AN ANALYSIS: **AUSTRALIAN SUPERANNUATION FUND INVESTMENT IN AGRICULTURE** 2014/15

The University of Queensland
Australia

UQ Business School

BDO

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FOREWORD

The importance of the agriculture sector
Our Agriculture industry plays a major role in the success of our economy and very importantly, our growth as a nation.

The industry represents approximately 12% of Australia's GDP, generating over A$145 billion annually and A$32 billion in exports. This is a significant figure and will only continue to grow as world demand for agricultural products continues to increase. To ensure the industry is well placed to meet this growing demand, Australian agriculture requires active investment at both a domestic and international level.

The majority of current large scale investment has either been debt funded or is received from international investors. The lack of domestic investment presents an exciting opportunity for the superannuation fund industry to consider agricultural entities as viable investment options.

Superannuation funds and agriculture - the opportunities are boundless
Australian superannuation funds represent a significant investment force. Total asset value amounts to $1.93 trillion as of 31 December 2014 according to official figures from the Australian Prudential Regulation Authority (APRA).

Given the prominence and importance of the agriculture sector to the Australian economy, it would seem like a viable area for investment. To date, limited investment has been made by superannuation funds.

The rationale behind the report
We established this report to try and:

1. Determine the level of superannuation fund investment in agricultural assets; and
2. Understand the current perception towards superannuation fund investment in the agricultural sector.

Report snapshot
In the first survey of its kind, BDO commissioned Professors Benson and Faff from The University of Queensland Business School through its commercial arm, UniQuest Pty Limited, to assess how much capital is being invested in agricultural products. As a result, some useful insights into the sentiment of superannuation funds towards investing in Australian agriculture were identified.

Snapshots from the research revealed:

- **Less than 0.3% of MySuper (superannuation fund products) assets are within the agriculture sector as of 30 June 2014**
- **MySuper offerings already constitute about one-third (30 per cent) of superannuation capital**
- **Superannuation funds largely invest in listed assets. If more agricultural companies became publicly listed, it may provide an easier avenue for superannuation funds considering investing in the sector.**

Our research findings are intended to get the conversation started on why superannuation funds are not investing in Australian agriculture and identify the underlying attitudes towards investment. We also wanted to draw attention to future opportunities and highlight the current obstacles faced by the sector in gaining more superannuation fund investment.

David Krause, BDO
National Leader, Food & Agribusiness

COMMITTED TO AUSTRALIAN AGRICULTURE

BDO has a genuine commitment to the agricultural industry. Our internal Food & Agribusiness industry sector group is made up of industry experts who attend industry briefings, contribute thought leadership to the industry and actively support industry stakeholders.

Members of our sector group attend industry conferences such as Global AgInvest New York, Global AgInvest Singapore, Australian Farm Institute, Rabobank's F20, Australian Agribusiness Association, Rural Press Club, Future Farmers Network and The Australian Global Food Forum.

"THE AGRICULTURE SECTOR IS A HIGHLY INEFFICIENT, MOSTLY FRAGMENTED MARKET, WITH LOW LIQUIDITY AND A NEED FOR ACTIVE MANAGEMENT. THESE CONDITIONS HAVE HISTORICALLY PRESENTED AN EXCELLENT OPPORTUNITY TO EXTRACT VALUE."

INVESTMENT SNAPSHOT

$A1.2T
INVESTED IN ALL SUPERANNUATION APRA REGULATED ENTITIES

$364B
INVESTED IN ALL MYSUPER PRODUCTS

OF THIS *ONLY*

0.3%
is invested in the ***agriculture sector***
BY MYSUPER PRODUCTS

1% being the maximum exposure

KEY LEARNINGS

There are a number of factors that are impacting on the viability of agriculture assets as potential superannuation fund investment options.

To give focus to our analysis, we concentrated on MySuper exposure to the agricultural sector (MySuper represents 30% of superannuation fund under management).

