# Nuts about Brazil: Why Japan's trading houses are going big in South America

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***The rush of Japanese traders securing grain origination in the emerging market giant offers lessons and opportunities for the broader investor community. Roberto Vitón, managing director at Valoral Advisors, takes a deep dive into their strategies and track records.***

Known as '*sogo shosha*,' the seven major Japanese trading houses – Itochu, Marubeni, Mitsubishi, Mitsui, Sojitz, Sumitomo and Toyota Tsusho – supply everything from energy and metals to grains and textiles to resource-scarce Japan.

Over time, they have expanded their footprints overseas, transforming into commodity houses as they ventured upstream to target production and origination assets. Following the financial crisis, they rushed to invest in physical assets across the global commodity complex: energy, metals and agriculture.

Yet, in recent years, the emerging-market downturn and the commodities rout, particularly in metals and energy, has prompted a shift in focus among Japanese groups. Because food demand is generally stable, these have continued to increase their agri footprints to become global traders, able to procure directly from around the world.

**A very competitive field**

Japanese trading houses are important players in the global commodity trading business. But when it comes to agricultural commodities, they lag the "ABCD" group – the four elite companies leading the global agricultural flows: ADM, Bunge, Cargill and Dreyfus, whose international network of origination, storage, processing, transport and trading accounts for much of the food produced and consumed globally.

What’s more, new competitors have recently emerged – besides the “ABCD” group and Swiss-based Glencore, a generation of Asian regional champions is also quickly stepping up its game. These include China’s Cofco, which acquired traders Noble and Nidera in 2016 and 2017 respectively, as well as Singapore-based Olam and Wilmar.

Interestingly, some of these companies have recently formed tie-ups with institutional investors, leveraging their financial resources to invest in capital-intensive agricultural assets. A joint venture between Bunge and Saudi Agricultural and Livestock Investment Company, for example, bought 50.1 percent of the Canadian Wheat Board in 2015 for C$250 million (€169 million; $194.22 million). The following year, the Canada Pension Plan Investment Board bought a 40 percent stake in Glencore Agri for $2.5 billion.

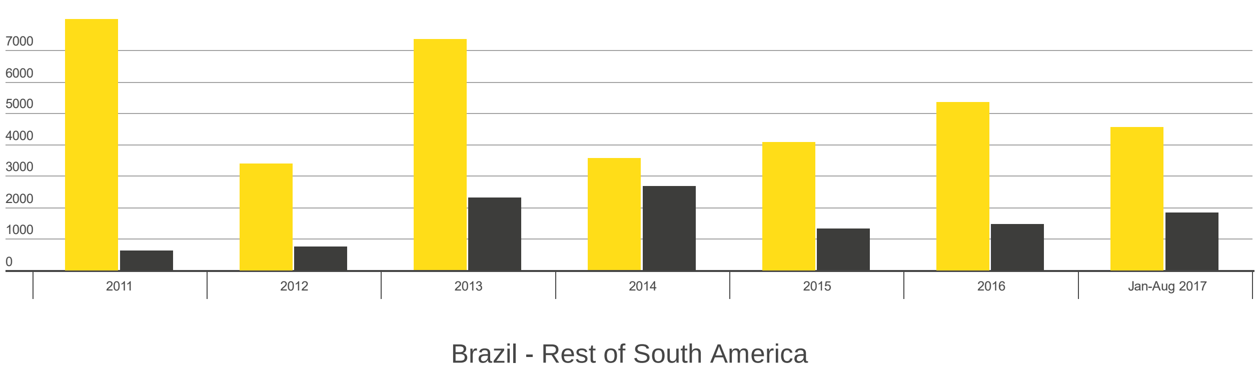
**The Brazil appeal**

Aware of such pressures and helped by vast balance sheets, Japanese trading houses have invested billions of dollars around the world, including in Australia and North America. However, Brazil has been the focal point of their investments – Japan’s seven major trading houses have acquired at least 13 businesses worth more than $2.5 billion since 2010.

