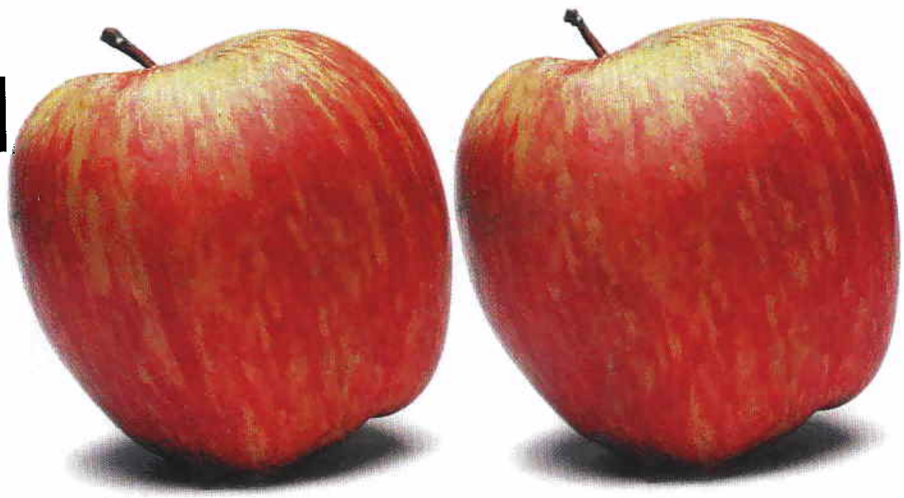


F OO D

AS THE MINING FRENZY BEGINS TO TAPER OFF, THE MOST FUNDAMENTAL OF COMMODITIES IS BEING TIPPED AS THE NEXT GLOBAL BOOM SECTOR BY SOME ASTUTE INVESTORS.

STORY • TIM TREADGOLD

FORTY YEARS AGO, Jim Slater re-wrote the investment handbook when he helped create the world's most successful asset-stripping takeover specialist of the 1960s, an investment bank called Slater Walker. He's doing it again. But this time the opportunity spotted by Slater to make another fortune is open to everyone.

Soft commodities, an asset class that includes everything from wheat to farmland, is replacing "hard" commodities such as minerals and metals as the next hot sector, according to Slater, who is based in London. Other professionals can see the same trend, including those of Deutsche Bank and Macquarie Bank, which have set up specialist investment funds to accommodate demand.

Slater is one step ahead of the pack – as he was in the '60s – although he is finding it more difficult than expected to put his money where his mouth is. Two months ago, in the first signs of a remarkable change of direction, Galahad Gold, a company in which Slater is a large shareholder and deputy chairman, announced the sale of its entire mineral assets accumulated over its four years listed on the London Stock Exchange.

The estimated $400 million in spare cash liberated from exiting the mining sector was to be redirected into soft commodities, especially grains such as wheat and corn, and high-quality farmland because of its scarcity.

"In the view of the board, the macro-economic indicators for the market in soft commodities, including grain and corn, have similarities to those of gold and copper when Galahad first invested in the mining sector [in 2003]," Galahad said in a statement in August. "The Galahad board believes that investing in farmland and related assets could be an attractive way to take advantage of the expected increase in the price of soft commodities."

