

BUYING FARM AND RANCH LAND CHEAPLY—REALLY CHEAPLY—THROUGH THE STOCK MARKET
WHEN BAD COUNTRIES HAPPEN TO GOOD COMPANIES

BY

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All stock quotes are as of the close of U.S. Markets 11-14-2014. All currency quoted in U.S. Dollars.
All land measurements are in acres.

“THE BEST TIME TO INVEST IS WHEN THERE IS BLOOD ON THE STREETS—EVEN IF IT’S YOUR OWN.”

Baron Mayer Rothschild, 1874

“THE GAMBLING THAT IS BUSINESS LOOKS WITH AUSTERE DISFAVOR ON THE BUSINESS THAT IS
GAMBLING.” Ambrose Bierce, The Devil’s Dictionary

DISCLAIMER—As with most articles in the financial press, it is important to use your own due diligence before considering an investment in any company. This is particularly true when the companies are Argentine companies, like three of the four companies analyzed here. Given the policies of the last ten years of the populist and ruinous Argentine presidents Nestor and Christina Kirchner, any security of an Argentine company should require more than the usual due diligence. This is not a recommendation to buy any of the four companies—that is for the reader to decide. Neither the blog owner/manager, author, nor editor owns any of the securities discussed here nor do they have any present plans to do so. Any information given is as of the date of publication and may not be applicable or pertinent in the future. The securities discussed here do not represent a diversified portfolio nor are they intended to.

NOTE REGARDING STRANGE SECURITIES—Past readers to the “Strange Securities, Bizarre Bonds, and Uncommon Commodities” Blog have read about investing in rhodium—a commodity that trades little—and Wimbledon Debentures--that trade at less than a glacial pace. The four companies (one holding company, three subsidiaries) discussed in this article all trade on either the New York Stock Exchange or NASDAQ. There is seemingly little about them that is unusual *per se*. What *is* unusual is the attempt to value the agricultural land of the holding company by deducting the value of its partial ownership of one of its subsidiaries while adding in a portion of the agricultural land of another subsidiary. The resulting values are approximate but compelling.

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I. THE PRIMARY PURPOSE OF THIS ARTICLE

The primary purpose of this article is to compare the approximate value that the stock market gives to farm and ranch land owned by a NASDAQ-listed Argentine company (Cresud) with comparable U.S. farm and ranch land.

II. WHAT THIS ARTICLE IS *NOT* ABOUT

This is not an article on Argentine macro-economic policies nor is it an article on Argentine politics. There is limited discussion (mostly in Section VI, "Additional Factors . . .") on the effect of the Kirchner presidencies (2001-current) on the Argentine economy. Fortunately, the Kirchner's effect is ending soon. Christina Kirchner's presidency has to end at the conclusion of her second term in November, 2015. There may be those who think that there cannot be a meaningful examination of individual Argentine companies without discussing "the big picture". There are hundreds of articles in the financial press about the Argentine economy that any investor can read. Our focus in this article is unapologetically narrow and it is mainly on a single company. There can be no doubt that Argentine politics and the Argentine macro-economic environment have negatively affected this company's valuation. We think it is better for this "Strange Securities . . ." blog to focus on the bizarre, somewhat hidden, pricing of agricultural land held by one company unknown to most American investors.

III. SUMMARY

This article has three objectives. The first objective is to introduce the reader to four inter-related companies. All four actively trade on either the New York Stock Exchange or the NASDAQ. Two are agricultural companies and two are commercial real estate companies. Three are Argentine companies and one is Brazilian. One of the four, Cresud (symbol "Cresy"), is both an agricultural

operating company and it is also the holding company for the other three companies. All four could appeal to both value investors (oversimplifying, an investor primarily interested in companies with undervalued assets) and growth investors (investors primarily interested in high growth in assets, sales, profits, or any combination of them).