Investments, generally concentrated in grain origination and export infrastructure, also went towards farming and input distribution. Such deals have Japanese trading houses in an attractive position to originate grains in the South American giant. Brazil’s annual agricultural exports have grown at a yearly average of 17 percent between 2000 and 2013, according to the Food and Agriculture Organization. Today the country ranks among the top exporters for products including soybean, coffee, beef and orange juice.

**LatAm powerhouse**

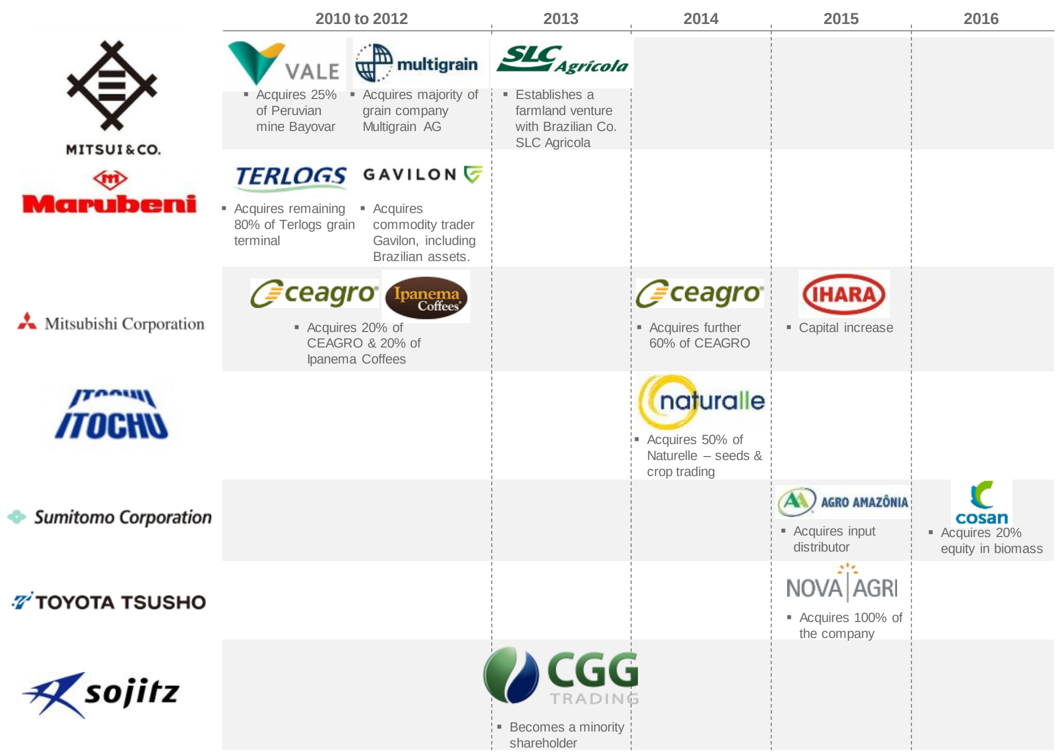
Food & agribusiness M&A volume, $m




Source: Valoral, proprietary database

But Japanese investments in Brazil have not been without challenges. Difficulties caused by trade deceleration in recent years, amid a slowdown in global growth and weak commodity prices, have been compounded by the Brazilian recession and financial volatility.

Mitsui booked a 6.3 billion yen ($57 million; €48 million) impairment loss in 2016 on goodwill of Multigrain, a Brazilian food producer and trader acquired in 2011. Cantagalo General Grains, a Brazilian farming and trading firm, recently restructured close to $170 million in debt owed by its trading arm – in which Sojitz is a shareholder.




Several reasons explain the underperformance. For one, the entry of Chinese rivals into Brazil has made the market for collecting and selling grain more competitive. Foreign exchange volatility in the country, and the over-indebtedness of farmers and traders, have brought a wave of loan defaults and financial stress that affected the whole value chain. Corporate governance issues also arose, particularly when trying to transform local and informal structures into large, international corporations.

