Concepts for alternative investment and financing models to expand sheep production in Western Australia (WA)

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The purpose of the case studies in the report is to demonstrate how some of the concepts may work. We have not carried out any due diligence on the financial performance of the case studies, and all Information and examples in them have been sourced from publicly available websites.

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# Summary

Globally competitive production systems, multiple trade routes, rising prices and growing demand for lamb from emerging countries bodes well for WA’s sheep industry. This report highlights a range of potential business and investment structures that could exist in WA to expand the industry so as to take advantage of this growing market opportunity. Key terms, benefits, costs and risks associated with various business models on how a sheep enterprise can be owned, managed, expanded and financed, are discussed. Case studies from other countries and industries are included to demonstrate how each potential business model may operate.

# Key highlights

* **Buoyant market signals for the sheep industry** – Australia’s low cost production system and reputation for quality has resulted in it being highly competitive in the global market and a leader in the global sheep trade. Market signals are positive as prices begin to strengthen on the back of rising global demand for red meat (particularly from developing countries) and a tightening of global supply.
* **Multiple sheep management options** – farmers can still gain exposure to the growth opportunities in sheep despite variances in their appetite for market risk, level of sheep expertise and their willingness to be actively involved in daily sheep operations. Some management structures that cater for these variances include co-operative farming, contracting out sheep management, developing contracts along the supply chain or entering into contract lamb production on a cost-plus basis. The potential terms, benefits, costs and risks of each of these approaches together with case study examples are discussed.
* **Multiple financing and capital raising options** – other than debt finance there are a number of financing options worth investigating when looking at expanding a sheep enterprise. Some options include selling and subsequent leasing back of land to release capital for expansion, seeking capital from an equity partner or joint venture partner, or leasing breeding stock.
* **Potential new business models to value add** – a number of new potential business models could exist for farm businesses looking to value add to their product or co-invest up the supply chain. These include commercial feedlotting, partnering with investors to process and market lamb, creating an environment for the development of niche marketing companies to operate, franchising breeding lines and developing dedicated supply chains aligned with the customer/retailer/end market. Some case studies from New Zealand, the United Kingdom and eastern Australia are included to demonstrate how these models can deliver value.
* **Structures to source and pool capital for investment** – there are a variety of structures on how capital could be sourced, pooled and invested across the supply chain to grow the sheep industry in WA. Some examples are investing in research and development companies to accelerate productivity, establishing a structure for Australia’s superannuation funds to invest, establishing syndicates for retail and wholesale investors to contribute to which pool funds invest in farm businesses, or processors/customers setting up a trust to source long-dated funds to invest in farm businesses to boost supply.
* **Success will require increased sheep and business management skills** – excellent sheep operational and business management is critical to the success of all business models. Moving from family farming into a corporate structure will involve increased scale, management, negotiation, reporting, compliance and quality assurance, as well as good communication. Skills will need to be developed in these areas and care needs to be taken with risk of management stretch. With increased scale comes increased requirement for staff management and employment skills.
* **Success will require better collaboration, commitment and communication** – collaboration and the flow of information along the supply chain is challenging under current systems. There are alternative value chain structures that can value-add but collaboration, commitment and communication across parties will be required to build trust and create value.
* **Success will require the right match of partners** – there are a variety of potential business models to grow a sheep enterprise. The challenge will be matching scale, term, returns and risk of the farm business with scale, term, risk and returns sought by investors.
* **Every farm business is different** – this report has been written to broaden how the sheep industry thinks in terms of production and export growth, attracting new participants into the sector and succession planning for the family farm business. There are a number of growth options available but ultimately the appropriate expansion model needs to suit your business goals, management expertise and risk appetite.

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# Executive summary

There are a number of reasons to consider investing in Western Australia’s (WA) sheep industry. Australia’s low cost production system and reputation for quality has resulted in it being highly competitive in the global market and a leader in the global sheep trade. Market signals are positive as prices begin to strengthen on the back on rising global demand for red meat (particularly from developing countries) and a tightening of global supply.

Demand for Australian lamb remains high due to its reputation for producing lamb to the highest quality with stringent animal welfare protocols and the highest food safety standards in the world. Investment in genetics, animal husbandry and pasture research has resulted in Australia having one of the lowest cost lamb production systems globally. WA producers have access to a range of supply chains, servicing international sheepmeat and live export markets, with established trade routes to more than 100 countries as well as domestic markets. This significantly reduces the market risk for sheep producers and also facilitates a competitive bidding environment for sheep, placing upward pressure on prices. Furthermore, WA has an international cost advantage being located closer to growing Asian markets than other exporting competitors.

