

FEATURE ARTICLE: THE SECRETS OF TOP-PERFORMING RED MEAT FARMERS

SUMMARY

The red meat sector is a \$9 billion industry and has grown at a compound annual rate of nearly 3% over the past 20 years. This run rate needs to lift if it wants to achieve its aspirational target of being a \$14 billion industry by 2025.

Our focus in this article is on-farm performance and what sets the top farmers apart from the rest. This is only one piece of the supply chain, but it's a major one. It also only focuses on the supply side of the equation, which is of course just one piece of the puzzle to lift the sector's run rate.

The Red Meat Profit Partnership (RMPP) is the first substantial step up in industry investment focused on lifting on-farm performance. The first part of this has been aimed at gaining a better understanding of what top performance looks like and its key drivers. In-depth interviews of top farmers found a range of key attributes, with the main ones including:

- Vision and drive; well-defined personal and business goals.
- Having the right skill set and a talented team, as well as using specialist advice when required.
- Above-average execution of key farm management practices and mitigation of risks.
- Passion and confidence in the sector, which drives investment and effort.

The key attributes and practices of top farmers from the RMPP findings were heavily weighted toward 'softer' attributes and key farm management practices utilised to achieve top financial performance. So we decided to analyse benchmarking data to help draw out which areas of the more measurable aspects of a farm are more or less important determinants of profit too.

Our findings regarding the key benchmark relationships included:

- A strong relationship between EBITR and the rate of return for all the main farm types (few surprises here). The relationship gets progressively stronger when moving from more intensive/finishing operations to hill country/breeding units.
- A similarly strong relationship between gross revenue and profitability for all the different land types. The same change in gross revenue yields a similar change in profit.
- A reasonably good relationship between the quantity of meat and fibre produced and profitability. Intuitively it wasn't quite as strong as we expected, suggesting other farm management practices are equally – if not more – important determinants of profitability.

- Sheep productivity is the most important determinant of profitability for all farm types within the sector. There was no relationship between beef production and profitability for the main farm types.
- A stronger relationship between profit and productivity for the enterprises that make up the largest proportion of total revenue for a particular farm type. This supports the notion that top performance requires investment and a focus on the areas of relative importance in a business.
- No relationship between farm expenditure and profitability, but a strong relationship between profit and cost efficiency suggesting top performance is driven more by the quality of expenditure and focus of investment than quantity. Three key areas of investment that stood out were cropping/pasture renewal, genetics and infrastructure.
- A strong link between profit and the equity within a farm (i.e. a lower equity position tends to lead to higher profitability).
- A reasonably significant negative correlation between the age of the operator and profitability for all farm types.

For top farmers, the link between the key 'softer' attributes and then successfully carrying out the connected farm management practices will be stronger than for the rest. This suggests that most farmers have a sense of what needs to be done to perform at higher levels, but it is only the top farmers who are fully committed and know how to consistently execute.

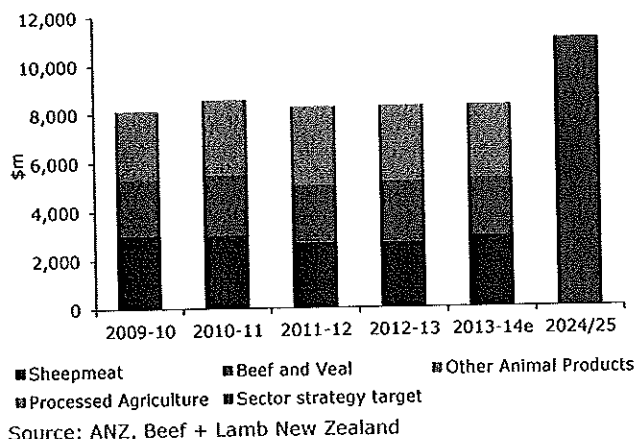
INTRODUCTION

It seems a little while ago now, but the Red Meat Sector strategy was released back in March 2011. Its purpose was to provide an 'umbrella' framework that individuals and businesses within the red meat supply chain could use to identify future opportunities for growth and improved profitability. Interestingly, there was a five-year priority plan provided and timeline of key initiatives that different parts of the sector were encouraged to undertake.

The collective aim of these initiatives was to set the red meat sector on a course toward growing real annual sector returns to \$11 billion by 2025 (\$14 billion nominal terms), as well as improving profitability for all the participants within the red meat supply chain.

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REAL SHEEP & BEEF SECTOR RETURNS (CONSTANT 2009/10\$, JUNE YEAR)



Unfortunately growth has been fairly slow since the announcement of the strategy, meaning the run rate required to hit the aspirational growth target has begun to climb. If you were marking the industry on the progress of the initiatives contained within the five-year priority plan, the score card wouldn't read well at present. There would likely be a lot of "yet to be completed" initiatives and several running over time – or, as the sector strategy progress report showed late last year – "in progress" initiatives.

Farmers are likely to have one of their best years in a long time in 2014/15 and early signs are it might even get close to the 2011/12 ripper for some. This probably depends on the mix of stock a farm is carrying, with those who have more 'beefies' likely to have even bigger smiles. **Meat processors have returned to being profitable again** after the 2012 disaster – albeit with margins that remain very slender. While reform appears closer, such positive cyclical swings have seen the pressure come off before and the appetite for change wane. **The sector still needs to move these reforms forward, as most of the structural issues identified in the sector strategy remain largely unresolved.** While the sector's general fortunes are on the rise, if it wants to fulfil its true potential and reach the heights it aspires to, there is still a real need to address its structural issues.

For industry performance to lift, a number of puzzle pieces need to fit into place. You need opportunities in the first place; New Zealand seems to have these in spades. Pricing signals need to be strong enough to encourage investment; you won't get this in the commodity game – it's all about service, product attributes and branding. You need good market access and clear channels into these markets. Everything is super-sized these days, so scale and partnerships are required to be relevant in

many markets. A favourable regulatory environment is required. There needs to be a strong pipeline of innovation. Each of these is a topic of research in itself!

Our focus in this article is on the supply side; we're assuming the demand side of the equation is taken care of. That may seem heroic to some, but the long-term maths of emerging market demand, modernisation of the food chain in new markets, westernisation of emerging consumer taste preferences, opening up of new cultural segments, preferential access to a wide range of markets, strong business relationships with key multinational foodservice and retailers all look pretty impressive to us. As Chinese President Xi Jinping mentioned on his trip downunder a few weeks ago, *"New Zealand will have to worry about the fact that there is more Chinese demand than you can possibly supply."*

One of the critical pieces of the puzzle (and focus of the RMPP) is lifting the financial performance of those in the bottom 80% closer to that of the top quintile, as a considerable gap has emerged. When the industry strategy was released, this was probably one of the lesser-recognised opportunities to up the sector's run rate and help improve farmer profitability. Nearly four years on, the idea has been better canvassed and seemingly acknowledged as a big opportunity by many.

