RESEARCH NOTE

Investing in Australian Agriculture – The Time Is Now
November 2014

Summary

The landmark free trade deal signed by China and Australia last week will fuel investment flows into certain Australian agricultural assets and demand for certain soft commodities. Given the potential scale, it is very likely to create a race for the most attractive assets and off-take contracts and logically push prices upwards.

For China, the agreement provides the welcome opportunity to address some of its increasingly pressing food-security issues. In particular the dietary shift from crop to a livestock based products, i.e. a more "affluent" diet, will lead to a widening domestic demand-supply gap for certain agricultural products over the next decades. Amongst others, dairy and beef will feature most prominently.

At the same time, the growing emphasis of affluent Chinese consumers on food safety and quality will amplify demand for "Brand Australia" products and direct investment into processing capacities delivering these products.

Given the magnitude of Chinese' food-security needs, demand and investment flows will be significant and should result in fierce competition with investment from other regions similarly facing food security issues (such as the **GCC** and other investors in agriculture).

Whilst the actual agreement will not take effect until after 2015, when all the legal points have been drafted and translated, a notable rise in investment activity should be imminent. Non-Chinese investors keen to gain exposure to the Australian agricultural sector will use this window before the rush kicks off.

Analysing China's food security needs

Food security issues facing China today are mainly attributable to the ongoing change in Chinese diets – amounts, quality and composition on the back of rapid economic growth and wealth creation. This dietary shift from crop to livestock based products imposes strains on agricultural production, due to its substantially higher resource requirements and will subsequently constrain China's food-output capacity and availability for the upcoming decades.

The shift towards a more affluent diet is far from concluded, with strong income growth continuing in China. Whilst total calorie intake per capita per day had reached 3,036 in 2009 (well above the world average of 2,831), it still remained almost 15% below the EU and more than 20% below the US. Livestock products have been the key contributor to the increase in calories and will continue to do so.

China's problem of strong growth demand and increasing supply constraints and shortfalls is highlighted by the drop in the food self-sufficiency rate to 88% in 2012 down from 98% in 2010. Much of the emergence of recent supply-demand gaps is due to the increased consumption of animal products and the development of China's livestock industry.

In 2012 the most notable shortfall was in dairy products with a self-sufficiency rate of 86.4% followed by mutton with 96.6% and beef with 99%. Supply-demand gaps will become much more pronounced by 2030 at which point self-sufficiency will have dropped to 76% for dairy products, 86% for mutton and 94.6% for beef.[1] (Figure 1)

Whilst the shortfall appears less severe for beef, the percentage figures disguise the magnitude of the gap in absolute terms. For beef, the gap will be an estimated 520 thousand tons by 2030. For dairy, the gap is projected at 21,700 thousand tons.

Feed grains will equally feel the impact of increased demand for animal products: Domestic self-sufficiency for corn is forecasted to drop 85% by 2030 from 98% in 2012. Soybean including soybean oil will suffer the most severe demand-supply gap with 2030 self-sufficiency projected as low as 14%.[2]

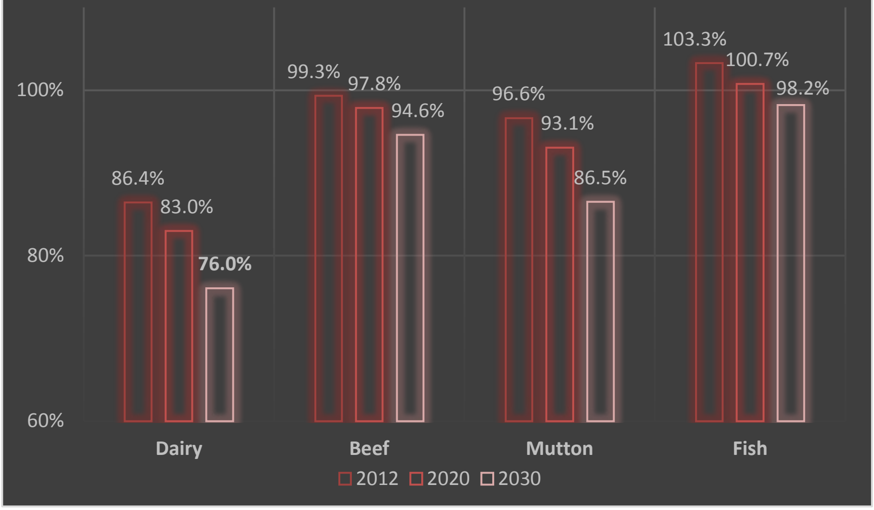


Figure 1: Chinese Self-Sufficiency in Key Livestock Products

For wheat and rice, the food grains most important to China self-sufficiency, will be maintained equally for vegetables, fruits and fishery products.