The second objective is the primary purpose of this article. It is to determine an approximate value that the stock market places on the agricultural land of the holding company, Cresud. Determining this will be done by deducting the value of Cresud's 65.45% holding in its non-agricultural, commercial real estate subsidiary, IRSA (IRS), from Cresud's market value. This will create a "stub" stock that represents the value of Cresud's agricultural land. Three values for Cresud's land will be computed. There will be per acre values for its total acres, its production acres (grazing and crop land), and its crop acres. Values for the three types of acres will be computed on the basis of "adjusted" enterprise value. "Enterprise value" is equal to market value (the number of common shares outstanding times the price of the shares) plus net debt (debt minus cash or cash-like assets). "Adjusted enterprise value" is enterprise value minus the value of Cresud's 65.45% ownership of IRSA. Adjusted enterprise value gives a truer per acre value than market value because it takes into account a company's debt. Cresud has substantial debt and much of it is denominated in U.S. dollars. This is important given the decline in the value of the Argentine peso versus the U.S. dollar. We do, however, believe that, given Cresud's substantial assets and the fact that the agricultural commodities that Cresud sells are priced in U.S. dollars, this debt can be dealt with effectively.

Additional factors that can affect the value of Cresud's land other than the number and type of acres (e.g., management, growth, the value of the Argentine peso versus the U.S. dollar) will be briefly discussed.

The third objective is to examine the value of U.S. agricultural land that is comparable to Cresud's land. The differences between the two are so substantial that an investor who wants to invest in land might find that investing in agricultural land via the stock market makes more sense than direct investment in U.S. farms and ranches. This may be especially true since American agricultural land has risen so much in recent years, perhaps to bubble proportions.

IV. FOUR INTERRELATED COMPANIES: CRESUD, IRSA, ALTO PALERMO, AND BRASILAGRO

The first objective of this paper is to present a group of four inter-related companies that are well-managed and loaded with commercial real estate or agricultural assets. Three of the companies are in Argentina and one is in Brazil. All four are publicly-traded in the U.S. Two are agricultural companies, Cresud and BrasilAgro (LND), and two are commercial real estate companies, IRSA and Alto Palermo (APSA). Cresud is the holding company for the other three. Cresud owns 65.45% of IRSA, which in turn owns 94.9% of Alto Palermo. Cresud also owns 37.5% of BrasilAgro.

In addition, Cresud is an operating company that owns outright nearly 2,300,000 acres of farm, ranch, or currently undeveloped land. It also owns the right to 326,172 acres that are under 35 year concessions and 112,000 acres (56,000 acres counted—see Section VI B (2) for the enormous increase in Cresud's leased land) that are under one to three year leases. 37.5% of BrasilAgro's 702,107 total

acres, or 263,290 acres, should also be counted among Cresud's acres. It has a total of almost 2,700,000 acres. For those who are acre-size challenged, 1,600,000 of them are nearly the same size as New Hampshire, Vermont, and Connecticut combined.

IRSA is, like Cresud, both a holding company and an operating company. In addition to owning 94.9% of Alto Palermo, which owns ten shopping centers in Argentina, IRSA also owns 29.99% of Banco Hipotecario (HIPO.BA), Argentina's largest mortgage bank.

As an operating company, IRSA owns a large portfolio of world-class real estate. It owns eleven office buildings; seven of them are over twenty stories. One is the thirty-six story 153 Third Building in Manhattan, better known as the "Lipstick Building" for its shape and for its partial red granite exterior. Three floors of it were infamously known as the headquarters of Bernard L. Madoff Investment Securities ("Where your money goes to vanish"). It owns 50-80% of three five star hotels. It also owns substantial residential properties in upscale areas of greater Buenos Aires

IRSA's holdings in publicly-traded companies nearly exceed its market value (but not its enterprise value). As of September 19, 2014 the value of its holdings were:

Alto Palermo's market value was		\$653,080,000
IRSA'S 94.9% OWNERSHIP OF ALTO PALERMO	=	\$619,704,590
Banco Hipotecario's Market Value was		\$650,760,550
IRSA's 29.99% of Banco Hipotecario	=	\$195,163,080
VALUE OF IRSA'S HOLDINGS OF THE TWO	=	\$814,867,670
MARKET VALUE OF IRSA ON 9-19-14	=	\$861,370,000
<u>(IMPLIED) MARKET VALUE OF IRA'S REAL ESTATE</u>	=	\$861,370,000 - \$814,867,670
	=	<u>\$46,502,330</u>

Value of IRSA's 75% interest in one building it owned,

(through 8-2014) Madison 183 in Manhattan =

\$185,000,000 * 75% = \$138,750,000

C. Alto Palermo is 94.9% owned by IRSA. It owns ten shopping centers in Buenos Aires, its suburbs, and major provincial cities. It has high operational cash flow, low debt, and pays high dividends. In addition to owning and operating shopping centers, it also develops real estate in areas adjacent to them.

