

Australian Dairy Farm Investment Forum 2014
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Dairy Australia



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Pathways to successful farm businesses

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Pathways to successful farm businesses

Presentation outline:

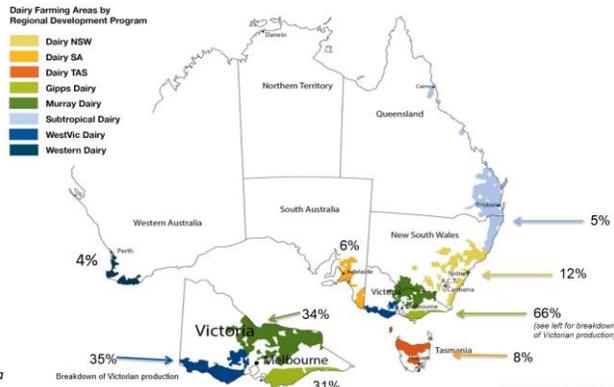
- A brief overview of the Australian dairy industry and our competitive position in the world
- Australian dairy farm profitability
- Australian production systems
- Characteristics of successful farm businesses

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Distribution of Australian milk production



Source: Dairy Australia

Note: percentages do not sum to 100% due to rounding

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Measures of farm financial performance

Profit

- Operating profit (EBIT)
- Return on Capital (with and without capital appreciation)
- Net cash surplus
- Capital appreciation
- Equity growth

Risk

- Debt:Equity
- Cost of production (with and without the cost of capital)
- Operating profit margin

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Australia's farm sector competitive advantage

Australia **does not** have (by world standards) cheap:

- Labour
- Energy (electricity & oil)
- Grain
- Interest rates
- Other cost structures

Despite this (and the challenges of the past decade) we remain **one of the world's largest dairy exporters**:

- Cheap land relative to its productive capacity
- Grain and fodder that is competitively priced and in plentiful supply
- Temperate (mostly) oceanic climate that allows:
 - Growth of good quality pastures suitable for grazing
 - Grazing of cows 'every' day of the year without the need for expensive housing infrastructure, machinery and labour inputs

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Australia's farm sector competitive advantage

High performing well managed pastures combined with judicious use of supplements allows farmers to:

- Produce milk at a low cost of production
- Make efficient use of capital
- Run profitable farms across a wide range of supply curves to meet the processors needs

In addition to milk processor interaction ...

The south eastern Australian milk processing sector:

- Balanced market portfolio – domestic/export and ingredient/retail
- Caters for all types of production curves - seasonal (NZ style) to flat (US)
- Provides flexibility in terms of seasonal pricing structures
- Will buy **every litre of milk** – on every day of the year, from every farm
- World class food safety
- World class product quality
- Not constrained by capital

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World's best dairy data

Dairy Industry Farm Monitor Project (DIFMP)

- Eight year partnership between Dairy Australia and the Victorian government (DEPI) to collect 75 full sets of farm physical and financial data from across Victoria
- Expanded this year to include 300 full sets of data from across Australia

DairyBase

- Currently in development, will initially house all DIFMP data collected to-date
- Aim to become the repository for all farm financial data sets (including consultants and accountants)
- Will provide a **world's best practice farm business analysis system**

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Returns Australian farms are generating

- High performing farm businesses are seen in every region
- Does not include capital appreciation (2-3% adjusted for inflation)

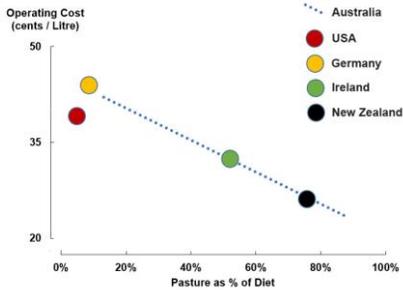
	Top Quartile RoA 6 year summary F09-F14				Top Quartile Cost of Production (\$/kgMS) 6 year summary F09-F14 (including depreciation & inputted labour)		
	Top Quartile 6yr Average	Bottom	Top		Top Quartile 6yr Average	Bottom	Top
South West Victoria*	6.1%	1.8%	9.6%	South West Victoria*	\$ 4.44	\$ 3.78	\$ 5.02
Gippsland*	5.6%	3.7%	8.3%	Gippsland*	\$ 4.37	\$ 3.87	\$ 5.08
Northern Victoria*	8.1%	2.8%	16.0%	Northern Victoria*	\$ 4.74	\$ 4.37	\$ 5.18
Tasmania**	8.5%	5.3%	12.1%	Tasmania**	\$ 3.82	\$ 3.66	\$ 4.10

Source: *DIFMP data **Tasmanian Dairy business of the Year Awards data

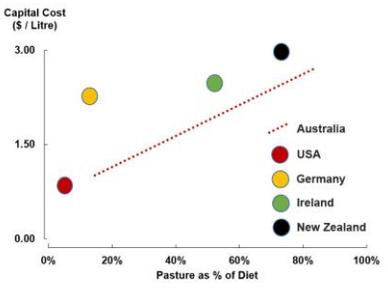
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How do Australian Production systems compare to the other key dairy regions?