The sector seems to be in a similar position to the dairy sector in the early 2000's. Consolidation, succession, investment and other structural changes (some undertaken by choice, others simply occurring by themselves) brought renewed vigour to on-farm performance. With an aging ownership structure in the red meat sector the chance for more consolidation and succession to 'blood' the younger generation and drive increased investment and improved performance seems to provide a similar opportunity.

In this regard the RMPP is the first material investment in a long time aimed at addressing the performance gap within the sector. It's a collaborative program worth \$64.3 million over seven years and brings together nine industry partners and the Government, who are coordinating their efforts to increase profitability and productivity in the red meat sector. All investment is centred behind the farm gate, aligning with the recommendations in the Red Meat Sector Strategy. **The key deliverables include:**

- **Benchmarking data** to allow farmers to compare their farm performance relative to others, including the best performers.
- **An understanding of how top-performing farmers achieve their results.**

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- **Better ways of communicating valuable information** to farmers about improving profitability.
- Generating **more interest** in sheep and beef farming as an **attractive career prospect**.
- **Awareness of how costs might be saved** between the farm gate and meat processors.
- **Clear and consistent messages for markets** on the high-quality, nutritious red meat products New Zealand farmers are producing.
- An **efficient and coordinated Quality Assurance system**.

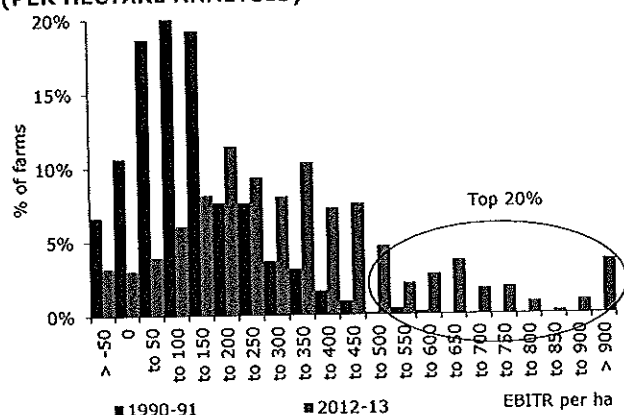
The program was officially launched in December 2013 and the first of the initiatives are starting to be delivered. Part of the early work has been trying to get a better handle on the secrets of top-performing farmers.

THE SIZE OF THE PRIZE

From an industry-wide perspective the potential to increase on-farm performance is immense.

The gap between the top 20% and the rest has doubled over the last 20 years. There even looks to have been a further divergence in performance within the top 20% in recent years, driven by high performers continuing to push the boundaries beyond what was thought feasible just a few years ago.

DISTRIBUTION OF RED MEAT FARM PROFITABILITY (PER HECTARE ANALYSIS)

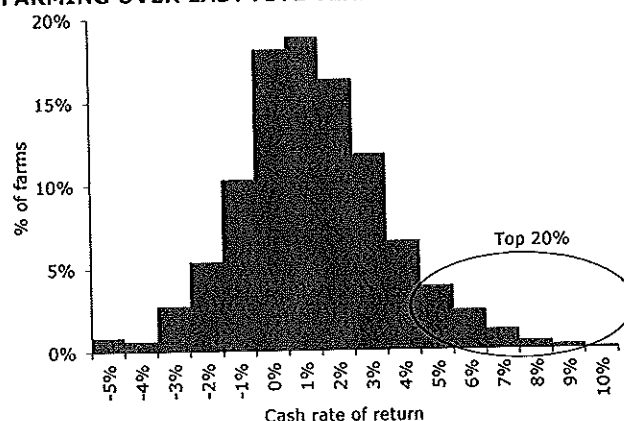


Source: ANZ, Beef + Lamb New Zealand

For the last five years the average earnings before interest, tax and rent (EBITR) was \$240/ha on the average farm – providing a measly return on total capital employed of just 1.1%. Over the same period the top 20% achieved average EBITR around the \$500/ha mark, with many more yielding above \$750/ha on a regular basis. This translated into a return on total capital employed of 4-7.5% for many of the top

20%. Both measures show the top 20% are outdoing the average by a multiple of two to three. Comparing the rates of return¹ achieved over the last five years with the top 20% in dairying only places the top performers in the red meat sector just slightly behind. The average rate of return in dairying is much higher, but the distribution a lot closer.

DISTRIBUTION OF RATES OF RETURN FOR RED MEAT FARMING OVER LAST FIVE YEARS



Source: ANZ, Beef + Lamb New Zealand

Various analyses have been conducted into the potential for shifting certain groups into the top echelons and how much extra revenue and profit this could yield the red meat sector.

Depending on the assumptions, the numbers are pretty big. Even using conservative estimates of how far the performance curve can be moved yields a large industry benefit, which would point the sector in the right direction for achieving its growth aspirations. If 30% of farmers in the bottom 80% achieved the same performance as the top 20% this would generate \$640 million (+23%) of additional EBITR each year (based on the 2011/12 season).

To break even (as measured by additional sector EBIT in year 1) on the \$64.3 million investment in the RMPP requires only a 3% movement of those in the bottom 80% to the top 20%. **Such movement**

¹ Rate of Return = EFS/Total Capital Employed.

EFS is standardised to an owner operator debt free basis for comparative purposes. EFS = Farm profit before tax + Non-owner Managerial Salaries paid + Interest paid + Rent (rent is also a cost of capital) less an Assessed Managerial Reward.

Assessed Managerial Reward is calculated as the Ruling Wage for an experienced farm worker, currently \$50,200, plus 1% of Farm Capital (land, livestock + plant & machinery at current market value at the start of the year). The 1% of Farm Capital recognises the stewardship for managing the farm asset.

Total Farm Capital includes an allowance for working capital recognised as 50% of Working Expenses and the Assessed Managerial Reward. The 50% of Working Expenses and Assessed Managerial Reward needs to be recognised because of the lumpy seasonal cash-flow requirements for sheep and beef farming i.e. working capital has to be borrowed, or introduced capital in the first place.

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of the performance curve not only improves financial viability, but also makes it easier to attract capital and carry out succession plans.

The key is getting more action, especially from those farmers who are keen to lift their performance. The first step in this journey involves trying to better understand the mysteries and secrets of what sets the top performers apart.