There are a number of business models and financing options potentially available to farm businesses and investors keen to capitalise on the growing market opportunities for lamb. The traditional and typical approach taken by farm businesses – which are generally family‑owned enterprises – wanting to expand their operation is to borrow funds from a financial institution to purchase more land and stock. There are numerous others ways to expand and this report discusses some potential alternative business models and financing structures that farm businesses and investors may wish to investigate further. Most of the models discussed are conceptual as they do not currently exist in the sheep industry in WA. Case studies from other industries and countries or hypothetical examples have been included to demonstrate how these models may be applied in WA.

There are challenges facing the local industry in capturing the global opportunities emerging in the red meat industry. Low predictability in profits due to a lack of price visibility and volatile feed costs (due to variable seasons and grain prices) is causing some resistance by farmers to invest in sheep. As a result, farmers continue to use land for cropping where forward prices are known and therefore profitability more easily managed. If we can alleviate some of these risks so sheep production offers more stable profitability or better price visibility, confidence to invest in the sheep enterprise will return.

This report discusses concepts for the introduction of alternative business models across the sheepmeat supply chain that could reduce risks and/or increase returns of sheep production in WA. Examples include investment in dedicated research and development in areas such as genetics, technology and pastures to reduce feed cost risk and increase productivity. There are a number of business models that support stronger relationships between participants in the supply chain which encourages longer term commitment of participants and therefore confidence to invest. Some examples include the introduction of forward contracts, an injection of new equity to invest in value-adding such as feedlotting or processing, and new supply chains that foster the development of niche marketing companies.

There are various ways of producing sheep that can be matched to the skill set and resources of the farm business. We discuss the pros and cons of a number of sheep management options including co-operative farming, leasing stubble, developing pastures in marginal cropping land, contracting lamb production, franchising, and contracting out the sheep enterprise to a manager.

Lack of capital is often touted as a reason for lack of investment or entry into sheep. This report summarises some capital raising options to rapidly expand the sheep business, which may or may not be complemented with bank finance. Some examples discussed in the report include joint ventures with an equity partner, sell and lease back land and increase hectares managed, livestock lease through a financier, or attract equity investment from Australian or international superannuation/pension funds, syndicated funds or private equity.

Bringing together WA’s top sheep management talent with the astute financial management acumen of patient investors could bring a lot of benefit and strength to farm businesses. This leads to a win-win for both parties. However, to create this value, better communication between farmers and investors is required in order to work effectively together towards the same goals. The challenge will be finding the right investor or partner for your business. DAFWA launched the InvestWest Agribusiness Alliance to better assist you to find brokers to help you in your search.

A number of strategies available to farmers and investors looking to increase exposure to the sheep industry are canvassed in this report. This is not an exhaustive list of potential business structures and other structures could be created such as Real Estate Investment Trusts (REITs) and stapled securities. The models should not be viewed as mutually exclusive, as the right structure for your business may encompass a combination of financing or operating structures, or in fact extract ideas from a number of business models covered in this report.

The risk, return and success of these business models will vary depending on the management skill, resources, collaboration and communication of all parties involved. There are numerous costs and benefits of each of the conceptual models and structures which are briefly discussed, however, these will differ across businesses. Any business considering entering into an alternative business structure will need to consult with appropriate advisors to ensure all risks, costs and benefits are taken into account.

This report encourages a change in mindset on how a lamb enterprise can be owned, financed and managed. If some of the business models discussed in this report are introduced to WA and well-managed, there is a high likelihood that sheep enterprises will become more profitable, productivity will improve due to increased investment in genetics, infrastructure and sheep management, the supply chains will be better aligned and integrated, markets will be more transparent with better price signals, and producers will have a greater connection with and access to customers/end-users and niche markets. Together this will ensure WA’s sheep industry remains internationally competitive and therefore profitable into the future.

# Introduction – challenging the status quo

The traditional and typical approach taken by farm businesses wanting to expand their operation is to borrow funds from a financial institution to purchase more land and stock. This report highlights some alternative business structures and financing methods that farm businesses may want to consider in achieving the same objective – a larger, more profitable enterprise.

The focus of this report is on expanding lamb production, targeting farm businesses and investors keen to capitalise on the growing market opportunities and strengthening prices for lamb. However, many of the concepts and structures discussed can be applied to other enterprises.

Section 1 of the report discusses how to increase sheep production on-farm by adopting alternative financing and management structures.

Section 2 is targeted at those producers looking to value-add to their product by partnering with investors to extract further value from feedlotting, processing or marketing lamb.

Section 3 highlights some structures on how capital can be sourced, pooled and invested across the supply chain to grow the sheep industry in Western Australia.

To demonstrate how the concepts for alternative business structures might work, numerous examples and case studies are showcased. The information on these case study examples has been sourced from publically available websites.