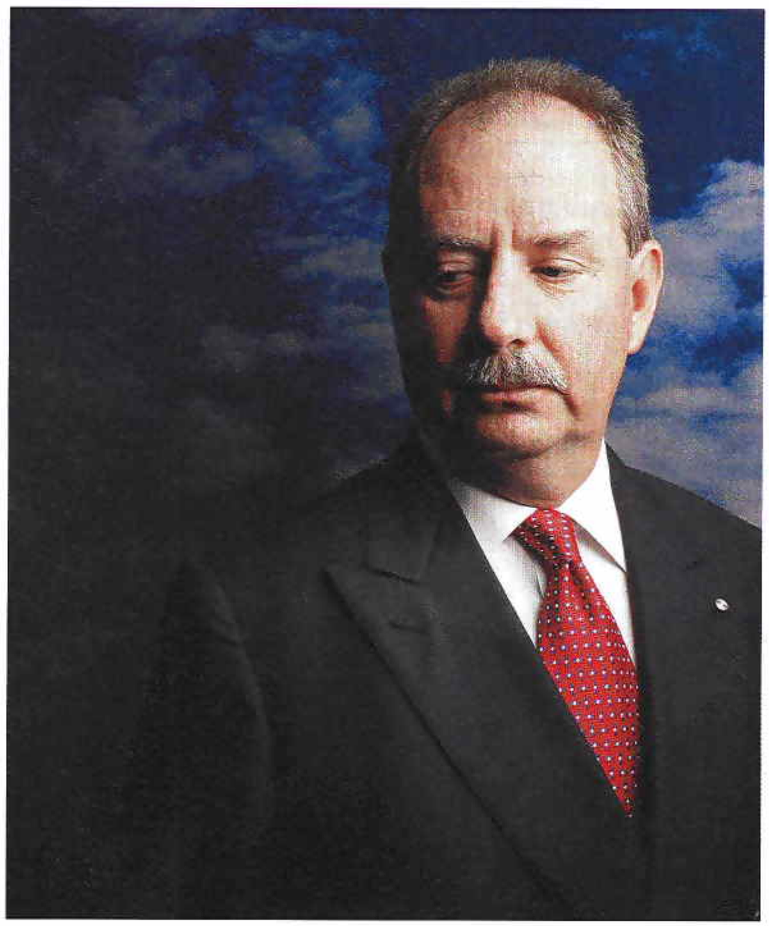
Nothing underlines that point more than the price of wheat which, partly because of drought in Australia, has hit an all-time high on world markets of more than $US9 ($9.75) bushel. It's a similar, but less exaggerated, story with corn, palm oil, sugar, beef and dairy products which are being pushed higher by the same forces that drove copper, nickel, iron ore and other mineral assets to record highs – Chinese demand.

Despite its desire to make a clean switch from mines to farms, Galahad has been caught by United Kingdom regulatory and legal rules which will now force it to liquidate its mining assets and return money to shareholders, complete with a handsome dividend because Galahad has been a very successful mining investor. Its annualised rate of return in the four years to August was 68.9 per cent, largely from trading in mineral assets rather than producing much.

Walking away from an investment track record the envy of most fund managers is not easy. But that's just what Galahad is doing because it believes that the price cycle for minerals has peaked and now is the time to rotate into the next asset class likely to outperform – the so-called "softs".

What is likely to happen, given the company's remarkable annual return, is that Galahad shareholders will take back their cash and follow the same management team into future "soft" commodity investments because of a widespread belief that switching from mining to agriculture remains a valid investment thesis, with China at its heart.

BOOM



Don Mackay: 'The real driver is increased wealth in the region. It's wealth that delivers the change'

Chinese consumers, comfortably settled into their new apartments in giant cities such as Shanghai, have acquired the metal-rich consumer items they need, such as air-conditioners, refrigerators and cars. They are now spending heavily on higher-quality food and clothing.

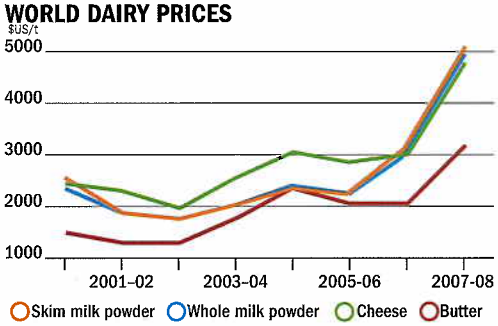
"There is a trend of rising red meat consumption emerging in China and other Asian countries," the chief executive of beef producer Australian Agricultural Company, Don Mackay, says. "It's partly changing eating habits, but the real driver is increased wealth in the region. It's wealth that delivers the change."

Futuris, with 48 per cent ownership of AA Co, has picked this moment to put its stake up for sale. The agricultural company, one of Australia's oldest, farms 630,000 cattle on 26 stations covering 8 million hectares of northern Australia, or 1 per cent of Australia's land mass. The cattle operation, Futuris believes, may be under-recognised in its portfolio.

