ANATOMY OF A PURE PLAY EQUITY FUND: A VIEW INSIDE PAINE SCHWARTZ PARTNERS

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Food and agribusiness is a multi-trillion-dollar global industry where investments have demonstrated higher total returns to shareholders than many other sectors.[1] These investments grew threefold to more than $100 billion from 2004 to 2013, according to McKinsey, and in 2018, the agtech sector alone saw investment totaling more than $2 billion.[2]

It is estimated that investment funds specializing in the food and agribusiness sector number nearly 450 with combined assets under management in excess of $73 billion.[3] While there exists uncertainty in global geopolitics, a tightening monetary cycle in some of the largest economies, trade tariffs that are changing the trajectory of global relationships and trading patterns, and increased volatility in financial markets, there remains high valuations in this burgeoning asset class. And for those who can see the forest for the trees and appreciate the long-term life cycle of investments in agriculture, there is much to gain by betting on this sector.

At Paine Schartz Partners' headquarters in New York, CEO Kevin Schwartz addresses colleagues.

Strongholds in the industry are those companies who seek to meet the global challenges of increasing agricultural efficiency, sustainability, and distribution infrastructure, as well as support and evaluate the multitude of cost-saving innovations flowing from the blossoming agtech sector. Thriving in building this sustainable agricultural system and raising the profile of private equity participation in the underpenetrated food and ag sector is Paine Schwartz Partners. Based in San Mateo, California, this private equity firm is leading the way in sustainable food chain investing with over $2.3 billion equity capital deployed across more than 57 investments in the sector.*

Twenty-nineteen was a busy year for Paine Schwartz, marked by the final closing of its Paine Schwartz Food Chain Fund V, L.P. (Fund V) in September, which targeted an impressive $1.2 billion and exceeded that goal at $1.425 billion, due to oversubscribed demand and strong interest from its investors. In addition to sustained strong support from North American limited partners, Fund V generated increased demand from the international community, including the Middle East, Western Europe, and Asia, including Japan.

"This was truly a global capital raising effort, with participation from new and existing limited partners around the world," said Kevin Schwartz, CEO of Paine Schwartz. "We have seen an increasing number of institutional investors focused on the food and agribusiness opportunity set, along with the need for sustainability, which is synergistic with driving positive investment outcomes in this sector."

The first investment under Fund V was in September 2019 in Advanced Agrilytics, an Indiana-based company that provides diagnostics to farmers. Their second portfolio addition, announced in October, was a 30 percent investment in AM FRESH's SNFL (Specialty New Fruit Licensing) subsidiary ("SNFL") in support of the leading end-to-end table grape company's consolidation. These companies join others in the Paine Schwartz portfolio, some of which are: AgBiTech, a Texas-based company that provides biological insect control solutions; FoodChain ID, a Chicago-based company that provides certification, and technical and testing services and solutions; Lyons Magnus, a leading food ingredient manufacturing company, based in California; and Wawona Packing Company, an industry leader in the fresh fruit category, also based in California.

As demonstrated by their rapid investment activity following the Fund's closing, Paine Schwartz sees a robust set of exciting opportunities to deploy capital towards sustainable solutions in the food and ag value chain, and expects to continue to do so in the coming months.

To get a view inside that investment mindset, *GAI Gazette* spoke to CEO Kevin Schwartz.

1. Finding new investment opportunities in ag requires a detailed understanding of crops, geographies, and complex value chains. Please explain Paine's due diligence methods along these lines.

We have always had a thesis-driven approach to investing in the food and ag value chain. We've developed processes, after more than a decade of deploying capital, which start with longer-range research projects that are global in scope and help to identify pockets of growth and opportunity for investment. We've done two of these substantial research projects over the last 10 years – they are 9 to 12 months of work for our internal team, and we also leverage some third party relationships – that we call Ag 2020 and Ag 2025. These create a roadmap for the opportunity set that we want to pursue in the portfolio construction of the funds. We constantly do detailed research on specific segments of the value chain and on specific investment

** Invested capital figures include co-investment. Includes platform and add-on activities by Paine Schwartz Partners as of October 2019, as well as by Fox Paine & Company (the "Predecessor Firm") as of December 2007*

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Kevin Schwartz during a visit to portfolio company Lyons Magnus' headquarters in Fresno, California.

opportunities. We approach this in two ways: twice a year we task our internal team, operating directors, and our network to develop around five specific research projects on segments of the value chain that they think are interesting for investing capital. That work is presented in the spring and in the fall to the entire firm. We discuss, debate, and prioritize, and ultimately we identify companies that we think might be an opportunity for investment where our capital and expertise can be transformative. We also have an internal, proprietary process where we define specific segments of the value chain and specific types of companies that we are constantly proactively developing. This allows us to create a pipeline annually of about one thousand unique potential investment opportunities which we distill down to a handful of investments each year.

The two key themes that we invest behind are productivity, and health and wellness, and those remain robust macro themes. The granularity of our work, given the three-dimensional cube of activity – hundreds of commodities, a lot of geographies, different points in the value chain where rents accrue – is a complicated cube. But having done this for a long time and with our thesis-driven approach, we know what we want to do proactively and our internal investment committee process is highly focused on prioritization, so that projects that we are not going to do get killed quickly, and projects that we want to pursue get huge attention and resources.

2. Where do you see the most opportunity – product-wise and geographically? Has the disruption from farm to table – with sustainability and traceability coming to the forefront, driven by consumers – impacted your investment philosophy?

