DENMARK & URUGUAY: THE HIDDEN GEMS IN THE GLOBAL FARMLAND SPACE

November 2021

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Over the last two decades, the food and agriculture sector has become a mainstream asset class for institutional investors. These investors appreciate the sector's attributes in terms of the fundamental growth drivers, the diverse range of asset strategies available including real assets, private equity and venture capital opportunities, and the ever-growing investment themes that the sector offers, including the linkages to sustainability, climate change, nutrition and others.

The evolution of this asset class has been impressive: Today there are 740 investment funds specialized in this sector, compared to less than 50 back in 2005. These investment funds manage in excess of $120 Billion and provide exposure to multiple investment themes around the world.

Despite this growth, this is a nascent asset class, in which typically institutional investors have less than 2% of their overall assets allocated to the sector. Going forward, it is expected that this asset class will continue to expand as investors recognize the opportunities associated to building a more sustainable and more efficient food and agriculture production system.

Among the existing asset strategies, investments in farmland continue to attract a large portion of investment flows, as investors recognize the role that farmland assets can have in a diversified portfolio including the low correlations with traditional asset classes, the potential inflation hedge, low volatility, the potential for stable cash income and the upside potential for capital appreciation.

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Farmland markets reacted very positively after the emergence of the COVID19 pandemics, as a combination of strong food demand and lower production and inventories for mainstream crops triggered a sharp increase in commodity prices which also resulted in higher farm income.

In this context, farmland prices in several markets like the U.S., Australia, Brazil and Spain showed important gains in the last year, in some cases above 10% in U.S Dollar terms. As we enter 2022, we expect to see continued interest from institutional and private investors to gain exposure to farmland assets, both for row crops and permanent crops.

This is not an isolated trend, indeed we expect that the coming years will likely witness more institutionalization of the food and agriculture asset class with increasing emphasis on sustainability, and where technology is expected to drive value creation across the sector.

This offers a bright outlook for farmland investments as investors increasingly conceive this asset as an attractive play to invest in sustainability, carbon sequestration and even technological innovation connected to a more efficient and sustainable food production system.

EMERGING OPPORTUNITIES IN A FINITE UNIVERSE

Mark Twain's famous quote "buy land, they're not making it anymore" has been a long-lasting slogan among farmland investors. However, for many decades, if not centuries, human beings have expanded the agriculture frontier, effectively increasing the arable area. In many cases, this process has transformed and degraded local ecosystems with a serious loss of soil and soil fertility and of the local biodiversity, besides other environmental harm.

Today, investors recognize that the agriculture frontier cannot be extended anymore. In fact, in their latest agriculture outlook OECD-FAO projects that over the coming decade, global agricultural production will increase by 1.4% p.a. and where 87% of the growth is expected to come from yield improvements, with only 6% coming from the expansion of the ag frontier.

However, and despite the high interest in farmland, most investors find it challenging to deploy capital in this space. Among the main reasons usually cited, it is the lack of knowledge of how farmland works, the perceived risks, and the difficulties to find trusted advisors and managers who can guide and help investors. More recently, growing restrictions to buy land by foreign investors imposed in several countries have also prevented more investors to join this space. Last but not least, investors are more aware about the potential negative impacts that climate change can have on farmland.

As a first step to assess farmland investments, we can think about a check list that investors can use to identify the most attractive opportunities on a global basis, for a given agriculture crop. Based on our experience, this exercise can provide a comprehensive overview of the opportunities available and their attributes vis a vis other possibilities. The figure below shows four major criteria that we can consider, among others.

FIG. 01: HIGH-LEVEL FARMLAND INVESTMENT CHECK LIST.

PRIMARY PRODUCTION COMPETITIVENESS FOCUS ON THE ATTRIBUTES OF A FARMLAND ASSET TO COMPETE IN THE PRODUCTION OF A SPECIFIC CROP.	**MACRO COMPETITIVENESS** FOCUS ON THE ATTRIBUTES OF THE COUNTRY TO COMPETE IN THE PRODUCTION AND MARKETING OF A SPECIFIC CROP.
FARMLAND MARKET DYNAMICS FOCUS ON THE MARKET CONDITIONS TO ACQUIRE, MANAGE AND SELL FARMLAND ASSETS IN THE LOCAL MARKET.	**LEGAL & INVESTMENT ENVIRONMENT** FOCUS ON THE EXISTING LEGAL FRAMEWORK AND INVESTMENT ENVIRONMENT TO INVEST IN FARMLAND ASSETS.

The primary production competitiveness is an important factor: Investing in the lower marginal cost producer of agriculture commodities is a good starting point, as crops are traded globally and prices fluctuate according to the evolution in supply and demand. The competitiveness in primary production is largely connected to the soil quality and the weather conditions but it also depends on the existing farming practices and the quality and availability of key inputs including seeds, fertilizers and crop protection inputs, as well as modern agriculture machinery.