- A paradox exists between the notion of Australia's historical reliance on agriculture and the reluctance of fund managers to invest in this sector
- In Australia, there is approximately $1.2 trillion invested in **all** APRA regulated superannuation products. This does not include Self Managed Superannuation funds which are regulated by the ATO
- There is approximately $364 billion invested in MySuper products
- In terms of assets under management, our sample represents 28% of all MySuper products; 22% of all products and seven of the top 20 MySuper products
- Only 0.3% is invested in the agriculture sector with the 1% being the maximum exposure
- Agricultural companies represent 0.44% of the ASX 200 index, which represents another relevant bound in terms of a 'passive' exposure
- Superannuation funds largely invest in listed assets, hence any growth in new listings from the agricultural sector will see more super investment in this sector
- Assets consultants generally do not focus on the agricultural sector
- The **lack of investable products** and the **lack of asset managers specialising in agriculture** are identified as the most important **obstacles** to investment in the sector
- Rates of return, cost of investment and volatility are also obstacles
- Illiquidity of agricultural investments also deters investment but less so than other reasons
- The short-term versus long-term focus is not perceived to be a highly relevant consideration for having low investment in agriculture
- A comment from our findings in relation to agriculture was:

  "The agriculture sector is a highly inefficient, mostly fragmented market with low liquidity and a need for active management. These conditions have historically presented an excellent opportunity to extract value add."

The final comment provides a key example of the opportunity for agriculture to be considered a viable investment for superannuation funds. By implementing measures to make the sector more efficient, significant value can be extracted.

INTRODUCTION

The state of play - the importance of Australian agriculture

Australia's agriculture sector has an incredibly important role to play in the continued growth and success of our economy. Between now and 2050, the world's population is expected to increase from about 7 billion people to almost 9.3 billion people, an increase of around 35%.

At the same time, a rise in income levels in developing countries is expected to see an increase in per capita calorie consumption and individual diets shifting away from being carbohydrate based to being protein based. The net effect, as forecasted by the Food and Agricultural Organisation, is that agricultural production in 2050 needs to increase by around 70%.

The strong growth in agricultural demand combined with growing supply constraints is expected to provide enormous opportunity for agricultural trade. Australia stands to more than double the real value of annual agricultural exports by 2050 to capture an additional A$710 billion in revenues.

Overcoming the obstacles

Maximising growth will require overcoming a number of challenges. ANZ estimates that there is a capital investment requirement for agriculture in Australia between now and 2050 of $600 billion to enable production growth. A further A$400 billion needed to support farm turnover is also needed.

Part of this investment will come from institutional investment, both domestically and international.

Setting the scene - The superannuation industry

The superannuation industry has grown significantly over the past 10 years. It has increased from $634.9 billion (2004) to $1,619 billion in 2013. Comparable data for the year ended 30 June 2014 has not been released as at the date of this report, however, interim data as at 31 December 2014 shows total superannuation assets continued to grow to $1.93 trillion.

Of the $1.93 trillion as at 31 December 2014:

- $1.2 trillion in assets were held by APRA regulated superannuation entities
- Self Managed Superannuation Funds (SMSF) held $568 billion (regulated by the ATO).

Superannuation assets are allocated over a number of different asset classes. Australian and International shares are the most popular allocation.

Investing in alternative assets

An alternative asset class has not traditionally been considered in the make-up of an investment portfolio. It may include assets such as real estate, commodities, private equity, venture capital and hedge funds. As such, Agriculture is considered an alternative asset.

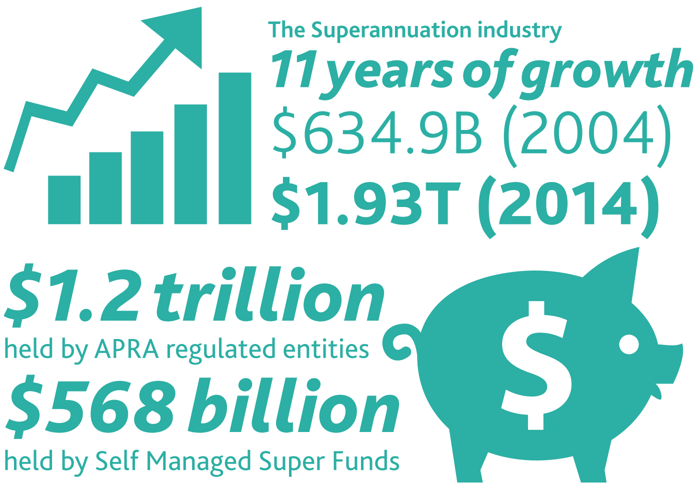
In recent times, sentiment towards alternative assets has fluctuated. Between 2005 and 2007, McKinsey & Company research estimates that global alternative assets under management nearly doubled, from $2.9 trillion to $5.7 trillion. Growth stalled during the GFC with market scandals, illiquidity, poor performance and major redemptions with many predicting a decline in the alternative asset class. However, recent years have seen a return to significant growth in alternative assets.

