SOUTH AFRICA'S FOOD SECTOR STUCK IN A LOW GROWTH CYCLE – AFRICA BECKONS

09 June 2014: The low economic growth environment in South Africa is putting local food value chains under increasing pressure. This is according to Herman Marais, managing partner at Agri-Vie, a Food & Agribusiness private equity investment fund, who says that the prices of essential goods and services are escalating at a higher rate than consumers are earning, which is resulting in decreased consumer spending power and is having a negative impact on the retail and food processing sector, as well as farmers.

Marais says that most South African consumers are under pressure financially, struggling to make ends meet. "Consumer's living standards are declining as their spending power decreases, and the prices of essential goods and services are escalating at a higher rate than consumer earnings, resulting in decreased affordability for luxury items and increased price comparison behaviour."

He says that retailers are feeling the impact of dwindling consumer spending power. "The average grocery trolley in the supermarket cost just over R400 in December 2013, which was up by only 1.6 percent from the previous period. This indicates that consumers are cutting back, as this increase is more than 4 percentage points below the inflation rate[1].

Marais says that food processors are being pressurised by price resistance at retail level, with labour and energy costs rising dramatically in the recent past. "Traditionally, the South African food manufacturing sector, like the rest of manufacturing in SA, was to a large extent built on the basis of competitively priced energy (electricity) and labour costs, however, South Africa's increased labour and energy costs have become less competitive in comparison to global peers."

He says that so far this has resulted in a structural change for the worse within the food manufacturing sector. He refers to the results of the Deloitte 2013 Manufacturing Competitiveness survey[2] for South Africa, which suggests that South Africa's competitiveness ranking will decline over the next five years.

"Cost and availability of labour and materials are the highest rated factors by South African manufacturers contributing towards competitiveness. Unit labour costs (the ratio of wages to labour productivity) in the manufacturing sector rose by an average of 5.8% per year from 1998 to 2012. Over the same period, unit labour costs in many European countries have fallen due to productivity gains. In addition, man-days lost to a surge in industrial action since 2012, particularly in the mining,

[1] http://www.iol.co.za/business/news/sa-shoppers-cut-back-as-costs-soar-1.1640674#.U3DFFq-KAdU

[2] http://www2.deloitte.com/content/dam/Deloitte/dk/Documents/manufacturing/manufacturing_ competitiveness_South_africa.pdf

agricultural and transport sectors, are likely to have had a negative impact on manufacturing productivity."

Furthermore, the survey revealed that for much of the past three decades, electricity prices in South Africa have been low and declining (in real terms). From 2008, however, the trend in real electricity prices took a dramatic turn and increased by 78% between 2008 and 2011. The sharp and sudden increase in energy costs, coupled with an unfavourable economic climate, put many food manufacturers under near-fatal pressure.

"The all Farm Requisites Price Index (FRPI), which is the official measure of the increases in prices of farming inputs, has more than doubled in the period since 2005, while the PPI (Producer Price Index) has experienced a materially smaller increase. The input costs that have mainly contributed to this increase have been fertilizers, herbicides, pesticides, energy and equipment, to name but a few. Therefore farmers, who by nature stand at the back of the local food value chain are currently in the weakest position as they bear the brunt of rises in input costs while having little leeway to pass on higher prices to food processors and retailers.

Marais says that Agri-Vie is invested in a portfolio of food & agribusiness companies who share many of the above challenges. "The Agri-Vie team works actively with its investee shareholders and company management on proven strategies to contend and overcome these challenges." These strategies include focusing closely on the following key elements:

- *Focusing on quality as well as reliable delivery*: These are characteristics that set thriving companies apart from average companies. Several Agri-Vie companies have consistently won customer recognition awards for their quality products and delivery strike rates.
- *Continuous improvement programmes to streamline business processes:* An unrelenting focus on cost-efficiencies through constantly questioning each aspect of the business pays rich dividends.
- *Scale:* Agri-Vie invest in growth companies and work with these businesses to achieve economies of scale in their operations which ultimately improves margins. Both organic and acquisitive strategies are pursued.
- *Vertical integration*: Forwards and backwards vertical integration create strong supply chains with greater efficiencies as well as cost advantages.
- *Value chain partnerships*: Experience has shown that participants in business value chains that adopt a broader perspective across the entire food value chain ultimately fare better than those concentrating only on their narrow self-interest.
- *New markets*: While the South African market for food products remains in a low growth environment, the same applies to many of South Africa's traditional export markets in Europe, where recovery is still at a very early, fragile stage. However, the economies of many Sub-Saharan countries North of South Africa are growing consistently at 6-7% annually, which is being fuelled by rapid urbanisation and a rising middle class. This creates opportunity for food value chains originating in South Africa to enter new, high growth markets either through

exporting or through setting up operations in-country. Agri-Vie, with its long standing operations in several countries of the region, work with its investee companies to do just that.

- *Focus on sustainability*: Global research into corporate performance confirms that a focus on environmentally and socially sustainable business leads to superior financial performance in the longer run while also being good for people and the planet. Agri-Vie enters into a compact with its investees aligning on globally recognised sustainability standards and practices.

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About Agri-Vie
Agri-Vie is a private equity investment fund focused on Food & Agribusiness in Sub-Saharan Africa with a mission to generate an above average investment return, as well as demonstrable socio-economic development impacts through its equity investments. The fund was initiated by Agri-Vie Investment Advisors with the cooperation of South African and international investors. The fund's vision is to be a catalyst for sustainable growth through investing in one of the foundation sectors of Africa's economies. Agri-Vie seeks to realise this vision through deploying development capital and management know-how according to sound investment and business principles. Agri-Vie Investment Advisors is a financial services provider authorized by the Financial Services Board, Registration number 33826. In December 2012, Agri-Vie won the *Agribusiness Investment Initiative of the Year 2012* award at the African Investor Agribusiness Investment Awards and in December 2013, Focus on East Africa presented Agri-Vie with the *Agribusiness Investment initiative of the Year 2013* award. A successor fund, Agri-Vie II is in the process of being raised. Visit www.agrivie.com for more information.