As part of the primary production competitiveness, we can include the impact of climate change, which is becoming a critical factor to invest in farmland. The latest projections presented by the Intergovernmental Panel on Climate Change of the United Nations show how lower rainfall and higher temperatures are expected in several key agriculture producing nations in the coming decades.

The overall competitiveness of a certain farmland asset also depends on existing infrastructure (both at the farm and on a country-level) to transport, process and ship production to global markets. Other important factors that influence the macro competitiveness include access to capital, taxes, regulations, trade conditions, labor market conditions, among others.

Other factor or criteria to consider is the farmland market dynamics. This may include the overall scale of the local farmland market as this can affect the capital deployment and the overall market depth to transact in these highly illiquid assets. The existence of a well established farmland lease market is another aspect to consider.

Equally critical is the legal and investment environment in the countries analyzed. This criteria considers the prevailing rule of law, the business environment and the specific legislation on foreign ownership of farmland.

This high-level check list can be further detailed if we zoom into a specific crop. Nowadays, there are two main types of crops targeted by investors. On one hand, row crops include all the cereals, fibers and oilseeds which are produced on an annual basis, including corn, wheat, soybeans, rice, cotton, among others. On the other hand, permanent crops include crops and orchards which are planted to last several or many years. They include fruits, nuts, vines, etc. For the purpose of this article, we will focus on row crops, which is the most basic entry point for new investors.