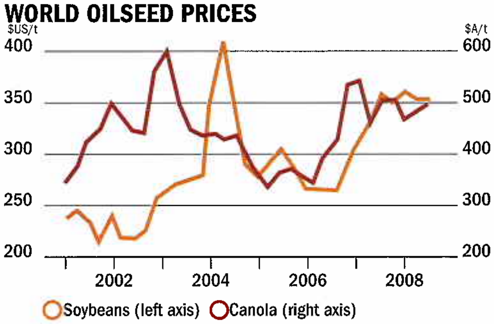
However, it is likely that the offer could draw a premium price or even a full offer from international agri-giants such as Manila-based San Miguel or Conagra, which know that such plum assets do not come on the market very often. AMP's Stanhope Pastoral Company was the last big sale of properties in 2003.

The investment value in AA Co is exactly what Galahad Gold is nominating for its own future direction: quality farmland, focused on northern

WORLD DAIRY PRICES



WORLD OILSEED PRICES



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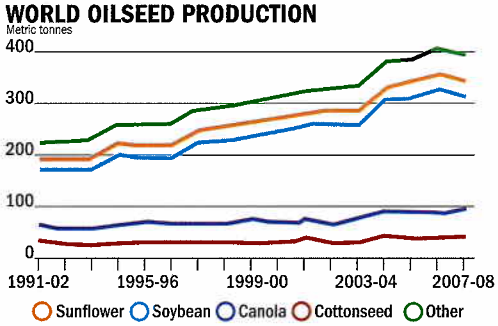
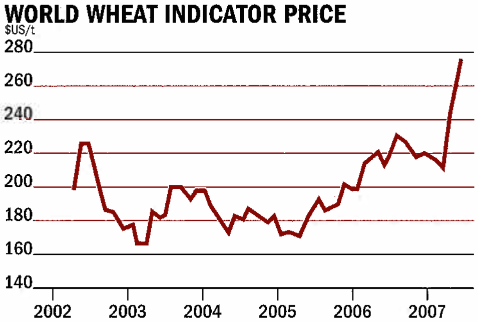
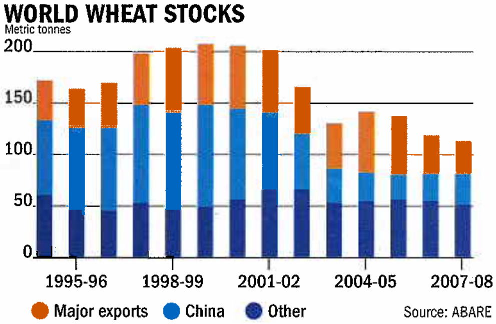


WORLD WHEAT INDICATOR PRICE



WORLD WHEAT STOCKS



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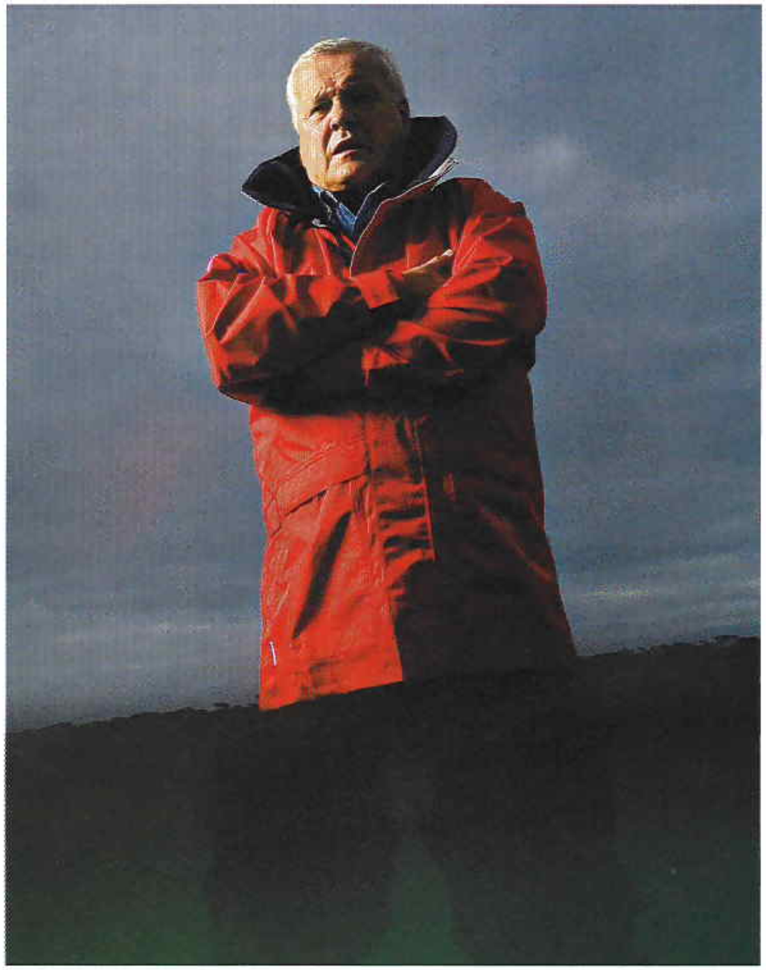