Investment destination Australia, the opportunity

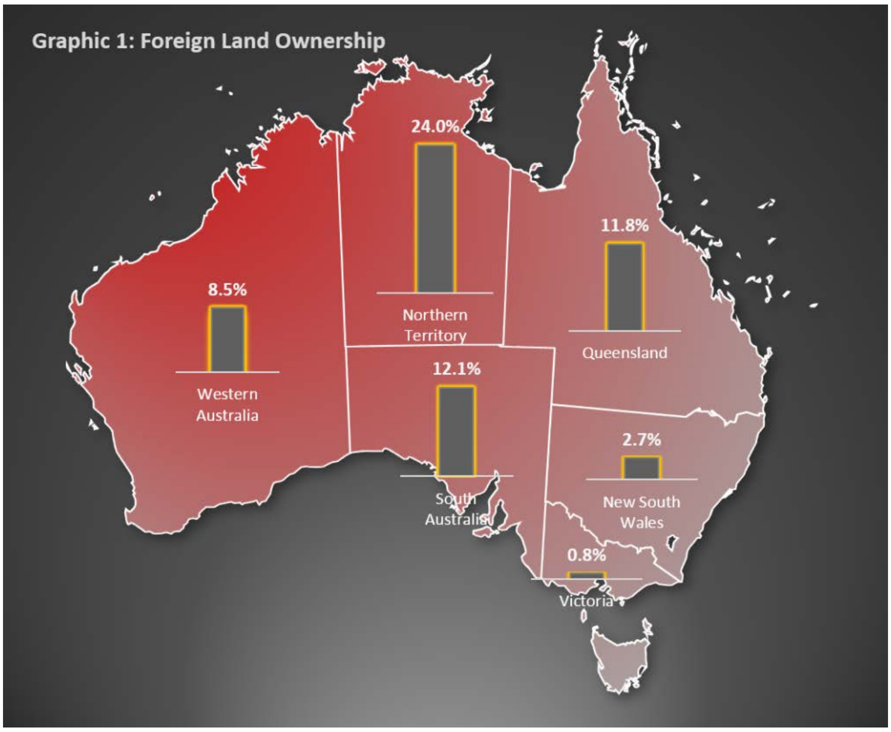
The agreement struck is expected to channel Chinese agricultural investment into acquisition of farmland and ancillary businesses in dairy, beef and mutton and into processing capacities delivering products "Brand Australia" for export to China.

Under the deal, the threshold for Chinese direct investments into Australia will rise to A$1.078 billion (US$939 million) from A$248 million (US$216 million). In return c.85% of Australian exports to China will not incur tariffs rising to c.95% upon full implementation of the deal. Tariff reduction will apply to dairy, beef and mutton (but not include certain other commodities such as rice, cotton and sugar).

[1] Data: CAPSIM simulation, World Bank, China Economic Update June 2014
[2] Ibid

Historically the share of agriculture in total foreign investment into Australia has been low. In 2011/12 it amounted to A$3.6 billion or 2.1% of FDI up from 0.1% in 2006. Four countries led by Canada with 24.8%, the UK 21.6% with, USA with 11.8% and New Zealand with 4.3% accounted for the lion share of foreign capital invested whilst China has never featured as key source of foreign agricultural investment in the past.

Farm and land ownership data highlights foreign investor's past limited appetite for investment destination Australia: 98% of Australian farm businesses and 89% of farmland are fully Australian owned.[3] With 24% the Northern Territories have the highest proportion of foreign owned land whilst Victoria has the lowest share at just 0.8%. (Graphic 1)



Graphic 1: Foreign Land Ownership

The state distribution of foreign land ownerships strongly differs from the food and fibre production and export activities. Although Victoria accounts for 3% of Australia's landmass only, it is the largest state exporter with a 29% share of Australia's total food and fibre exports.