THE SECRETS OF TOP-PERFORMING RED MEAT FARMERS

One of the overriding features of top performers is an individual's motivations and business goals. Compared with other types of farming, "enjoying a chosen lifestyle" is often a stronger overriding motivation for many red meat farmers than making money. This is fair enough, but gives one less wiggle-room to complain about the state of the industry when farm-gate prices are down! Ultimately you need to have the motivation and willingness to be able to reach the top. This is the same for any activity or industry you engage in.

The second aspect is having the right skillset and team. This involves investing in oneself, as well as having a skilled team. Equally, it involves having access to quality specialists who can provide quality advice in key areas to guide decisions. Having the right skillset, team and access to expertise allows all the basics of farm management to be executed to an above-average standard on a more regular basis, leading to superior performance.

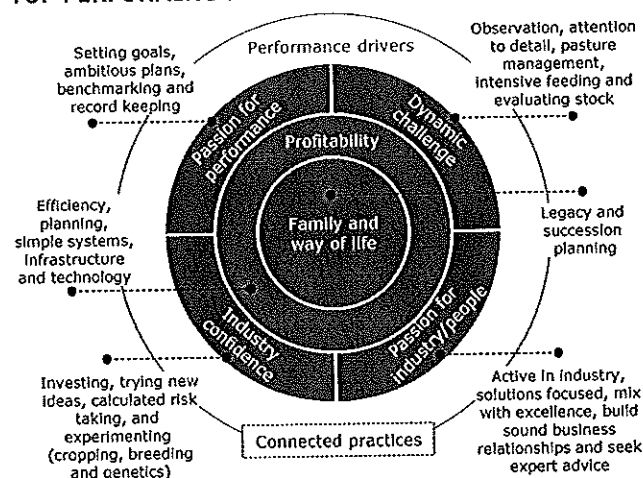
When these aspects are coupled with real passion and confidence in the sector's outlook, this drives the cycle of investment and performance, leading to growth. Many might say the effort/reward isn't big enough, but this will probably depend on how much value is placed on the "lifestyle" aspect of farming and the confidence in the sector's outlook. Both circle back to one's business goals and motivations.

The next section provides a summary of a RMPP qualitative survey of top-performing red meat farmers and their key drivers.

The qualitative survey of top-performing farmers found the drivers for the mid-tier farmers are similar in some ways to those further up the curve, but different in others.

With the mid-tier farmers, it was found that 'passion for performance'; 'industry confidence'; 'passion for industry and people'; and the 'dynamic challenge' will be drivers for them as well, to varying degrees. However, the relevance of these drivers for motivating them to go the extra mile will not be anywhere near as strong as it is for the higher-performing farmers.

TOP PERFORMING RED MEAT FARMERS DRIVERS



Source: Red Meat Profit Partnership – UMR Research November 2014

The link between the drivers and then successfully carrying out the connected practices is weaker with mid-tier farmers compared to their higher performing counterparts.

This suggests that most farmers have a sense of what needs to be done to perform at higher levels, but it is only the top performers who know how to consistently execute.

Family and way of life

For almost all farmers, family and the way of life that farming provides is central to the attraction of sheep and beef farming. Family is an important driver of performance, as many want to be able to provide their children with similar opportunities to those they were given by their parents. This means succession planning is important to most. Top performers tend to be more confident that they will succeed in succession planning particularly because their operations are profitable. There is also a sense of carrying on a family legacy that seems to drive performance, with many describing the family history of their farm with pride. There is a keen desire to build on and develop the potential in the farm that was first carved out by those who went before.

The way of life that sheep and beef farming provides is a key motivator keeping farmers on the land. For top performers, farming allows them to spend time with family while making good profits and maintaining an enviable way of life. Being part of a rural community also plays a significant role in creating the life these farmers seek. Many are active in their local schools and strongly interested in maintaining connections with those who share their world. Mid-tier farmers relish the way of life that farming provides, but for them profit is not necessarily a key driver. First and foremost, it's a welcome bonus of doing what they enjoy.

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Profitability

Top farmers have a much keener focus on making good profits and they know which aspects of their operations make the best returns. Consequently, this is where they focus the majority of effort. Coupled with this, they are more likely than mid-tier performers to **have firm plans in place to grow their operations, and a strong appetite to invest to increase returns and/or the size of their farming business.** They also have a much firmer grasp on the financials of their business.

A key factor driving profitability is thorough planning and efficiency. Top farmers often describe themselves as good planners and they have a fervent focus on looking at ways to make their operations more efficient. This relies partly on adopting innovative practices and looking for ways to implement ordinary farming practices for less cost than their counterparts. **They know that good infrastructure is critical to efficiency and they work to maintain a well set up, organised operation.**

Top farmers are interested in new technologies, but only insofar as they drive efficiency and provide a return on investment. Increasing efficiency seems to be the dominant driver for new technology making its way on to top-performing farms. Without a clear sense that new technology can create time savings and/or improve accuracy, it remains outside the farm gate. A small number of top farmers are early adopters of new technology, but these farmers tended to be younger operators who are much more comfortable with it and see themselves at the forefront of the next generation of farmers.

Industry confidence

A key factor that drives top farmers' willingness to invest and grow is their confidence in the long-term sustainability of the sector. All top performers strongly believe that sheep and beef farming is going to continue to be profitable and sustainable well into the future, while delivering an enviable way of life. Their boldness is driven by both confidence in market demand for their quality products (mainly sheep meat) and confidence in their own ability to achieve even greater productivity behind the farm gate.

This confidence drives a greater appetite for change and an almost constant exploration of new ideas. Underlying this is a determination to do better and a belief that they can. Most top performers are experimenting with a percentage of their farm system every season. Through this experimentation they are not necessarily taking substantial risks, but rather making calculated

decisions on opportunities where they are reasonably confident of significantly increasing returns. And more often than not they're right.

Cropping and putting in new pastures is a key area where top farmers seem to be continually experimenting. Crops enable them to significantly lift the performance of their animals to boost productivity, which flows to the bottom line. **It is difficult to get crops right and this is an area in which many top farmers are willing to pay for specialist advice,** or seek information to improve their understanding of cropping. **Genetics is another key area** where top farmers are willing to experiment and invest considerable money. Many see their use of genetics as a critical aspect to their farming success.

Mid-performing farmers have mixed levels of confidence in the future of the industry. They are most likely to believe that their ability to earn greater returns is largely governed by off-farm influences. This group are not necessarily risk averse; rather they tend to be slower to act and less confident about trying something different from what they've been comfortably doing for years.