Hagen Stehr: 'Our biggest issue today is we haven't got enough fish to satisfy the market'

Australia where rain is now more plentiful than in the drought-stricken south-east.

"Land is the key to our business," Mackay says. "If you say to yourself where can you grow food that is clean, healthy and delivered in a consistent way then there aren't many countries that you can name, and Australia is one of them."

Mackay could have been reading from the original Galahad spiel about rotating out of minerals into soft commodities. "Productive farmland that can be developed efficiently is a scarce resource and we believe that prices have the potential to continue rising over a period of several years," he says.

Another emerging winner from the hunt for high-quality Australian foods is the Adelaide company Clean Seas Tuna, a freshly floated business that specialises in fish breeding and the pursuit of the richest prize in the ocean, southern bluefin tuna.

"Our biggest issue today is we haven't got enough fish to satisfy the market," the chairman of Clean Seas, Hagen Stehr, says. "We've started the business with kingfish, mulloway is second and tuna to follow as the propagation project."

Stehr, who has won fame and fortune as one of South Australia's Port Lincoln "tuna kings" through ownership of quota to catch (and fatten) wild tuna caught in the Southern Ocean, has invested a large chunk of his private fortune in trying to unlock the secrets of the southern bluefin breeding cycle.

That job, which has passed a number of important milestones, is now being undertaken by Clean Seas in its research centre at Arno Bay near Port Lincoln. If successful, Clean Seas will effectively have a perpetual source of tuna for the fish-hungry Japanese market where premium-quality bluefin can fetch $70 a kilo.

The challenge, as will quickly be discovered, is that agricultural investment brings its own risks.

4 Reasons why 'soft' may beat 'hard'

1. Investors believe that soft commodities – food, fibre and farmland to produce it – are heading for the same lucrative supply-demand pinch that hard mineral commodities have just gone through.
2. China is predictably the motivator as consumers will follow spending on hard goods with better diets and clothing.
3. Years of investor neglect have seen the number of Australian rural stocks decline.
4. Rural stocks face risks of their own, including drought, disease and the ability of producers to react to shortages faster.

Soft options

If Jim Slater is having trouble achieving his goal of quitting the mining industry and investing in agriculture then so will everyone else – although for somewhat different reasons. Slater's challenge is clearing legal and regulatory hurdles. Australian investors should not have that problem, but they will find that agriculture offers far less choice than mining, and a number of companies have severe problems caused by the drought, which has slashed farm-related profits.

On choice, it is worth looking at how the minerals boom has flooded the Australian Securities Exchange with new floats and delivered big profits to companies in production. A rough count of listings on the Australian Securities Exchange shows about 600 companies in the mining or "hard" commodity business.

The hunt for "soft" exposure is much more difficult because there are only about 60 companies, mainly under the headings of food, beverage and tobacco or paper and forest products.

If lack of choice in the soft sector stands out as the first obstacle to obtaining exposure, then size – which also implies the depth of the market – is the second. The top 100 ASX-listed companies include 17 mining and oil members, led by BHP Billiton, Rio Tinto, Woodside, Newcrest, Zinifex, Alumina and Oxiana.

Only three agriculture-related companies make the top 100, and getting to that lowly number is stretching the definition of "soft" because the three include the fertiliser maker Incitec Pivot and Wesfarmers, which also makes fertiliser through its CSBP division.

The third possible top 100 "soft" participant is Goodman Fielder, which is best known for its production of packaged foods and groceries. After that it's down into the rump of the market to hunt out smaller companies operating in specialised areas, such as timber, wine and fish.