D. BrasilAgro owns and operates farms and ranches in Brazil. It is noted for being nearly debt-free, having high growth, a high percentage of its total land of 702,107 acres as crop land, and an inability to make money. High growth companies like BrasilAgro frequently don't make money at first since they are plowing (Sorry Mike, Michelle. Couldn't resist) money back into expanding the business.

V. GIVING AN APPROXIMATE VALUE THAT THE STOCK MARKET ASSIGNS TO CRESUD'S ACRES

The primary purpose of this article is to give approximate values to Cresud's agricultural land and then, in Part VII, to compare those values to comparable U.S. land. Such an exercise is both hypothetical and approximate. For example, it doesn't take into account any possible tax consequences of such a sale nor the fact that the executive officers and board of directors of Cresud, IRSA, and Alto Palermo are identical. Also, many investors may own Cresud as much for IRSA's substantial commercial real estate portfolio as for Cresud's agricultural land. Nevertheless, the land values produced by such an attempt are extremely compelling compared to similar agricultural land in the United States.

The steps used to value Cresud's land are:

1. Determine Cresud's enterprise value.
2. Determine Cresud's adjusted enterprise value by deducting Irsa's market value from Cresud's enterprise value.
3. Determine Cresud's total acres, its productive acres (grazing and crop land), and its crop acres.
4. Determine the per acre value of each type of land by dividing the adjusted enterprise value by those types of land.

Step 1: Determining Cresud's enterprise value. Cresud's enterprise value is its market value (number of common shares times the price of the shares) + net debt (debt – cash or cash-like assets). Cresud's market value is \$561,700,000. Its enterprise value is \$1,260,000,000.

Step 2: Determining Cresud's adjusted enterprise value. Cresud's adjusted enterprise value is \$1,260,000,000 - \$618,502,500 (Cresud's 65.45% ownership of IRSA's market value of \$945,000,000) = \$641,498,000.

Step 3: The number of Cresud's acres by type are:

<u>Total acres:</u> A. Land owned outright by Cresud	=	2,367,515 Acres
B. Cresud's 37.5% ownership of BrasilAgro's 702,107 acres	=	263,290 Acres
C. One half of Cresud's Leased land 112,270 x .5	=	<u>56,135 Acres</u>
<u>Cresud's Total Acres</u>	=	<u>2,686,940 Acres</u>
<u>Productive Acres</u> A. Productive acres owned by Cresud	=	993,342 Acres

B. Cresud's 37.5% of BrasilAgro's 247,841 productive acres = 92,940 Acres

Cresud's Productive Acres = 1,086,282 Productive Acres

Planted, or Crop, Acres A. Crop acres owned by Cresud = 509,026

B. Cresud's 37.5% of BrasilAgro's 197,680 Crop Acres = 74,130

Cresud's Crop Acres 583,156 Crop Acres

Step 4: Determine per acre prices by dividing adjusted enterprise value by type of acre

A. Price per total acre: = $\frac{\$641,498,000}{2,686,940 \text{ Acres}}$ = \$238.74 per total acre

B. Per productive (grazing and crop land acre) = \$590.54 per productive acre

C. Per crop (or planted) acre: = $\frac{\$641,498,000}{583,156 \text{ Acres}}$
= \$1,100.05 per crop acre

It is important to note that the price per crop acre gives no value to Cresud's 503,126 grazing acres or 1,600,658 reserve (currently undeveloped) acres. The price per productive acre gives no value to Cresud's reserve acres. None of the types of acres give any value to other factors affecting the value of the company's land (e.g., 68,000 head of beef cattle. See next section for a discussion of some of these factors).

VI. ADDITIONAL FACTORS AFFECTING THE VALUE OF CRESUD'S LAND

There are many factors beside the number and type of acres owned by Cresud that affect its value. Although we believe that the positive factors outweigh the negative ones there are, nevertheless, three major negative factors affecting Cresud.

