L.E.K.

EXECUTIVE INSIGHTS

VOLUME XVI, ISSUE 15

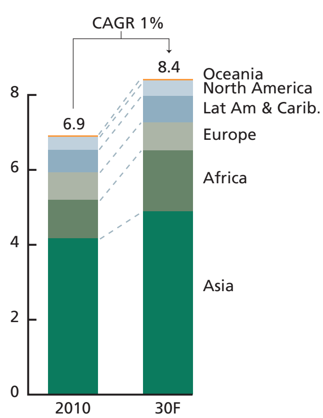
Global Agribusiness Investment: Attractive Long-Term Outlook Generates Interest from Strategic Players and Financial Sponsors

Global agribusiness is in the midst of a major transformation, driven by long-term demographic trends and the need to feed an increasingly hungry planet. Over the past several years, rising awareness of these forces has triggered increased investment in agricultural biotech, farm mechanization, irrigation and other farm yield enhancement levers. It has also generated a spike in investment and M&A activity by strategic operators and financial sponsors, leading to greater consolidation across many portions of the agribusiness value chain.

While last year's prices of many agricultural commodities were low compared with historical levels (with some exceptions), operators and investors anticipate sustained higher commodity and food prices in the future given the growing pressures on the food demand/supply balance. These and other factors suggest that the underlying economic fundamentals for investment in agribusiness and food production are strong and will remain strong for the medium to long-term.

Global demand for food is rising and while production has kept pace so far, future gains will be increasingly costly and difficult to achieve without greater investment across the agribusiness and food value chain. Without such investment, further breakthroughs in agricultural biotech, chemistry and even growing techniques will be a challenge. Investment is particularly needed in developing markets such as Africa in order to develop basic agricultural infrastructure (e.g., irrigation), increase access to better farm inputs (e.g., small horsepower tractors or other adapted rotor tillers) and elevate the skills of local farmers.

Figure 1
World population growth by region
(billions)



Source: UN Department of Economic and Social Affairs, U.S. Census Bureau, Brookings Institute, OECD FAO Agricultural Outlook, L.E.K. analysis

Global Demographic Factors Supporting Agribusiness Fundamentals

Food demand is increasing as a result of growing populations, rising incomes and an expanding middle class. Urbanization, particularly in the developing world, is also increasing the number of people who depend on others to grow or produce food for them. Demand for food is expected to increase globally by 2% per annum through 2022, with most of that growth coming from the developing world. Consumption is expected to rise across all key food segments, as well as for crop–based biofuels, with protein demand growth outpacing that of carbohydrates on a global basis.

In order to meet expected demand growth, global food production will need to rise. Recent increases in food output

Global Agribusiness Investment: Attractive Long-Term Outlook Generates Interest from Strategic Players and Financial Sponsors was written by **Peter Walter**, a managing director in L.E.K. Consulting's New York office, **Chris Kenney**, a managing director in L.E.K. Consulting's Chicago office and **Carol Wingard**, a managing director in L.E.K. Consulting's Boston office. For more information, contact basicindustries@lek.com.

have come primarily from higher productivity and improved crop yields, as land under cultivation has not expanded significantly on a worldwide basis over the past decade. Increased productivity has been achieved through greater application of irrigation, advances in biotech-driven seed and crop protection, steadily increasing farm mechanization, and more efficient agricultural supply chains.

There are, however, obstacles to increased production growth over the medium to long-term. Agricultural logistics and infrastructure (storage, terminals, etc.) are still under-developed in many parts of the world. Significant investment will be required in coming decades to boost harvests and ensure that crops move more efficiently from where they are grown to where they are consumed, whether destined for food, feed or fuel. In Africa, for example, irrigation, fertilizer use and mechanization are all still relatively nascent in most countries. And globally, government and consumer concerns about GMO varieties have, to date, limited their acceptance and adoption in many countries.

Commodity crop prices have become increasingly volatile in recent years given more variable weather patterns and greater overall financial speculation in commodities. This poses a potential risk not just to farmers, who bear the direct impact of lower crop prices, but also to farm input suppliers, as farmers are less willing and able to invest in mechanization and other discretionary farm inputs if crop prices don't support farm-level investment. Greater price volatility, however, may benefit others, such as companies supplying crop drying and storage equipment, as these systems give growers more flexibility in deciding when to sell crops they've produced.

