, recognizing the globally competitive position of the Australian agriculture market, given its relative value and attractive characteristics from an investment perspective. Investors within Australia to date have mostly comprised of institutional investors and high-net-worth individuals.

In the current economic environment, as it becomes harder to find investments that hit the mark, with interest rates normalizing and the current levels of inflation, we expect more investors globally will look to agriculture, particularly to managers that can drive value through a differentiated approach in this environment. ■

Brad Mytton is managing partner and Frank Barillaro and Anthony Abraham are partners of Roc Partners

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