A. Negative factors

1. Thirteen years of the economic policies of the populist presidents Christina Kirchner and her predecessor/deceased husband, Nestor. The Kirchner presidents have seen two sovereign bond defaults that have ended Argentina's desperately needed access to international credit markets. Official statistics have been so unreliable that the International Monetary Fund (the IMF) censured Argentina for its statistics. The only other time this happened was in 1954 when communist Czechoslovakia was censured.

2. An unofficial annual inflation rate of 41%, which is widely considered to be more accurate than the official rate of about 20%. Since wages are a major cost input of agricultural

producers, rapidly escalating wages to meet inflation increases are a negative for agricultural producers. (But see “6” under “Positive Factors” below for a discussion of agricultural land as an inflation hedge).

3. The Argentine peso has declined significantly against the U.S. dollar. The official Argentine peso/U.S. \$ rate was 4.60 pesos to the U.S. dollar in late 2012. It is 8.77 to the U.S. dollar now. The black market rate is about fourteen pesos. This makes any imports such as equipment or parts more expensive. It contributes to the flight of capital as Argentines trade out of the peso to “harder” currencies (usually the U.S. dollar) to avoid ongoing declines in the peso’s purchasing power. (This is a great deal harder than it sounds. There are strict controls on the removal of hard currencies from Argentina, including dogs that can sniff out Argentine travelers with hidden extra dollars or euros beyond the limited amount allowed for international travel. The dogs are trained to smell the inks used in dollars and euros.) Cresud must now earn 1.91 times as many pesos as it did in 2012 to be able to pay off one dollar of U.S. debt. (But see “6B” under “Positive Factors” about the ameliorating fact that agricultural commodities are priced in U.S. dollars). The peso’s decline directly affects Cresud negatively since much of Cresud’s debt is U.S. dollar debt.

B. Positive factors

1, 2, and 3—Huge increases in:

1. “Reserve” land converted to production. Both Cresud and BrasilAgro have huge undeveloped reserves of land. Cresud defines reserves as:

Most of Cresud’s land reserves are located in marginal areas where agricultural and livestock activities are not fully developed. The company believes in the improvement of the productivity of such lands and the increase of their value in the long term.

Cresud has as one of the two cornerstones of the corporation “The acquisition, transformation, and sale of farmland.” Since 1994, Cresud has transformed 333,585 reserve acres into productive use. It converted 38,999 acres into production in the 2014 fiscal year. BrasilAgro has converted 247,841 acres into developed land since its inception in 2007.

2. Acres owned or controlled. In 1994, Cresud owned 50,070 acres and leased 1,819 acres. In 2013, Cresud owned 2,367,515 acres and leased 112,270 acres—or, a 47.28 *times* increase in owned land and a 61.72 *times* increase in leased land.

3. Profits on the sale of land. Whether the 32 farms and ranches that Cresud has sold since its inception were purchased or were created from reserves, Cresud has sold them for an average gain of over 200 percent.

4. Cresud owns substantial agricultural assets in addition to land. Cresud owns over 68,000 beef cattle, 15,000 sheep, 2,400 dairy cattle, and over 99,000 tons of storage capacity.

5. Because of urban expansion, some of Cresud's early farms that it still owns are now partially being sold for commercial development. In 2013, Cresud sold part of one farm for \$2.40 per square meter. At that price, an acre is worth almost exactly \$10,000.

6A. Agricultural land is an effective inflation hedge. "While having a low correlation to traditional investments, farmland has a high positive correlation to inflation—this appears to hold true in most jurisdictions . . . U.S. research shows a correlation of positive .54 between U.S. farmland and the Consumer Price Index (CPI). Farmland's correlation to CPI significantly exceeds that of stocks, bonds and non-farm real estate."

6B. Argentine agricultural land is a hedge against the peso's decline. Argentine farmers and ranchers are less exposed to the decline in the peso because agricultural commodities are priced in U.S. dollars. If the value of the peso declines against the dollar, farmers and ranchers may get paid in pesos but the number they receive goes up. Most Argentines would love to have this option.

7. Argentina is the cheapest place in the world to grow soybeans. It has relatively low cost labor and good infrastructure for transferring the beans to the primary market, China. Soybeans are Argentina's largest dollar value export. Cresud is the second largest soybean grower in the world. Because of these facts, Cresud has signed Joint venture agreements with (primarily) Chinese companies to look for promising farms for the foreign companies to buy and Cresud to manage.