Years of consolidation and investor neglect has seen the number of listed Australian agricultural companies shrink dramatically. Whereas once you could buy shares in the two great farm trading houses, Elders and Dalgety, now you have to buy their "conglomerate" parents. That's Futuris, in the case of Elders, and AWB, the wheat trader that owns what was once Dalgety but which now encompasses the older farm trading (and namesake arm) of Wesfarmers – and which also includes exposure to drought and remaining legal issues tied to AWB's involvement in Iraq.

Exposure can be found, with an agricultural portfolio including stocks such as:

- **Australian Agricultural Company** (beef and rural land)
- **Clean Seas Tuna** (fish farming)
- **Maryborough Sugar**
- **Warrnambool Cheese** (dairy)
- **AWB** (wheat, rural trading)
- **Gunns** (timber)
- **Namoi Cotton**

They are all good companies, but they are all exposed to "agricultural risk", ranging from drought to floods, and from disease in the fishing sector to oversupplied markets should supply response prove to be quicker than the experts expect. Rotating investment funds out of mining into agriculture is a fine theory but as with all investments, "caveat emptor" – let the buyer beware.

Drought and floods are the obvious first hurdle. But there is also the challenge of finding a home for your money. While mining investments have blossomed in the boom, agricultural opportunities have shrivelled. On the Australian Securities Exchange, there are close to 600 mining and oil stocks, 10 times the number of agricultural stocks.

Time is also a critical factor. Right now, it is easy to see that most mineral prices have hit a peak, or are close. The force that has taken them into record territory is the slow supply response to high demand, especially from China.

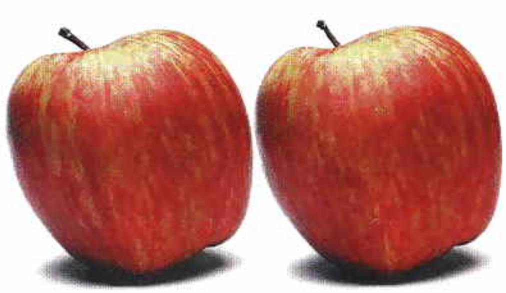
But agriculture may turn out to be different because there are fewer barriers to entry and farmers can respond quicker than a mining company, which invests years in discovering and developing a new mine.

One man who has solved the problem of "soft versus hard" commodities is Richard Elman, chief executive of Hong Kong company Noble Group and one of the last European "taipans" to run a classic Asian trading house that deals in everything from iron ore and coal to soy and sugar.

Elman's view of the world is remarkably simple. He says that China and other Asian countries need more of the basic building blocks of a modern society, and that means someone has to supply them with raw materials. "As the economy of the world improves, as the standard of living improves, so do people improve their diet," he says. "Food is the first thing people spend money on. The second is televisions and refrigerators. The third is a car and maybe the fourth is a house. But, it's food first."

In Australia, Elman is best known as an important player behind small mining companies. Noble Group is a big shareholder in Gloucester Coal and Territory Iron, and the re-emerging producer of vanadium (which is used to harden steel), Precious Metals Australia. Noble also has a life-of-mine marketing contract on the manganese produced at the Woodie Woodie mine of Consolidated Minerals in Western Australia.

'Productive farmland that can be developed efficiently is a scarce resource ... prices have the potential to continue rising over a period of several years'



Elsewhere, Noble is better known for its "soft" operations. It handles 10 per cent of South America's soy exports and crushes 10 per cent of China's soy into consumer-ready products. It's a similar story with sugar in which Noble is expanding its South American interests, either to sell for its traditional use as a sweetener or to European and North American ethanol refiners.

Nonetheless, investment banks sniff the change in the air. Mining remains a fat fee earner, but agriculture, in its many forms, is staging a revival. In July, a Deutsche Bank subsidiary, Tilney Private Wealth Management, expanded its exposure to agriculture.

"We are seeing a classic supply-demand pinch in soft commodities that seems set to get tighter with time as the traditional supply-side responses are unable to keep up," TPWM's chief economist, Peter Bickley, said in a statement. "We are expecting a shift in pricing that will be structural rather than the more usual cyclical event."

Go back five years and only one word in that statement has to be changed to reflect what happened in the mining sector. Swap "hard" for "soft" and you can see how history might well be repeating itself as people such as Jim Slater head for the mining exit and say hello to life on the farm. ●