Attracting investment capital is critical

Agricultural investment growth within alternative asset portfolios is being fuelled by positive investment sentiment. Australia, with a strong competitive advantage in agriculture, has a role to play in global agricultural investment portfolios. However, returns to Australian agriculture tend to be lower than agricultural investments in Russia, Africa and South America. It's important that Australia maintains a low level of sovereign risk in order to be able to attract investment capital.

Agricultural investment is also benefiting from the shift to an absolute return type of investment framework. Institutional investors are redefining how they measure performance in order to better align outcomes with objectives. Agriculture measures up well on a risk/return basis and, whilst it is unlikely to get investors rich quickly, it can deliver significant wealth over the longer team.

In line with the shifting investment framework, there is an emerging trend for institutions to categorise alternative agricultural investments under a much larger food and agribusiness public equities umbrella. This is opposed to treating them as part of a stand-alone alternative allocation.



OUTLINE OF OUR RESEARCH

The objective of our research was to:

- Establish the amount invested by MySuper fund managers in the Agriculture sector
- Gain insight into the motivations underlying decisions to invest in, or avoid, this sector.

Given the lack of publicly available information on portfolio compositions, we surveyed superannuation fund managers to assess the proportion of assets invested in Australian agriculture.

The survey questions were divided into four sections. In the first three sections (a section each for MySuper products, Choice products and Defined Benefit plans) managers were asked to provide information on the following:

- Funds under management
- The percentage of funds invested directly as opposed to indirectly
- The percentage investment in Australian as opposed to international agriculture investments
- The target asset allocation for Australian agricultural investments.

The fourth section of the questionnaire requested information as to why the agriculture sector does not feature strongly (or at all) in their portfolios and allows participants to provide general comments to this end.

The research has focussed on MySuper products as this allows a more focused understanding of fund strategies.

Setting the scene: MySuper products

MySuper products were first launched on 1 July 2013 as part of an initiative of the Gillard Government in power at the time. The products were developed to give customers access to a range of easily comparable and relatively simple products. They are also expected to create more competition within the industry and ultimately lower the cost of administration. As MySuper products are relatively new, there was no useful historical data to refer to. However, the focus on this group going forward is consistent with the Government policy to encourage superannuation investors into a single fund product.

The majority of entities have just one MySuper product as restricted by current legislation. As at 30 June 2014, there were 103 entities offering MySuper products. These funds are free to offer an unlimited number of other superannuation products, although they are required to meet legislative requirements.

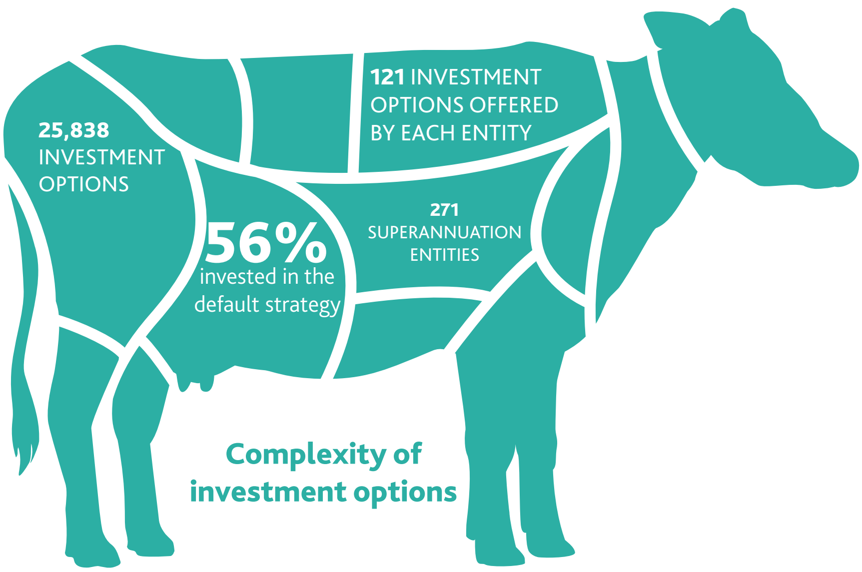
To date, MySuper products represent 20% of APRA regulated products.