This report encourages a change in mindset on how a lamb enterprise can be owned, financed and managed. If some of the business models discussed in this report are introduced to WA and well implemented there is a high likelihood that sheep enterprises will become more productive and profitable, supply chains better aligned and integrated, and markets more transparent with better price signals with producers having greater connection with and access to customers/end-users and niche markets.

# Why invest in the WA sheep industry?

* **Globally renowned as a high quality and safe product** – Australia is globally recognised for its breeding conditions, advanced farm management, stringent animal welfare protocols and the highest food safety standards in the world.
* **Established trade routes** – WA has established trade routes of live and processed lamb into over 100 countries worldwide.
* **Internationally cost competitive production and processing sectors** – WA has one of the lowest cost sheep production systems in the world. The costs of production of WA representative farms in the Agribenchmarks survey in 2014 are shown shaded below under the labels Australia-2000 (WA), Australia-4800 (WA) and Australia-7800 (WA). The cost of processing in WA is also relatively competitive to other sheepmeat exporting nations, however, this does vary depending on capacity and associated utilisation rates.

Figure 1 Total costs of sheepmeat in United States dollars per 100 kilograms (US$/100kg) liveweight (Source: Agribenchmarks 2014)

* **Few international competitors and relatively high barriers to entry** – sheep production for most countries is all about domestic consumption except for Australia and NZ who together traded 70% of the world’s sheepmeat in 2014. Australia dominates world trade in sheep (see figures 2 and 3). In 2014 Australia was the second largest exporter of live sheep and sheepmeat (by value), accounting for 20% (live) and 34% (meat) of the world’s total sheep exports respectively. New Zealand is the only other country that exports lamb on the same scale as Australia.

Meat production is generally increasing, although constrained by scarcity of land, adverse weather events, environmental policies, slowing productivity gains and rising grain prices (both as a meat production cost and competitor for land). These factors combined with aging infrastructure and time delays associated with building flock numbers creates barriers to new entrants, allowing those already in sheep to benefit from any increase in lamb and wool value.

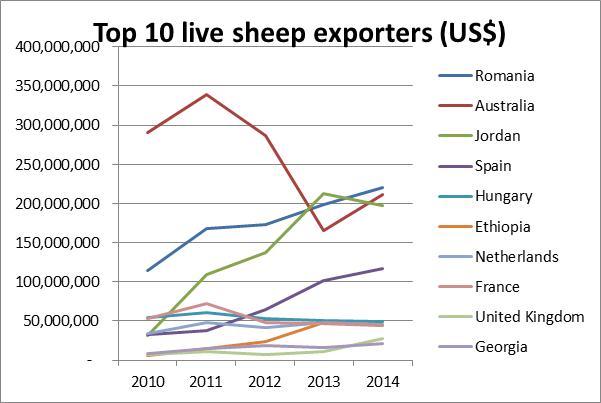


Figure 2 Top 10 live sheep exporting nations by value, 2010-2014 (Source: Comtrade)

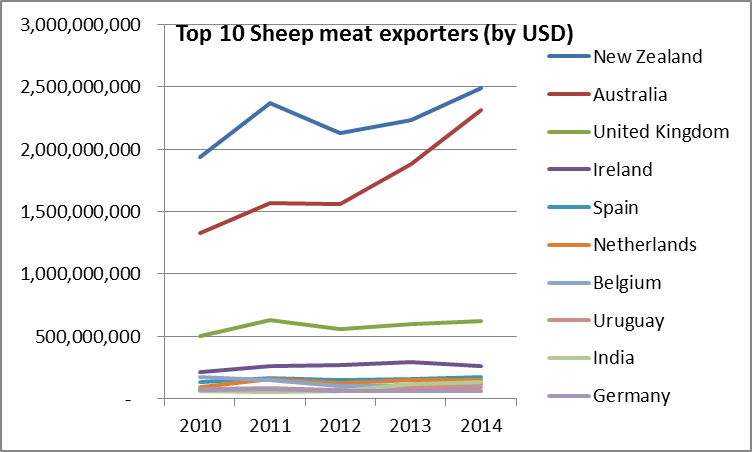


Figure 3 Top 10 sheepmeat exporting nations by value, 2010-2014 (Source: Comtrade)

Western Australia exports around 80% of the sheepmeat it produces (on a weight basis), though this accounts for only 15% of the mutton and 10% of the lamb exported from Australia. The close proximity to the key live export markets in the Middle East means that WA is the dominant source of live sheep with an 82% share of Australian live exports in 2014-15 (Based on Australian Bureau of Statistics customised report, DAFWA analysis).