Region	Pasture as % of Diet	Operating Cost (cents / Litre)
USA	~10%	~38
Germany	~15%	~42
Ireland	~55%	~34
New Zealand	~80%	~28



Region	Pasture as % of Diet	Capital Cost (\$ / Litre)
USA	~10%	~1.1
Germany	~15%	~1.8
Ireland	~55%	~2.4
New Zealand	~80%	~2.9

Source: IFCN/Xcheque Pty Ltd

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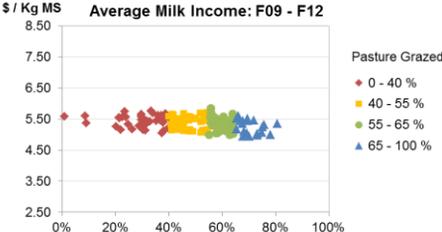


Best production system for Australian conditions

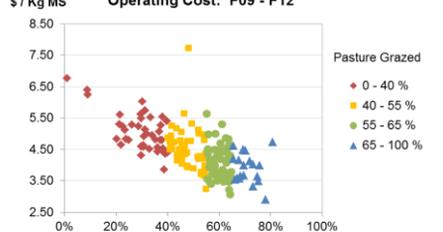
Australian dairy systems range from:

- Intensive grazing with >80% of feed as grazed pastures
- Intensive feeding with >80% of purchased supplements or conserved fodder
- More intensive feeding systems are used to extract more from the milk price schedules (flatter curves) ... but increase the operating cost of production

Average Milk Income: F09 - F12



Operating Cost: F09 - F12



Source: Victorian dairy industry milk supply trends: Analysis of the drivers of farm profit

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Best production system for Australian conditions

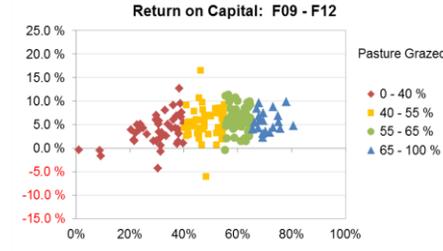
Why do Australian dairy farmers supplement cows grazing pasture?

- More intensive feeding systems make more efficient use of capital (more saleable product sold per \$ invested)
- Similar RoC are observed when grazed pasture constitutes 40-80% of the feed intake of the whole farm
- Australian seasonal conditions are more variable than New Zealand ... however we have an 'endless' supply of locally produced concentrates, fodder and by-products

Total Capital Employed: F09 - F12



Return on Capital: F09 - F12



Source: Victorian dairy industry milk supply trends: Analysis of the drivers of farm profit

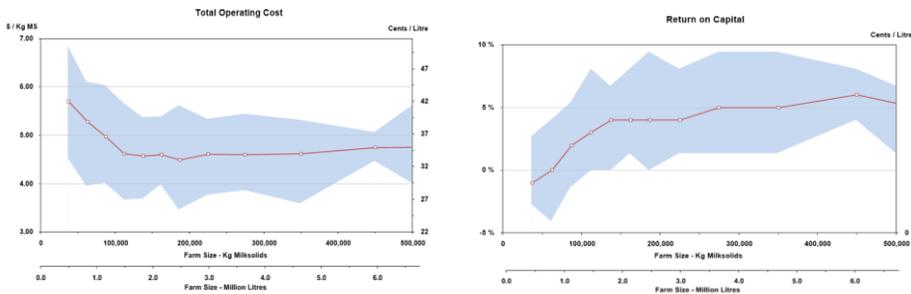
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Does size make a difference?

- Yes it does ... but only for farms producing <120,000 kgMS (approximately 250 cows)
- Above this level the relationship between increasing herd size and return on capital is weak
- Larger farms require more 'operational' expertise
- Intensive feeding systems require more expertise



Source: Victorian dairy industry milk supply trends: Analysis of the drivers of farm profit

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Key characteristics of the higher performing Australian farms

- High level of operational skill (with skin in the game)
- Combining a strong balance sheet with drive (usually means two generations)
- Owner operator(s) providing >30% of labour and performing most overhead tasks
- 400-800 cows (200,000-500,000 kgMS)
- 450-550 kgMS/cow
- High performing pastures and cost efficient feeding systems
- High labour efficiency
- Strong focus on cost control
- **Understand their farm business and are consistent in their approach to farming**

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Investing in dairy farm businesses – pitfalls to avoid

- Timing of entry/major stakes at the wrong stage of the price cycle
- High overhead cost structures – impose corporate management structures
- Herd size too big and/or grown too quickly
- Sub optimal production systems:
 - Focussed on **low cost** as opposed to **low cost of production**
 - Focussed on production without insufficient input cost consideration – more milk is not always more profitable
- Short-term focus on returns
- Reaction when performing below expectations

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How do corporate ownership structures replicate successful existing businesses?

- Replicate family farming businesses
- Partner with local management expertise and allow managers to accumulate assets
- Low overhead costs structures
- Production systems that pass the local sensibility test (i.e. are the results being achieved on similar farms?)
- Incorporate local technical expertise
- Flexible long-term view of returns – equity or flexible lease, not loans
- Not imposing onerous reporting requirements, focus on key indicators
- Start with the end point in mind e.g. exit strategies, staged management buy out
- Utilise their current in-house agribusiness support services and management structures