Recent Major Trends in Agribusiness Investment

Agribusiness operators and investors are keenly aware of the need for investment and have been capitalizing on some of the opportunities in the following ways:

1. Research and development: Private sector investment in agri-related research and development rose annually between 2006 and 2010. Most investment funding has been targeted at crop seed biotech, crop protection chemicals, and farm equipment and machinery. R&D spending growth has been greatest in farm machinery, crop seed and biotech R&D, each rising by 12% annually between 2006 and 2010. Private investment currently accounts for about 70% of total global agribusiness investment, with the public sector funding the remainder. An increase of 50% in private sector investment—to $200 billion annually—is expected by 2050.

2. Acceleration of M&A activity: M&A activity in agribusiness has grown rapidly, increasing at 18% p.a. between 2002 and 2012, with double-digit growth in almost every sub-sector. Agribusiness operators are using acquisitions as a means to achieve a number of goals, including:

- Greater vertical integration across relevant value chains.
- Higher strategic market position in key commodities/value chain segments.
- Ownership of key strategic assets such as technology/IP, well-located processing and logistics facilities, etc.

As a result of the surge in investment, many sub-sectors within agribusiness have undergone significant and rapid M&A-led consolidation.

- As of 2009, the four largest crop seed and biotechnology companies collectively had a 54% share of their global market, up from 33% in 2000.
- The top four agri-chemical companies together accounted for 53%of their market, up from 41%.
- The four largest farm machinery companies collectively represented 50% of their market vs. 33% nearly a decade earlier.
- The four largest animal health companies together had 50% of the market, up from 42%.

3. Rise in interest from financial sponsors: Investment in agribusiness by financial sponsors has also grown significantly over the past decade, as evidenced by the dramatic rise in the

Figure 2

Estimated number of active global agribusiness funds by asset class (2005-13)
(number of funds)

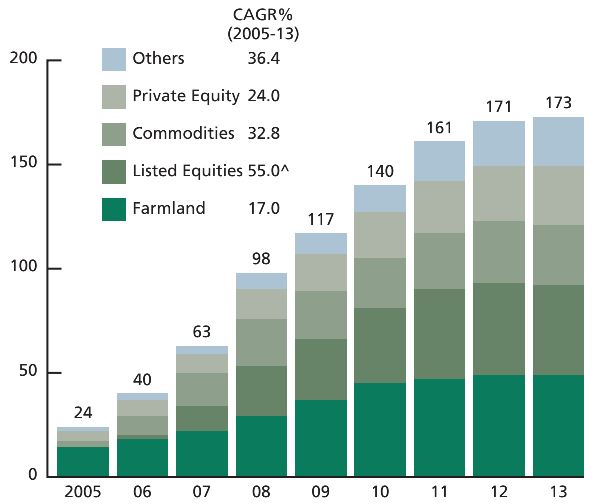
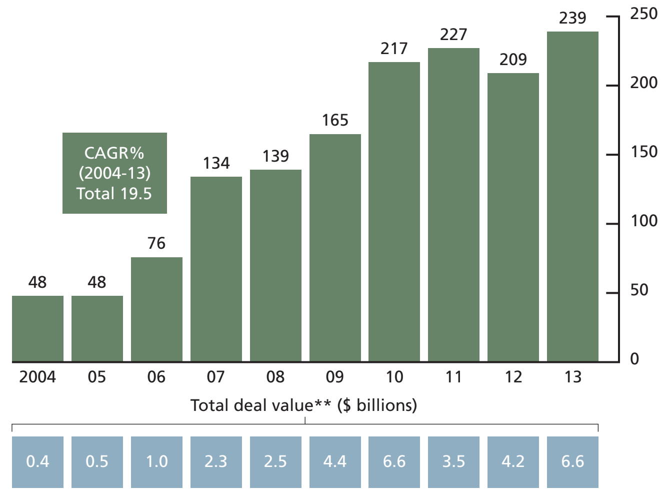


Figure 3

Global private placement* in the agribusinesses Total number of deals
(with disclosed and undisclosed value)



Note: *Private placement is a private sale of newly issued securities (equity or debt) by a company to a selected investor or a group of investors; **Only representative of deals with disclosed transaction values ^CAGR calculated with years 2006-13
Source: Valoral Global Agribusiness Investment Outlook, Marketwatch, CapitalIQ, L.E.K. analysis

number of agribusiness-focused investment funds, the number of deals done and the investment value of those deals. In 2009, 165 agri-related deals were completed, valued at $4.4 billion, as compared with 239 deals worth $6.6 billion completed in 2013. Most private agribusiness investments between 2009 and 2013 were targeted at producers/processors of commodities and foods, with an average investment of $31 million per transaction.

Most Promising Current Agribusiness Investment Areas

We have observed a number of investment theses being pursued by investors with some variability depending on the type of investor. Those interested in the growing and processing portions of the value chain are tending to pursue different strategies than those focused on farm inputs and automation.