Challenge of dynamic environment

Sheep and beef farmers work in a challenging dynamic environment, making it difficult to solve the performance puzzle and get it right year after year. **Top farmers get it right more often than not** and they gain a lot of satisfaction from excelling in a business where many just break even. Succeeding despite the fluid and unpredictable nature of the farming environment is a factor that drives top farmers to perform. **Many of them are competitive, reluctant to accept failure, and they work hard to be the best they can.**

Part of this hard work is paying constant attention to detail and making sure they are actively observing what is happening on their farms. This close focus on their farm means they are ready to respond and make decisions at the right time. **Getting this timing right seems to be a key difference between top and mid-tier farmers.**

Top farmers pay close attention to the basics such as growing grass, keeping their stock healthy, and feeding them well. Focusing on the detail is critical to getting these activities right. Top performers generally feel they spent more time weighing and condition-scoring their stock than other farmers. They use this information to run far more intensive feeding operations. Pivotal to succeeding with feeding stock is the time and effort put into making decisions on rotational grazing, preferential and priority feeding. To feed stock well most top farmers also have a strong focus on subdivision, good water and soil fertility.

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Passion for industry and people

Top-performing farmers are strongly driven by a passion for the industry and desire to see improvements right across the sector.

This leads to many of them being actively involved in industry initiatives, such as extension activities and competitions. They are much more likely to take responsibility for the industry and less likely to play the 'blame game' when it comes to industry challenges.

They are also more inclined to want to mix with other people within the industry, seeing them as critical to helping drive performance on their own farm. This includes rural professionals, other farmers around the country, suppliers and staff. **When it comes to advice from rural professionals they mostly seek out technical and specialist direction,** such as from agronomists, vets, technicians and accountants. **They like to surround themselves with talent** and bounce ideas off them to help drive performance in their farm business. Many of them are good communicators, which helps them to ask the right questions and get the best information. There is also a theme of top performers often being strong husband and wife teams and having a keen focus on staff.

Passion for performance

Top performing farmers have clear goals, often articulating these using figures and concrete examples of where they plan to be and when they want to get there. Some younger farmers have quite ambitious plans and are moving quickly to drive profitability. **Mid-tier farmers tend to have fewer clearly-defined goals and they appear to have less conviction and confidence that they can achieve them.** They place more emphasis on the influence that external factors (such as climate and prices) have on the bottom line.

Linked to achieving and meeting well-defined goals is a greater interest in and commitment to benchmarking and record keeping. Keeping records of overall performance helps top farmers monitor if they are on track to meet their goals and targets. The older top performers seem to be more mixed in their approach to regular day-to-day measurements; however, they have a firm grasp on the overall performance of their farm. There is a stronger theme of younger top performers having a greater focus on measuring and recording data to help guide their regular decision making.

Checklist

The table to the side provides a summary of the key attributes and practices of top performers. It includes the RMPP findings, as well as some of our own. It provides a bit of a checklist for those mid-tier

farmers who want to ascend further up the mountain. As the RMPP findings point out, most have a sense that these things will be important, but it is only the top performers who know how to consistently execute.

Key attributes and practices of top performers

VISION AND DRIVE

- Well defined personal and business goals.
- Passion for industry and to succeed.
- Confidence in industry outlook.
- Stability in relationships, both personal and with other business partners.

PEOPLE SKILLS

- Good communicators.
- Interaction with other people in the sector.
- Use of specialist advice in technical areas.
- Surrounded by talent.

KEY FARM MANAGEMENT PRACTICES

- Pay close attention to the key farm management basics – feed production, utilisation and animal performance.
- Benchmark to assess performance in key areas.
- Record keeping, especially of pasture and livestock performance/condition.
- Younger generation use more monitoring and recording to guide decision making.
- Older generation use more nous.
- More precise business practices.
- Planning and efficiency in business practices.
- Use of financial management tools.
- Flexible stock policy with regular stock rotation.
- Good anticipation, which leads to optimal timing of decision making.

KEY INVESTMENT AREAS

- Investment back into business to drive performance, especially infrastructure.
- Sector confidence providing platform for business investment.
- Research and experimentation with proportion of business.
- Use of new technology that delivers improved efficiencies etc.
- Focus on genetic selection.
- Crops and supplements used.
- Invest to improve pastures and feed production.
- Use of innovation to drive down cost in key areas.

OTHERS

- Mitigate key risks to provide consistent performance.
- Governance, especially in large and more complex businesses.

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EXAMINING THE KEY BENCHMARKS

Given the range of businesses that exist within the sheep and beef sector it is often difficult to easily pull out the defining benchmarks and metrics that influence financial performance. There is often a lot of conjecture about which metrics matter more in various situations because of the range of business models employed. The key attributes and practices of top performers from the RMPP findings were heavily weighted toward the 'softer' skillsets and key farm management practices utilised to achieve top financial performance.

Examining benchmarking data from the last four years helps to draw out which areas of the more measurable aspects of a farm are more or less related to performance. The more important benchmarks connect the dots to the 'softer' skillsets and key farm management practices that drive financial performance.

To do this we have used Beef + Lamb's Sheep and Beef Farm Survey data as it has the best consistency and coverage (in terms of farm types and metrics covered) for the sector. We have also cross-referenced some of the data points with our own internal data and that of consultants. We used the last four years to help look through the business cycles that have occurred, such as fluctuating returns (with the lamb price going from \$116 in 2011/12 to \$82 in 2012/13). Earnings before interest, tax and rent on a per hectare (EBITR/ha) basis has been used to define financial performance and examine the key benchmark metrics that have mattered more over the last four years. Over this period the surveyed farms were ranked by EBITR/ha into deciles for each farm type. By grouping the surveyed farms into deciles it helps to reduce some of the noise that is created by the wide range of business models employed. In interpreting the results we must always bear in mind that correlation is not causation, but the results can nonetheless spark ideas about what might be causal, and crucially, able to be changed, when it comes to top performance.

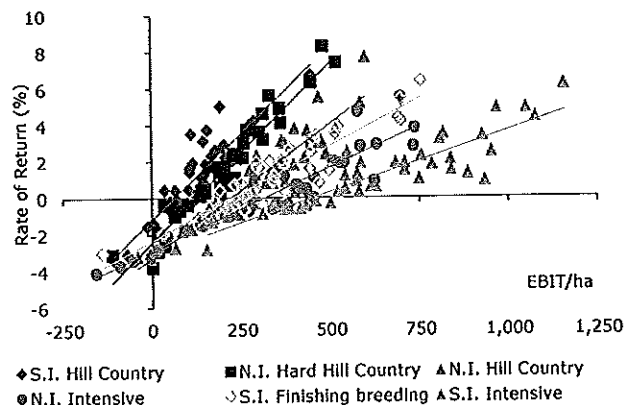
Best use of capital

There is a strong relationship between EBITR and the rate of return for all the main farm types. Therefore, any metric which is a strong predictor of EBITR will also have a strong correlation with the rate of return. This is unsurprising given the mathematical relationship between the two performance metrics.