Such challenges have not been exclusive to South America: Itochu has had difficulties with Dole Food Company's Asian fresh produce and global packaged food businesses, which it acquired for $1.7 billion in 2012. Marubeni booked impairment losses in 2015 on goodwill of its US grain-trading subsidiary, Gavilon Holdings, acquired in 2013.

**A new wave of opportunities… and capital**

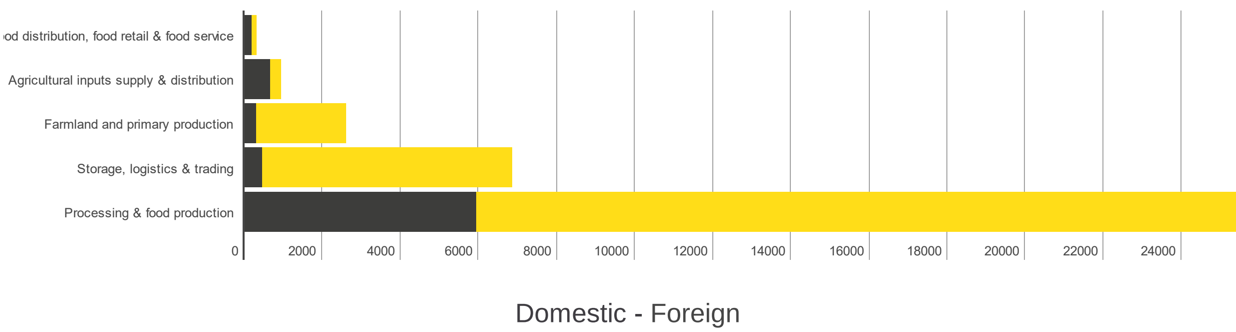
Trading agricultural commodities is a low-margin business. In Brazil, the M&A wave seen in agribusiness until 2014 and the fight for market share – which pushed up valuations – have likely put further stress on balance sheets and strained profitability.

As we consider 2018, the Brazilian economy will likely continue to recover despite remaining political tensions – leaving behind the recession and nurturing an agriculture sector likely to expand further.

The country is seeing a resurgence in food and agri M&A (close to $5 billion in such deals were announced in the year to August, with an overwhelming participation of foreign companies and investors). While transactions are likely to happen across the value chain, there is evident interest in agricultural inputs, distribution and consumer products for the local market, where opportunities for consolidation remain and best management practices can improve profitability. There is also growing appetite from private equity firms and institutional investors willing to expand their food and agribusiness platforms.

**Open for business**

Brazilian agri M&A by sector and investor origin, 2011-2017




Source: Valoral's proprietary M&A database. Includes only deals over $10m in size.

For Japanese trading houses, it seems the strategy of the day is to focus on adding value to their primary agriculture holdings – a worthy effort now that the low-hanging fruit of the commodity boom is gone. Interestingly, opportunities are rife both in the export and domestic markets. They include:

**Feed:** Grains used as inputs into businesses such as milling and animal feed processing for livestock and aquaculture.

**Organic agriculture**: Organic crops and fruits are growing in popularity in Brazil.

**Specialty crops:** Non-GMO cereals and oilseeds, soy protein derivatives and pulses are experiencing rising demand as well.

**Wood chips:** An emerging sub-sector amid a rush to build biomass power plants.

Although they remain a niche in the overall food and agriculture value chain, these sectors are growing in Brazil – offering an interesting trade-off for investors between value, profits and the lack of sufficient scale. This is not lost to Japan's trading giants. Marubeni is reportedly in advanced talks to acquire the port terminal of Santa Catarina in São Francisco do Sul in southern Brazil, which specializes in bulk grain and is close to Marubeni's Terlogs terminal.

As demand for food makes the agri supply chain ever more global, we expect that the '*sogo shosha*' will remain big in Brazil.

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The original article can be found on:

[https://www.agriinvestor.com/nuts-brazil-japans-major-trading-houses-going-big-south-america/](https://www.agriinvestor.com/nuts-brazil-japans-major-trading-houses-going-big-south-america/)