Growing and Processing

1. Value chain integration: Some operators are investing in or expanding into segments of the value chain to boost access to inputs, improve integrated processing capabilities/cost position and/or control a greater share of the end-to-end supply chain. Value chain integration is attractive as it helps operators to achieve a higher strategic market position in their specific portion of the value chain, while it also helps to shelter processors from commodity price volatility.

2. Geographic/crop expansion: Expansion into new geographic production markets or into specific crop segments is another strategy being pursued to secure access to feedstocks and help drive yield improvements. Large global agri-processors and traders have used this approach to increase their reach and share of commodities where they are strong, as well as to build new commodity capabilities.

3. Land bank accumulation: Investments in land bank or plantation assets can produce returns on crop production gains as well as potential long-term land value appreciation. However, it has become increasingly challenging to find and acquire large land banks given the scarcity of available arable land as well as political sensitivity to large-scale foreign direct investment in land banks.

Farm Inputs Automation

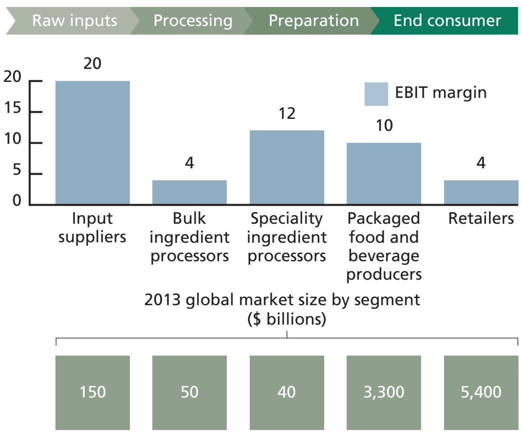
4. Technology/biotech: Many investors have been placing bets on farm automation, "precision" farming solutions, crop protection systems, and other emerging technologies to help boost yields, optimize water and fertilizer efficiency, and lower costs for growers. There are numerous opportunities for such technologies to be adopted around the world. Over the medium term, however, many more such solutions will need to be simpler and more affordable to be accessible to growers in developing markets.

5. Distribution channel ownership: Given the distances that must be crossed to get agricultural inputs to market, as well as the existing fragmentation and localized nature of agricultural distribution channels, there is strong value to be gained from further improvements in this sector. Whether pushing more product categories and brands through existing channels, or bolting together strong local/ regional distributors to achieve greater scale economies, we expect to see investors seizing consolidation and up-scaling opportunities in farm input distribution, as well as vying for strong positioning in key downstream channels.

Figure 4

Global agricultural value chain profitability by segment (2013)

(percentage)



Source: Seventeenth Annual Agribusiness Conference – Dupont presentation

There is little doubt that investors will continue to look for opportunities to participate in agribusiness, while strategic operators continue to build scale and reach through organic means and M&A. Many attractive opportunities are out there and the winners will be those who invest in sound, value-creating strategies given the shifting industry landscape.

INSIGHTS@WORK®

L.E.K. Consulting is a global management consulting firm that uses deep industry expertise and analytical rigor to help clients solve their most critical business problems. Founded more than 30 years ago, L.E.K. employs more than 1,000 professionals in 22 offices across Europe, the Americas and Asia-Pacific. L.E.K. advises and supports global companies that are leaders in their industries – including the largest private and public sector organizations, private equity firms and emerging entrepreneurial businesses. L.E.K. helps business leaders consistently make better decisions, deliver improved business performance and create greater shareholder returns.

For further information contact:

Boston
75 State Street
19th Floor
Boston, MA 02109
Telephone: 617.951.9500
Facsimile: 617.951.9392

Chicago
One North Wacker Drive
39th Floor
Chicago, IL 60606
Telephone: 312.913.6400
Facsimile: 312.782.4583

Los Angeles
1100 Glendon Avenue
19th Floor
Los Angeles, CA 90024
Telephone: 310.209.9800
Facsimile: 310.209.9125

New York
1133 Sixth Avenue
29th Floor
New York, NY 10036
Telephone: 646.652.1900
Facsimile: 212.582.8505

San Francisco
100 Pine Street
Suite 2000
San Francisco, CA 94111
Telephone: 415.676.5500
Facsimile: 415.627.9071

International Offices:
Bangkok
Beijing
Chennai
London
Melbourne
Milan
Mumbai
Munich
New Delhi
Paris
São Paulo
Seoul
Shanghai
Singapore
Sydney
Tokyo
Wroclaw