With an apparent land reserve of 26 million hectares mostly located in Northern Australia, Australia has c.6% share of new cropping land available globally. However, difficult access, limited infrastructure and suitable rainfall patterns, vastly reduce the area where farming is practicable to a maximum of 7% of assumed land reserve.

Australia's agrifood industry exports between 60 to 80% of its production predominantly as basic commodities. Nevertheless, with globally acknowledged processes, production standards and robust agrifood regulatory system, Australia's agrifood industry has the potential to target high-value export markets and leverage and develop the "Brand Australia" further.

Conclusion

The Australian agrifood industry offers attractive targets for investment on various levels. Chinese food-security needs combined with the landmark free trade deal signed last week provide a strong investment case for Chinese capital once the agreement is fully implemented and are likely to drive asset prices up. However, as the agreement will not take effect until after 2015, there is a window of opportunity for Non-Chinese investors to take advantage of opportunities.

[3] Parliament of Australia

For further information please contact Torsten Böhler or David Ellis at Abacus Emerging Markets:

Torsten Böhler
Managing Director
Phone: +44 (0) 20 7769 6784
Mobile: +44 (0) 7712 833 404
Email: torsten.boehler@abacusem.com

David Ellis
Director
Phone: +44 (0) 20 7769 6784
Mobile: +44 (0) 790 669 7836
Email: david.ellis@abacusem.com

Abacus Emerging Markets Limited

Mayfair Office:

Abacus Emerging Markets Limited
53 Davies Street
Mayfair
London
W1K 5JH
T: +44 (0) 20 7769 6784

www.abacusem.com

City of London Offices:

Abacus Emerging Markets Limited
Warnford Court
29 Throgmorton Street
London
EC2N 2AT

Reliance on this document for the purposes of engaging in any investment activity may expose you to a significant risk of losing the entire amount invested.

This document has been provided to you solely for your information and may not be reproduced or redistributed, in whole or in part, to any other person.

This document is directed at and is being distributed only to (i) persons outside the United Kingdom, or (ii) persons who fall within the definition of "investment professionals" in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 as amended (the "**Order**"), or (iii) high net worth companies, unincorporated associations and partnerships and trustees of high value trusts as described in Article 49(2)(a) to (d) of the Order, provided that in the case of persons falling into categories (ii) and (iii) the communication is only directed at persons who are also "qualified investors" as defined in section 86(7) of FSMA (each a "**Relevant Person**"). Any investment and investment activity to which this document relates is available only to, and will be engaged in only with, Relevant Persons. Any other persons who receive this document should not act upon it.

The distribution of this document in other jurisdictions may be restricted by law and persons into whose possession this document comes should inform themselves about, and observe any such restrictions. Any failure to comply with these restrictions may constitute a violation of the laws of any such other jurisdictions.

In particular, neither this document nor any copy hereof may be taken or transmitted into the United States or distributed, directly or indirectly, into the United States or to any US person (as defined in Regulation S of the US Securities Act 1933). By accepting this document you agree to be bound by the foregoing limitations.

Whilst all reasonable care has been taken to ensure that the facts stated herein are accurate and that the forecasts, opinions and expectations contained in this document are fair and reasonable, neither Abacus nor any other party have verified the information contained herein and accordingly none of Abacus, or any other party, nor any of their respective directors, officers, employees, consultants, service providers or contractors make any representation or warranty, express or implied as to the accuracy or completeness of the information or opinions contained herein and shall not be in any way responsible or liable for the contents hereof and no reliance should be placed on the accuracy, fairness or completeness of the information contained in this document. No person accepts any liability whatsoever for any loss howsoever arising from any use of this document or its contents or otherwise arising in connection therewith.

Any opinions, forecasts or estimates herein constitute a judgment as at the date of this document. There can be no assurances that the future results or events will be consistent with any such opinions, forecasts or estimates. This information is subject to change without notice. It may be incomplete or condensed and it may not contain all material information concerning the relevant opportunity.

This document does not constitute or form part of and should not be construed as, any offer for sale or purchase of (or solicitation of or invitation to make) any offer to buy or sell any assets or securities nor shall it or any part of it form the basis of or be relied on in connection with any contract or commitment whatsoever.

The recipient of this document is responsible for doing its own full due diligence and research in connection with any opportunity realised.