What is perhaps a little more interesting is that the relationship gets progressively stronger when moving from more intensive/finishing operations to hill country/breeding units (i.e. the same change in profit yields a bigger increase in

the rate of return for the latter). This highlights the influence that other land uses (especially dairying) have on intensive/finishing land values (majority of capital employed) and the greater enterprise diversity of these operations. Perhaps what it best highlights, though, is that if you're not investing for capital gains, or future land use change, and you want to be focused solely on sheep and beef, the best use of capital is investing in hill country as opposed to intensive/finishing units.

PROFITABILITY RELATIONSHIP WITH RATE OF RETURN

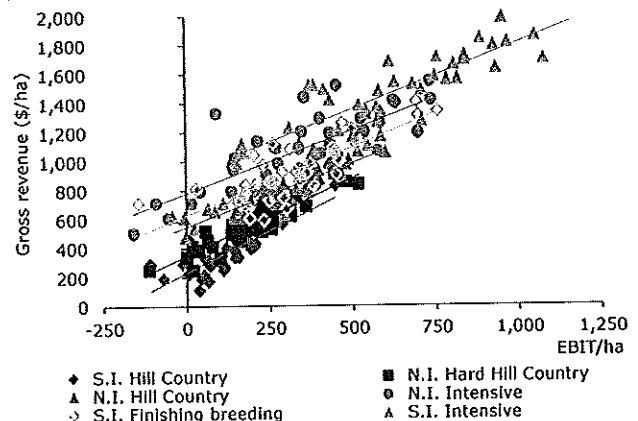


Source: ANZ, Beef + Lamb New Zealand

Gross revenue

Surprisingly, there was a similarly strong relationship between gross revenue and profitability for all the different land types (i.e. a given change in gross revenue yields a similar change in profit). On the revenue side, the main things a farmer can control are the type (the mix of livestock according to price signals) and volume of meat and fibre produced. While we did analyse the price side there wasn't an overly strong relationship between the prices received for sheep and beef sold

PROFITABILITY RELATIONSHIP WITH GROSS REVENUE



Source: ANZ, Beef + Lamb New Zealand

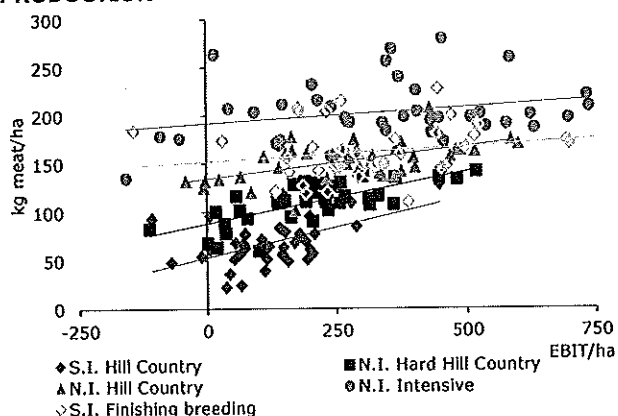
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and profitability when comparing within a year. This highlights the fact that the majority of farmers receive very similar farm-gate prices if selling the same class of stock at a similar time of the year. Comparisons between years obviously yield different profit results due to the fluctuations in farm-gate prices, but in the majority of cases this is outside a farmer's direct control. How farmers adapt stocking and management policies to these conditions is, however, critical for the consistency of returns.

Meat and fibre production

There is a reasonably close relationship between the quantity of meat and fibre produced and profitability. But it wasn't quite as strong as our intuition suggested it should be. The relationship is stronger for those on hill country properties; as opposed to intensive/finishing (i.e. the same change in meat production has a bigger impact on profit on hill country properties). For intensive/finishing this probably highlights more diversity, with the likes of dairy grazing, cash crops and other income making up a larger proportion of revenue. However, it also likely highlights that other farm management practices – such as weight gain generated, cost of feed utilised, trading margins created and the timing of buy/sell decisions – are equally, if not more important, determinants of profitability for more diverse (trading operations) and complex farm operations – which intensive/finishing properties generally tend to be. This reinforces the RMPP findings that top performers have stronger connections across all the key farm management practices.

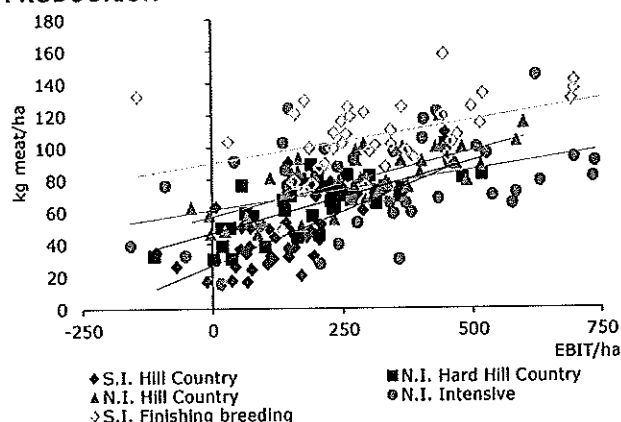
PROFITABILITY RELATIONSHIP WITH MEAT PRODUCTION



Source: ANZ, Beef + Lamb New Zealand

Interestingly, splitting out sheepmeat (primarily lamb), wool and beef production shows the sheep side of the business is the more important determinant of profitability for all farm types. But again the relationship is stronger for hill country.

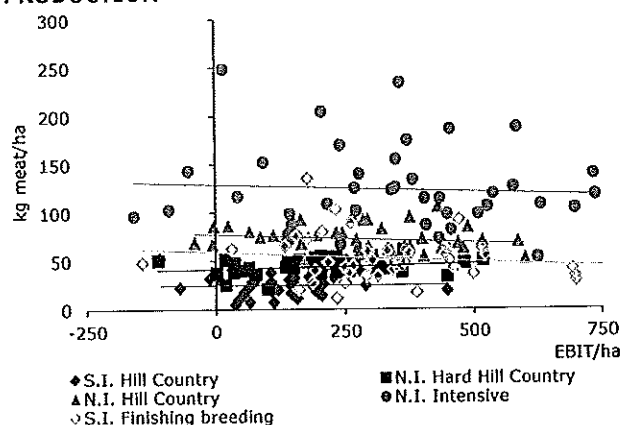
PROFITABILITY RELATIONSHIP WITH SHEEPMEAT PRODUCTION



Source: ANZ, Beef + Lamb New Zealand

On the other hand there is no identifiable relationship between beef production and profitability for the main farm types. This isn't surprising given the role beef cattle – and specifically breeding cows – generally play in pasture management on many properties. No doubt if we were to take a deeper dive into a solely-focused, bull beef-finishing operation, weight gain and beef production, alongside trading margins, would be very important determinants of profitability. Perhaps what this highlights is that somewhat of a rethink is required on the role beef cattle play in NZ operations, especially if the schedule price is to stay as strong as in recent months.