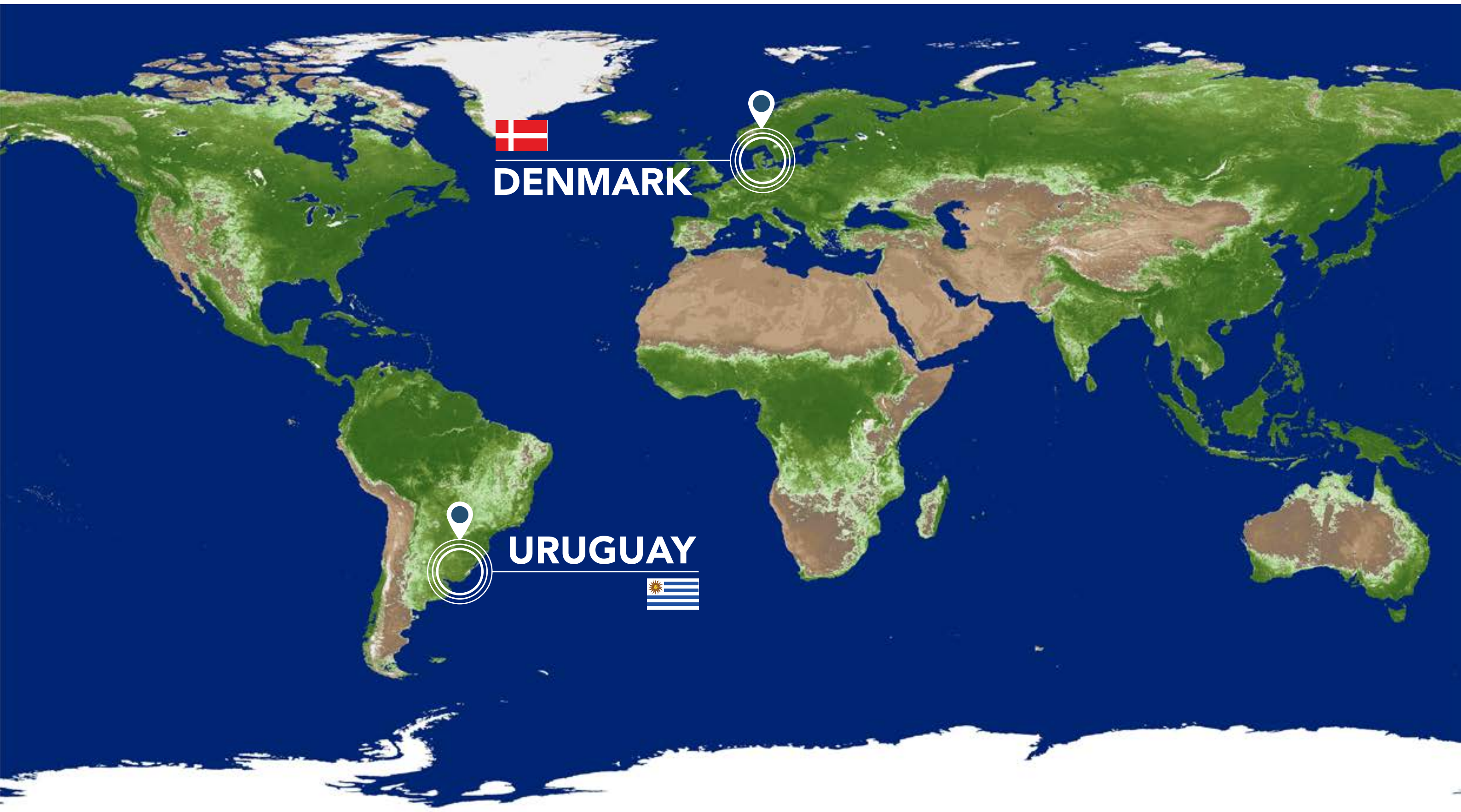
DENMARK & URUGUAY:
A SINGULAR OPPORTUNITY IN THE GLOBAL FARMLAND SPACE

When we look at the existing opportunities around the world which can check all these boxes for row crops, we realize that in today's markets only few countries score high across the board. These may include some of the largest farmland markets such as the U.S and Australia. Indeed, these two countries have been among the largest receptors of capital inflows in the global farmland asset class.

There are two 'unusual suspects' that rank very high in our check list and that have remained below the radar so far: These are Denmark and Uruguay, two relatively small nations (Uruguay ranks 91st and Denmark 133rd in land area) that have a long tradition in agriculture and that offer a unique combination of attributes for farmland investing.

In the next page we show some indicators about Denmark and Uruguay, with focus on their agricultural profile.

COMPARATIVE DATA FOR DENMARK AND URUGUAY



KEY INDICATORS	URUGUAY	DENMARK
Population (2020)	3.5 Million	5.8 Million
Surface (km²)	181.034	42.094
GDP ($ Billion, 2020)	54	355
GDP per Capita ($, 2020)	15.442	61.320
S&P Sovereing credit rating	BBB	AAA
Arable area (Million Hectares, 2019)	14.0 Million	2.6 Million
Cereal Production Area (Million Hectares, 2019)	0.7 Million	1.4 Million
Cereal Production (Million Tons, 2019)	3.6 Million	9.5 Million
Oilseeds Production Dedicated Area (Million Hectares, 2019)	1.0 Million	0.2 Million
Oilseeds Production (Million Tons, 2019)	2.9 Million	0.7 Million
Dairy Production (Fresh milk, Million Tons, 2019)	2.2 Million	5.6 Million
Number of cattle (2019)	11.4 Million	1.5 Million
Number of pigs (2019)	0.1 Million	12.7 Million
Food & Agriculture Imports ($ Billions, 2019)	1.2 Billion	11.3 Billion
Food & Agriculture Exports ($ Billions, 2019)	5.2 Billion	16.5 Billion

SOURCES:
World Bank, FAO, Trading Economics.

FIELDS OF PROMISE

Denmark and Uruguay have a similar population and have a well-established and competitive food and agriculture industry. Moreover, both countries have a diversified export-driven agriculture sector, including a mix of crops, oilseeds, dairy and meat production. Interestingly, the two countries are also leading in renewable energies and animal welfare.

And while the countries are in different latitudes (Denmark at 56° North and Uruguay at 32° South), both countries present attractive soil and weather conditions for agriculture production in template weathers, with ocean influence.

Moreover, current legislation in both countries allows foreign investors to purchase land. And while there has been a flow of foreign investors in recent years, these markets have stayed away from the largest investment flows.

One reason which explains this fact is the lack of knowledge about these markets. Another factor is that the relatively small farmland markets in these two countries have limited so far the interest from institutional investors who wish to deploy significant amounts of capital. Private investors have led these markets in the last decade.

One of the consequences of this limited investment flow into these markets is that the prevailing farmland prices may be below what would be the equivalent prices seen in other comparable markets. In our assessment, we consider that along time, prices in Denmark may converge to prices in neighbor Germany. In Uruguay, we expect prices to converge to the highest prices seen in Brazil and to prices of similar type of land in the U.S.

We believe that this may happen sooner than later as the opportunity set for farmland investments continue to shrink when we consider the growing legal and climate restrictions around the world.

Certainly, both countries have several differences, including a different level of economic development and distant 11,600kms from each other. But when it comes to farmland investments, they are closer than what it appears.

During the last decade, Valoral Advisors has advised several investors to purchase farmland assets in both countries, whereas Blue Harvest has focused its investment advisory services solely towards Denmark. In both cases, the process to screen farms, perform all the agronomic due diligence and close transactions was smooth, transparent and efficient. Moreover, in both cases we brought local, reputed tenants with whom we established long-term relationships.

When investors look at these existing investments, they recognize the same attributes that we highlighted in this article. Going forward, we expect that these hidden gems will soon be discovered and brought to the spotlight.