The Superannuation - complexity of investment options

According to APRA data, there were 271 superannuation entities with four or more members as at 30 June 2013. In total these entities offered 25,838 investment options. This diversity demonstrates a high level of complexity when selecting investment options.

The average number of investment options offered by entities was 121, with a median of nine. At the upper extreme, one entity offered 2899 investment options. It is noted that, on average, 56% of the invested assets are in the default strategy.

The sample for the distribution of the questionnaire is based on the APRA List of Authorised MySuper products. There are 95 unique entities on this list offering 118 MySuper products. Questionnaires were sent to the 95 entities.



SURVEY RESULTS

Summary Statistics

Table 1 Total Amount Invested in Assets by Superannuation Funds as at 30 June 2014

	Amounts invested in Assets by all appraised MySuper products	Amounts invested in Assets by funds who returned the questionnaire - MySuper Products	Amounts invested in Assets by funds who returned the questionnaire - Choice Superannuation Products	Amounts invested in Assets by funds who returned the questionnaire - Defined Benefits Superannuation Products	Total invested across all products by respondents	Total invested across all products for all APRA funds
	$ mill	$ mill	$ mill	$ mill		
Total Investment in Assets	364,690.30	102,769 (28% of APRA MySuper)	135,609	36,446	274,824 (22% of APRA, all products)	1,232,724
Average	3,171.20	9,343	12,328	9,111		
Maximum	55,160.9	24,491	73,000	16,389		
Minimum	1.0	857	11	2,900		
Median	635.7	5,400	4,100	8,578		
Number of cases	114	11	10	4		

This table provides a summary of statistics for funds who returned the questionnaire and summaries for APRA Products. Where the data is gathered from the questionnaire the relevant question is noted. Figures are separated for MySuper, Choice and Defined Benefit Products where available.

APRA Statistics

- Data relating to assets under management for the targeted group of 114 products is provided in the APRA report: Interim Quarterly MySuper Statistics, issued November 2014
- Total investment in assets by MySuper products at 30 June 2014 was $364 billion, compared to $1.232 trillion invested by all superannuation funds (MySuper products inclusive) regulated by APRA
- Approximately 30% of superannuation assets are in MySuper. It is worth noting that only 40% of entities offer a MySuper product. Both these figures are expected to dramatically increase within the next two years, as funds are required to transfer their members who are in the default option to MySuper products by 1 July 2017. Total investments under the default strategy, as at 30 June 2013, were $411 billion or 44% of all investments.

Survey Information

- In terms of assets under management, our sample represents 28% of all MySuper products and 22% of all products.
- Seven of our respondents are in the top 20 of the MySuper products. The top 20 (10) funds have $291 ($242) billion invested in assets, representing 79% (67%) of total investment in assets by MySuper products.

OUR SAMPLE REPRESENTS 28% OF ALL MYSUPER PRODUCTS AND 22% OF ALL PRODUCTS.