PROFITABILITY RELATIONSHIP WITH BEEF MEAT PRODUCTION



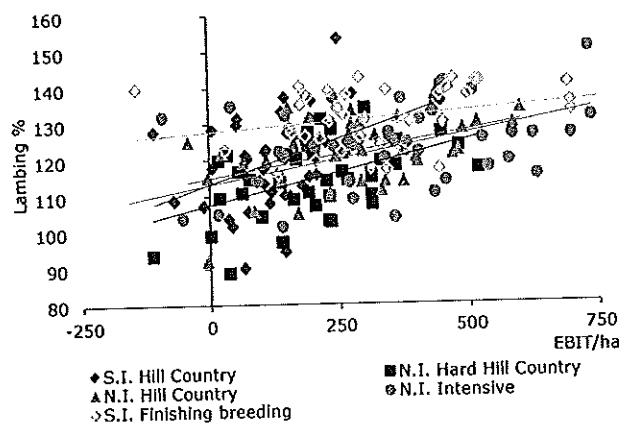
Source: ANZ, Beef + Lamb New Zealand

The focus of top performers on the areas that matter the most, as highlighted in the RMPP survey, can be seen in a number of other productivity indicators. A prime example is the stronger relationship between lambing percentage and profitability for hill country and breeding operations compared to intensive/finishing units (i.e. the same

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change in lambing percentage has a bigger impact on profit for hill country and breeding operations).

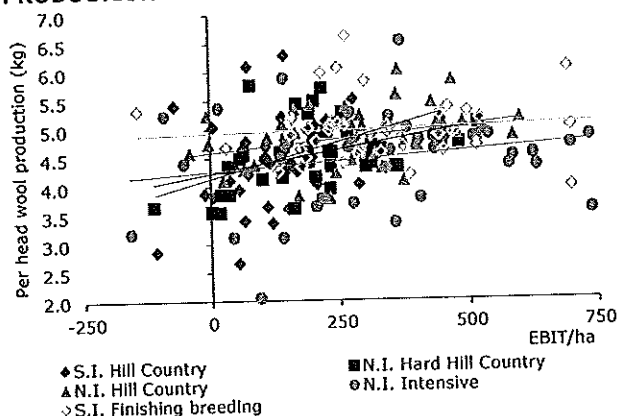
PROFITABILITY RELATIONSHIP WITH LAMBING %



Source: ANZ, Beef + Lamb New Zealand

Another example is the stronger relationship between wool production and profitability for S.I. Hill Country, or N.I. Hard Hill compared with other farm types (i.e. same change in per head wool production has a bigger impact on profit for these farm types). This is due to the fact that these operations usually generate 15-25% of their gross revenue from wool, whereas for other farm types it is less than 15%. These operations also generally target the mid-to-finer end of the clip, which yields higher prices.

PROFITABILITY RELATIONSHIP WITH WOOL PRODUCTION



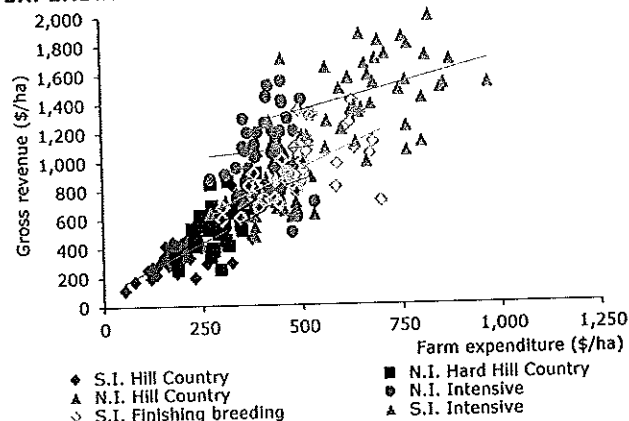
Source: ANZ, Beef + Lamb New Zealand

The stronger relationship between profit and productivity measures that make up a larger proportion of total revenue on a particular farm type supports the notion that top financial performance requires investment and a focus on the areas of relative importance for a business. This requires the basics to be executed to an above-average level and key risks mitigated to deliver consistency.

Expenditure and investment

There's an old saying – you have to spend money to make money. Well, there is some truth to this to drive top financial performance in the sheep and beef sector. There is certainly a strong relationship between the amount of money spent and what is generated for all farm types.

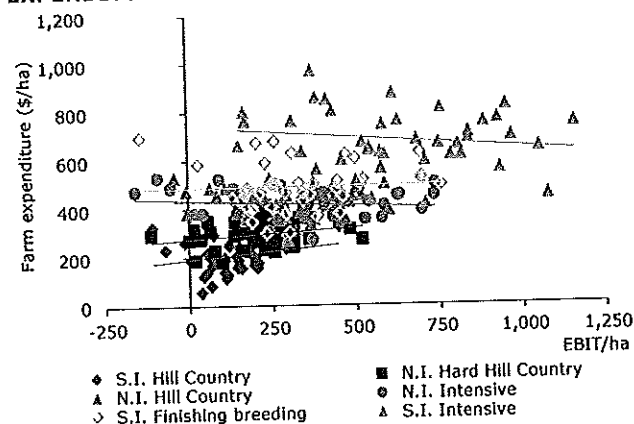
GROSS REVENUE RELATIONSHIP WITH FARM EXPENDITURE



Source: ANZ, Beef + Lamb New Zealand

But what is much less clear is the link to profitability – examination of the benchmark data shows virtually no relationship between farm expenditure and profitability. Digging a little deeper into the key areas of farm expenditure that one might expect would drive higher productivity and better bottom lines also produced little. In fact there were fairly weak relationships between profitability and the likes of animal health (most farm types slightly positive) and fertiliser, lime & seeds (half the farm types showed a positive trend, while the other half were negative) expenditure for most farm types.