It's an interesting dual demand-driven situation on the production side of agriculture because there's a need for more productivity, and there's a need to produce more with less, and that requires investment capital and expertise and insights, which has been a hallmark of our investment strategy. But there's also consumer demand for sustainable products, for healthy foods, for traceability and transparency, and for knowing where their food comes from and what's in it and being able to choose what they put in their bodies. We've seen that really impact the upstream parts of the value chain pretty dramatically. This is why we have included FoodChain ID, the market share leader in certifying the label The Non-GMO Project, in our portfolio. Consumers in many cases have decided they don't want to eat GMOs. So we've been able to invest in a company that is providing that transparency and verification to the consumer.

There's no question that there is a need from a productivity perspective, and a demand from a consumer perspective, for a more sustainable and very transparent food chain.

To speak to the productivity perspective, we are seeing a demand for natural or biological solutions to increasing productivity. For example, in the control of pests, rather than using broadly harmful synthetic chemistry, there's a push for biological, natural solutions. We've been able to invest in companies that have those technologies which are every bit as effective as the older synthetic chemistries, but are very targeted and are natural and not harmful. We've also invested heavily in high-value specialty produce, things like berries, avocados, and stone fruit, which are part of a healthy diet. As we look to deploy Fund V, you'll see the same themes. The first two investments that we've made in Fund V are into a company called Advanced Agrilytics, which is using proprietary data and software tools to enable much better insight on farms to dramatically drive yield, and the other is SNFL, which is the leading provider of table grape genetics globally.

Checking out products at Lyons Magnus' headquarters in Fresno, California.

3. Can you please explain and expand upon the role that environmental, social, and governance (ESG) criteria play for Paine Schwartz in evaluating each of its prospective investments?

We have strived to be on the forefront in food and agriculture private equity investing with respect to ESG. We have adopted an approach where we have integrated ESG into our investment process, from research through execution and ownership of the individual companies. So when we are screening companies as potential investments, we are actually scoring them against ESG principles.

When we own companies, we create metrics around ESG principles and we expect to see improvement on those metrics during our ownership. We have started to annually audit our firm and our portfolio companies against those ESG criteria, and we've also recently become a PRI signatory.

We think there is an incredible synergy between these ESG principles and delivering good outcomes, particularly in food and agriculture investing, and sustainability is a core part of that. We will continue to be more proactive in our journey to be best-in-class from a private equity perspective with what we are doing in ESG.

4. What makes Paine Schwartz unique as a firm, and why do companies in the industry look to you for partnerships?

First, by way of personal background, we are from the ag and food industry. My personal background is multiple generations in agriculture. We didn't just analyze the macroeconomic trends and determine food and ag was an interesting place for investment – we lived and breathed it. It's been a part of us from the beginning – so for our team, there's a real passion for the industry.

Number two, we've created a diverse team whose skill set goes well beyond an investment skill set, with a focus on having the best insights into where the opportunities are in food and agriculture. This is fueled by the research platform that we've invested so heavily in over many years. We've also brought in operating executives from the industry so that more than half of the team are ag industry veterans. And the third reason is that we have a set of capabilities inside the firm that can help transform companies and grow them, and as a result, create value. It's a very growth-oriented approach.

The combination of capability, insights, and passion for the industry makes us very unique. We are certainly in the lead in the private equity context with respect to those capabilities and that team construct. About 80 percent of the investments we make are in family-owned businesses so families trust us. We have created a proven track record of success with this by simply doing what we say we are going to do, and spending more time in our boots than our dress shoes.

5. What typically happens following Paine Schwartz's investment in a company? What goals do you set for your investments, and how do you go about creating value?

Following an investment, we work with the key stakeholders of the investment company to establish a joint business plan and strategy for what we are going to do, always keeping our sights on transformation and growth.

We align around a set of strategic goals and objectives and ensure that the company has the resources to execute those plans.

6. What's next for Paine Schwartz? More investments in Fund V? A Fund VI?

Our focus right now is on creating value in Fund IV, and deploying capital for new investments in Fund V. We feel good about the pipeline for new investments. We just raised roughly $1.4 billion and that is just scratching the surface on the opportunity for investment in what is an $11 or $12 trillion industry. We also will continue to build our team and expertise, and raise more funds in the future.

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It's very rewarding to work in a sector that really matters and is tangible to everyone because we all eat. The demand dynamics are evident and the complexity of the value chains required to deliver against that demand curve create many interesting investment opportunities, such that not only can we deliver optimal investment outcomes for our investors, we can also have a real positive impact [in the world]. The whole team at Paine is very excited about that as we focus on making sound investments and transforming companies in our portfolio. But the sky's the limit in this industry. There's so much opportunity.

About Kevin Schwartz, CEO, Paine Schwartz

Prior to co-founding Paine Schwartz Partners in 2006, Schwartz was a managing director at Fox Paine & Company, which he joined in 2002. Prior to this, he worked for the private equity firms Fremont Partners, where he assisted with the management of approximately $1.7 billion of funds, and American Industrial Partners, which managed approximately $1 billion of funds. He began his professional career at Goldman, Sachs & Co.

Schwartz serves on the boards of Advanced Agrilytics, FoodChain ID, Lyons Magnus, SNFL Group, Verdesian Life Sciences, and Wawona Packing. He is a member of the Rush Associates board at the Rush University Medical Center. Schwartz is a graduate of the University of Illinois (Bachelor of Science in Accountancy), and was raised in Moline, Illinois.

Sources:

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