TABLE 2 Summary Survey Results for MySuper funds

	% invested directly (indirectly)	% invested in Australian Agriculture	% of agriculture invested directly (indirectly)	% invested in overseas agriculture	% Target allocation for agriculture investments
Average	14(86)	0.30	7.38(92.36)	0.35	1.27
Maximum	50(100)	1.00	59(100)	1.00	2.00
Minimum	0(50)	0.00	0(41)	0.00	0.54
Median	4(96)	0.15	0(100)	0.05	1.27

TABLE 3 Choice Funds Percentage Invested in the Australian and Foreign Agricultural Sector

	% invested in Australian (Foreign) Agriculture For Choice funds 2014	% invested in Australian (Foreign) Agriculture For Choice funds 2013	% invested in Australian (Foreign) Agriculture For Choice funds 2012
Average	0.37 (0.4)	0.25 (0.32)	0.26 (0.33)
Maximum	1.00 (1)	1.00 (1)	1.00 (1)
Minimum	0 (0)	0 (0)	0 (0)
Median	0.30 (0.49)	0.15 (0.28)	0.19 (0.28)

Summary statistics relating to the MySuper product responses are provided in Table 2. Responses in relation to Choice are very similar to MySuper products so have not been included. Where the responses were different for Choice, we have summarised the results in Table 3.

As noted in the table above, the majority of the funds under management are managed indirectly with three of the funds outsourcing 100% of their asset management.

Based on our sample, on average **only** 0.3% is invested in the agriculture sector with the 1% being the maximum investment level.

- If we apply this latter percentage to total MySuper funds under management, it would equate to about $3.6 billion. This figure is an '**upper bound**' on the exposure of these funds to agriculture. A number of funds advised they would not complete the questionnaire, because they have zero investment in agriculture or because they invest only to the extent that this asset class belongs to their benchmark index. The ASX 200 index included four companies that could be classified as agriculture. These companies represent 0.44% of the total index, which represents another upper bound in terms of 'passive' exposure to agriculture (i.e. 100% in the index)
- The amount invested by the MySuper respondents in overseas agriculture is 0.35%, very close to the Australian investment. The **maximum** target asset allocation amongst these funds is 2%
- When comparing MySuper to Choice Products, there were very few differences in responses. Based on the sample, the result suggests that the MySuper products have similar characteristics to the Choice products with respect to our area of interest.
- Key comparisons between MySuper and Choice funds were:
  - Nine of the 11 responding funds adopted the same percentage of direct vs indirect investment. Four funds had different percentages invested in Australian (foreign) agriculture, and these percentages were slightly higher for the choice funds
  - Only one fund had a different target allocation for agriculture investment and this was 0.08% higher for Choice funds.

The percentage of funds invested in Australian agriculture by Australian fund managers is very low – indeed, on average less than 1% of invested assets.

SURVEY RESULTS CONT

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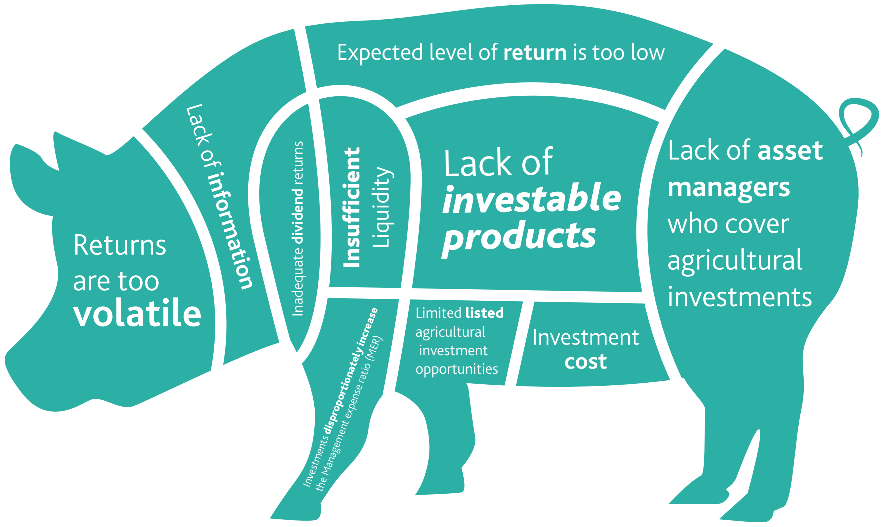
TABLE 4 Reasons as to why Funds do not Invest in the Agricultural Sector.