8. It is too common for a company's management to be described in glowing terms (e.g., "world class management") shortly before the managers are led to jail or the company goes bankrupt because of massive fraud or mismanagement. The management of Cresud, IRSA, and APSA know how to run their businesses well. They have been doing so for decades. IRSA has been able to achieve 95%+ occupancy of its buildings despite the fact that it ties rent increases to the performance of the U.S. dollar, not the Argentine peso. APSA has had 95% occupancy in a difficult retail environment. That Cresud was able to grow the number of their farms and ranches from seven to 32 in twenty years is impressive. That they did so while selling 33 farms in the same time period is, well, world class.

9. Investing in Cresud provides a level of diversification that very few other companies can provide. The value of diversifying investments used to be considered one of the most important precepts in investing. It was (and to a considerable extent still is) thought that by being diversified an investor would have some investments go up while others went down or, at the very least, not go up or down as much. Unfortunately, in the 2008-09 meltdown virtually all asset classes went down with a high degree of correlation (similarity of movement). While the correlation of asset classes has diverged more since 2008-09, they are still moving more closely than has historically been the case. Things can, however, change quickly in investing. Diversification may not be considered to be quite as important as it once was but it is still intuitively best not to have all your eggs in one basket.

For an investor seeking diversification, it would be hard to imagine many companies that would better serve that purpose than Cresud. By investing in Cresud, an investor diversifies into:

- A. Cresud and the three other companies in Cresud's holding company.
- B. Vast holdings of agricultural land.
- C. Significant commercial real estate, primarily through IRSA. Office buildings are a substantial part of the property portfolio but so are retail (Alto Palermo) and residential commercial real estate.
- D. Geographic exposure. Cresud or its subsidiaries have holdings in five South American countries, the United States, and Israel.
- E. Exposure to emerging markets. Most of Cresud's holdings are in Brazil and Argentina.

VII. U.S. FARM AND RANCH LAND PRICES COMPARED TO CRESUD'S

The value of Cresud's agricultural land becomes more apparent when examining comparable U.S. land. Fortunately, there are detailed records of U.S. farm and ranch sales available from both government agencies and the private sector.

There has been a substantial increase in the value of U.S. farm and ranch land in recent years. The increase has been so significant that some experts think that agricultural land prices have reached "bubble" proportions where the price of land makes a reasonable return on investment unlikely. Whether this is based on the current popularity of "alternative investments" among money managers, the higher commodity prices that have prevailed until recently, or the relatively good financial condition of the dominant buyers of farm and ranch land—namely, existing farmers and ranchers—is a source of speculation. What is certain is that U.S. agricultural land prices have greatly increased in recent years until finally leveling off in 2014. The 2014 level probably reflects declining commodity prices after two years of good crops.

According to the University of Missouri Extension, the price of Iowa and Nebraska farmland nearly quadrupled in the 2004-2014 decade. Farm Credit Services is a cooperative that is a leading lender to farmers and ranchers in Iowa, Nebraska, South Dakota, and Wyoming. It publishes an annual report on agricultural land prices in the four states it serves. Significantly, the prices reported are based on actual agricultural real estate sales; not on subjective estimates. The 2013 report is based on over 3,500 sales. The average price of Iowa farm land was \$9,800 an acre, down slightly from average prices earlier in the year of \$10,100 an acre. Premium farm land in Iowa went for \$12,000 to \$17,000 an acre. Nebraska dry (unirrigated) farm land sold for an average of \$5,900. Irrigated farm land sold for an average of \$8,100 an acre. U.S. pasture land averaged \$1,500 an acre.

CONCLUSION

There are good reasons why U.S. farm and ranch land should sell for more than comparable Argentine land. Nevertheless, at some point the difference between U.S. and Argentine agricultural land prices becomes too great. Each Cresud crop acre is valued at about one tenth of a comparable acre in Iowa. In addition, Cresud investors get more than two million pasture and reserve acres, 65.45% of IRSA and, therefore, most of Alto Palermo, 37.5% of BrasilAgro and a management noted for selling both its agricultural land and commercial real estate for substantial profits. Christina Kirchner's presidency has to end in November, 2015. It will be interesting to see how long investors will be so risk-adverse that they won't "buy", through the stock market, Argentine and Brazilian farm land for a tiny fraction of the U.S. price by purchasing shares of Cresud.