PROFITABILITY RELATIONSHIP WITH FARM EXPENDITURE



Source: ANZ, Beef + Lamb New Zealand

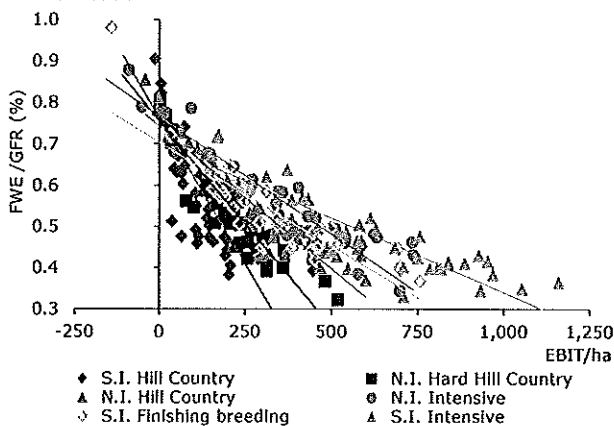
FEATURE ARTICLE: THE SECRETS OF TOP-PERFORMING RED MEAT FARMERS

Averages can hide as much as they reveal. An inconclusive relationship between spending and profit at an aggregate level gets more interesting when you look at the exceptional performers. **The top 20% of farmers generate good results through solid farm management practices, efficiencies and cost control, but a smaller subset add willingness to invest for an exceptional result.** The exceptional performers simultaneously minimise overheads and variable operating costs and invest in the areas that drive productivity.

More accrual and management accounting and better investment analysis help these farmers make better investment decisions. **Low confidence and focus on costs and cash results have limited the willingness to invest for long-term results.**

While the weakness in the industry average expenditure relationships seemed a little unusual, **a much stronger association with profitability exists for the amount of farm expenditure used to generate gross revenue (a proxy for cost efficiency).** There is also a more positive relationship between profitability and the quantity of fertiliser and lime applied. **Both indicators suggest better profitability is much more about the quality of expenditure than the quantity.**

PROFITABILITY RELATIONSHIP WITH COST EFFICIENCY



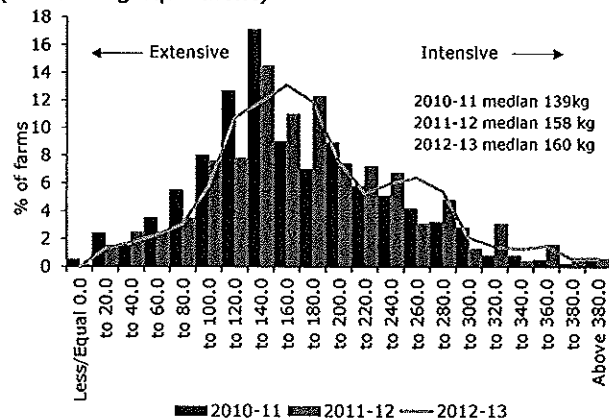
Source: ANZ, Beef + Lamb New Zealand

This supports the notion that top financial performance requires expenditure to be focused on areas that provide efficiency and innovation. Interestingly, the relationship between cost efficiency and profitability was stronger for hill country/breeding operations compared with intensive/finishing units (i.e. the same change in cost efficiency has a greater effect on profitability). This is probably again due to the larger diversity in enterprises for intensive/finishing units.

Three key areas of focus for investment (or expenditure, depending on how you want to look at it) are **cropping/pasture renewal, genetics and infrastructure.**

The combination of better genetics, more dry matter production, and best-practice farm management practices is really starting to push the boundaries. Many of the top performers on better land are consistently achieving annual meat production in excess of 400+ kgs/ha, which is well up on the industry average of 150-250 kgs/ha.

NET MEAT PRODUCTION KG PER HA (carcase kg equivalent)



Source: ANZ, Beef + Lamb New Zealand

Examining benchmarking data and return on investment analysis shows a reasonable relationship between better profitability and the area of crop and pasture renewal being undertaken. The relationship was stronger for intensive/finishing units, as these operations have a larger area of land better suited to crop production.

The use of some cropping to lift performance, mitigate climatic risk and provide farm policy flexibility seems to be flavour of the month.

There's a large range of crops being utilised by top performers, with the most common being lucerne, plantain and maize. Most farmers see the benefit of applying more than one type of crop to their farm in order to diversify risk. Crop choices depend on the region, climate and land class. Increasingly, dairy farm management techniques for pasture and crops are being applied to meat and fibre production by some.

Genetics is another key area of investment and constant review. Many top performers are willing to experiment and invest considerable money to capture better returns. Many pay a premium for stock with superior genetics as it enables them to realise the greatest return on their other

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breeding stock. The key traits they tend to focus on vary, but include fertility rates, growth rates and wool production.

Key farm management practices to take full advantage of these investments generally include feed budgeting and the monitoring of animals' performance. Top producers usually focus on ensuring full utilisation of feed, maintaining its quality, and the maximisation of animal growth rates. The majority have their own feed budgeting system through excel spreadsheets rather than using commercial software-based farm management tools.

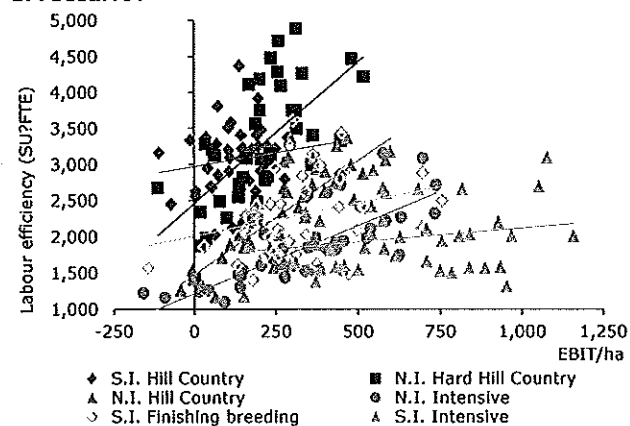
Many have flexible stock policies with regular rotations that include strip and cell grazing of prime stock. There is also regular weighing to monitor and understand animal performance. Grazing rotations and other practices are then adjusted accordingly. As technology advances in linking these practices together this will no doubt start to see increased investment and uptake of such commercial tools too.

Investment in good infrastructure – be it the wool shed, yards, or software – is crucial for labour efficiency. This allows the key farm management practices mentioned above to be quickly and easily undertaken.