Statement	Average response on scale of 1-7 where 1 is strongly disagree and 7 is strongly agree
The expected level of **return** is too low	4.4
There is a lack of **asset managers** who cover agricultural investments	5.4
There is a lack of **information** regarding investment in the industry	4.8
There is a lack of **investable products**	5.7
Our superannuation fund takes a **short term** return focus while agricultural investments require a **long term** return focus	1.9
These investments do not provide a sufficient level of **liquidity** for the fund	3.9
Agricultural returns are too **volatile**	4.6
There are limited **listed** agricultural investment opportunities	5
Agricultural investments do not provide adequate **dividend** returns	3.8
The **average** rates of return is too low	4
The initial investment **cost** is too high	4.2
Agricultural investments disproportionately increase the Management expense ratio **(MER)**	4.9

Why are funds *not* investing?



OBSERVATIONS

Our survey respondents gave us some great insight into the reluctance superannuation funds have towards investing in Australian agriculture. Although the sector is very promising and could provide an attractive option to fund managers, there are a number of reasons why investment levels remain low.

Potential reasons for a 'bias' against investment in the agricultural sector.
The questionnaire also included a series of statements or observations, identified as possible reasons for managers to avoid agricultural exposure in their portfolios. A summary of results are presented in Table 4.

- The most important reasons noted are the lack of investable products and the lack of asset managers
- Notably, the short-term versus long-term focus is not perceived to be a highly relevant consideration for having low investment in agriculture. One interpretation of the response to this statement is that superannuation funds do not have an overly short-term focus
- Rates of return, cost of investment and volatility are also very relevant, although secondary to the investment opportunities provided by the Australian agriculture
- Liquidity is relevant but less so than other reasons.

Anecdotal information was also gathered from the comments provided by managers in the survey and by informal telephone conversation. Table 4 presents extracts from the comments.

The observations that matter
Important observations from our research included:

- The agriculture industry is not a focus of asset consultants
- There are no institutional offerings or products available that allow a ready investment for fund managers.
- Funds have limited budgets in their active management
- The cost of exploring agricultural investments, by individual funds, would exceed these budgets.

Given that the funds do not conduct industry research on the sector, it is not surprising that the perception of agricultural investments is that they are illiquid, volatile and do not provide the required risk/return relation.

However, one comment which does demonstrate the potential value of investment in agriculture is:

> *"The agricultural sector is a highly inefficient, mostly fragmented market with low liquidity and a need for active management. These conditions have historically presented the best opportunities to extract value add."*

SUMMARY

Our findings highlighted a number of key insights that included:

- Companies have a number of options if they're looking to attract investment and raise capital
- Foreign direct investment in agriculture has traditionally been quite strong in Australia. This is ultimately beneficial for the sector and economy as a whole, assuming it's the right investors and an appropriate arrangement.

International investors taking the opportunities on offer
According to our research on superannuation investment in Australian agriculture, foreign investors are more likely to purchase agricultural assets than domestic counterparts. This means these local assets may be an unrealised opportunity for capital. As this research showed, only 0.3% of MySuper assets are investing in the sector, mostly because fund managers are unfamiliar with industry and see limited options for purchases.

FOREIGN INVESTORS ARE MORE LIKELY TO PURCHASE AGRICULTURAL ASSETS THAN DOMESTIC COUNTERPARTS, WHICH MEANS THESE LOCAL ASSETS MAY BE AN UNREALISED OPPORTUNITY FOR CAPITAL.

Changing perceptions is key to viability
To raise capital, particularly from domestic sources, agricultural enterprises need to focus on ways to make their companies more visible and appealing to fund managers. This can be done in a number of ways:

- Every enterprise is different. Companies should work with food and agribusiness advisors to develop tailored investment proposals.
- Companies could evaluate other strategies to attract interest. For instance, listing on the Australian Stock Exchange. This may prove ideal for some enterprises as fund managers identified the lack of listed assets as a primary reason for not investing in agriculture.

Success dependant on effective business strategy
The Australian agriculture sector is dynamic and constantly evolving. It provides an exciting investment opportunity for superannuation fund investment if companies deliver proven value.

For agricultural companies to successfully invite potential superannuation fund investment, careful and robust strategic plans must be designed, implemented and executed. Demonstrating value to superannuation fund managers is vital and each company must assess how these exciting opportunities fit within their own business strategy.

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