Labour efficiency

Having the right people and access to specialists when required is important to all businesses no matter what sector. Unsurprisingly, as the RMPP work concluded, top performers like to surround themselves with talent. **Labour efficiency, as measured by the number of stock units to full-time equivalents, shows a positive relationship with profitability for all farm types** (i.e. a higher rate of stock units to full time equivalents yields better bottom lines). This reinforces that those with

PROFITABILITY RELATIONSHIP WITH LABOUR EFFICIENCY



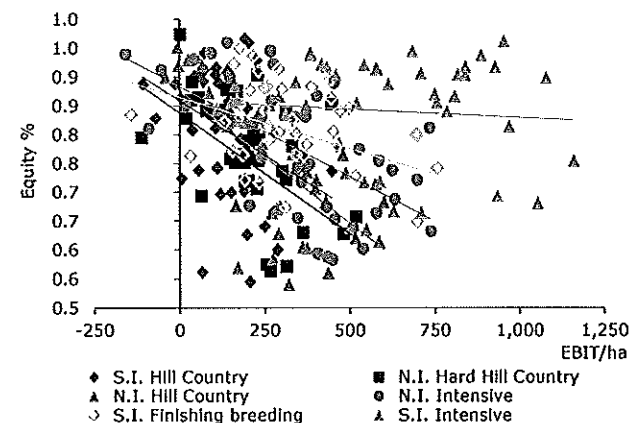
Source: ANZ, Beef + Lamb New Zealand

more 'talent' can probably manage more stock and still maintain their performance (lambing %, weight gain etc). It's also likely to be linked through to the number and mix of enterprises (i.e. more tends to add complexity), size of operation and use of technology/ different farm management practices to drive business efficiencies. Nonetheless no matter how labour efficiency is generated it needs to be an area of focus, with it generally being the fourth-largest expenditure category on a sheep and beef farm.

Leverage, motivations and succession

One of the more interesting relationships we found was a strong link between profit and equity for all farm types (i.e. a lower equity position tends to lead to higher profitability). The link was less strong for S.I. Intensive farms, perhaps due to the influence of dairying, but it's difficult to conclude this, with the generally high equity positions.

PROFITABILITY RELATIONSHIP WITH EQUITY



Source: ANZ, Beef + Lamb New Zealand

One could draw a number of potential explanations for this link. In our mind two of the more important ones that stand out are:

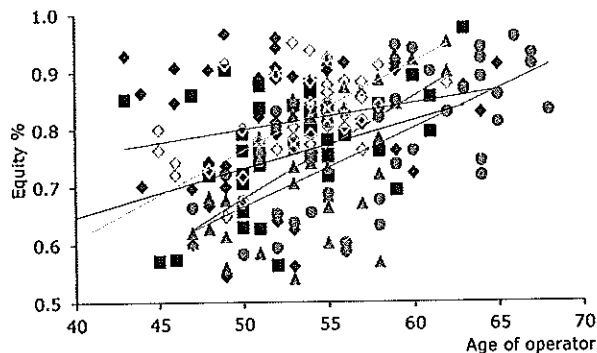
1. **Those with a lower equity position run their business a lot harder.** This links back into motivations and business goals being a key determinant as to where farmers sit on the performance curve. The flip-side is that there is an outside need to achieve better profitability when there is a lower equity position i.e. there is a need to achieve higher profitability to service interest costs.
2. **More investment through the use of outside equity (usually debt) helps drive better profitability.**

The motivation of those with a lower equity position will vary. But it could also be a simple correlation rather than causal, as we found that the

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stronger the equity position, the older the age of the operator for all farm types, except for S.I. Intensive farms again.

EQUITY AND AGE OF OPERATOR

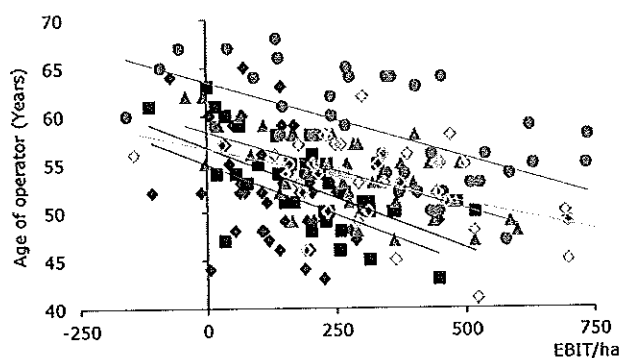


◆ S.I. Hill Country ■ N.I. Hard Hill Country ▲ N.I. Hill Country
● N.I. Intensive × S.I. Finishing breeding

Source: ANZ, Beef + Lamb New Zealand

Furthermore, we found a reasonably strong negative correlation between the age of the operator and profitability for all farm types (except S.I. Intensive again). Some of this runs counter to what the Red Meat strategy and RMPP work has found, but intuitively as a generalisation these relationships make some sense to us. There is plenty of research that shows business drivers and motivations change as you near retirement age. This is not to say this is the rule, rather a generalisation for the industry – there are plenty of older operators that are achieving top performance. But it again highlights the role an individual's motivations and desired lifestyle play in driving performance.

PROFITABILITY RELATIONSHIP WITH AGE OPERATOR



◆ S.I. Hill Country ■ N.I. Hard Hill Country ▲ N.I. Hill Country
● N.I. Intensive × S.I. Finishing breeding

Source: ANZ, Beef + Lamb New Zealand

Perhaps what these links best highlight is the succession challenges the industry is going to face over the next 10+ years. Like the dairy industry, the search for succession solutions is

giving rise to alternative structures such as equity partnerships, which can provide better access to capital and a channel for skilled young people to gain a stake in a farm as managers, or partial owners. However, unlike the dairy industry the search for succession solutions has not yet given rise to greater uptake of business models like contract milking, share milking, profit sharing and equity partnerships in sufficient numbers to rejuvenate the industry.

Outside capital injection is only part of the answer to achieving rates of return attractive to prospective young operators. Either farm values must adjust to reflect the profitability of the land, or alternatively, farms will need to lift productivity through good management and innovation to compensate.

WRAP-UP

There is plenty of room for optimism in the red meat sector despite the challenges. There is no rocket science, or too many secrets around the attributes and farm management practices needed to achieve top performance year-in and year-out.

First and foremost it comes back to one's business motivations and goals. Ultimately you need to have the motivation and willingness to be able to reach the top. This is the same for any activity or business you engage in.

The second aspect is having the right skillset and team. This involves investing in oneself, as well as having a skilled team. Equally, it involves having access to specialists who can provide quality advice in key areas to guide decisions. Having the right skillset, team and access to specialists **allows all the basics of farm management to be executed to an above-average standard on a more regular basis, leading to superior performance.**

When these aspects are coupled with real passion and confidence in the sector's outlook, this drives the cycle of investment and performance leading to growth.