* **Positive export price trend** – lamb prices in real terms have increased at a faster rate than other agricultural commodities over the last two decades (see Figure 4). This is a signal of strengthening demand and tightening global supply. WA’s export price free on board (FOB) of chilled processed lamb carcasses has trended up over the last decade from below $4 per kilogram (kg) to close to $8/kg (carcass) (see Figure 5). Since 2000 the export price of lamb into the high value United States (US) market has increased from around $6-7/kg (shipped weight) to over $10/kg while cuts into the Chinese market, typically lower value, have doubled from $2/kg to over $4/kg (see Figure 6).

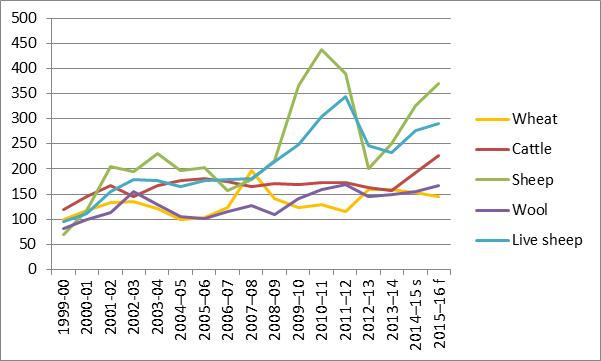


Figure 4 Index of prices received by farmers (base year 1999-00 =100). (Source: Australian Bureau of Agricultural and Resource Economics and Sciences)

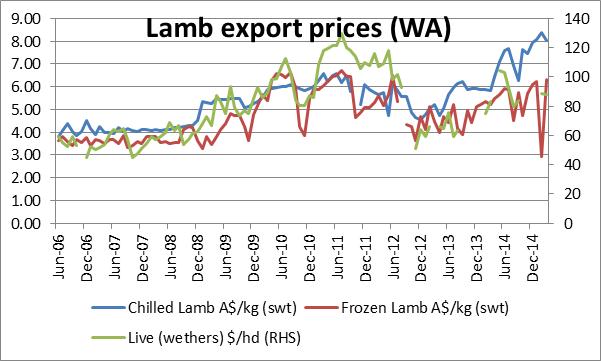


Figure 5 Estimates based on Australian Bureau of Statistics (ABS) data; Department of Agriculture and Food, Western Australia (DAFWA) analysis. Nominal values

Figure 6 Australian lamb export prices to different markets ($/kg shipped weight) (Source: ABS data, DAFWA analysis)

* **Multiple markets and supply chains to sell into** – WA sheep producers have access to sheepmeat export markets through five export-accredited processors (WAMMCO, Fletchers, Hillside, Beaufort Meats and V&V Walsh), domestic sheepmeat markets through a number of processors, and live export markets through a number of agents servicing the live export shippers. Multiple market options provide flexibility for producers and facilitate competition among buyers to secure sheep and therefore put upward bidding pressure on prices.
* **Close proximity to developing markets where demand for red meat is growing** – there is a growing middle class in China, increasing propensity and capacity to spend on higher value products such as red meat. South East Asian economies are also growing rapidly. To better illustrate the potential demand growth and market opportunities, these countries have a population close to two billion people and currently just consume 2-3kg lamb/capita. This compares to Australia with a population of 23 million and consumption of lamb around 10kg /capita. Western Australia has an international cost advantage being located closer to these markets than other exporting competitors (for example New Zealand, Uruguay, United Kingdom, Europe).

Figure 7 Global sheep meat consumption in China and the rest of the world, in million tonnes. Source: Organisation for Economic Co-operation and Development (OECD)

* **Wool offers a valuable income stream accounting for just over half the gross value produced by the sheep industry** –approximately 4-6kg wool (greasy) is produced each year from Merinos creating approximately $35/head of additional value. Since 2009/10, the volume of WA wool exported has remained steady at between 50 and 70 million kg greasy, while the average price has increased from $6/kg to around $7-7.50/kg greasy (FOB) and it was as high as $8.50/kg in 2011/12.
* **Complements and can de-risk the cropping** **enterprise** – in areas of WA the cropping and sheep enterprises in rotation often complement each other. Having pastures in the rotation for sheep production often allows the crop enterprise to produce higher yields at a lower cost and therefore be more profitable. For instance, pastures often assist crops with weed management, reduce herbicide resistant risk, improve soil health and add nutrients (Nitrogen) to the soil.

## Investment risks

The main risks associated with investing in the sheep enterprise in WA are:

* **Market risk** – price volatility and lack of contracts available result in poor price visibility. This makes investment decisions more difficult.
* **Seasonal risk for free range/pasture fed sheep** – variable seasonal rainfall influences cost of feed and therefore cost of production. Higher feed costs in a low rainfall year are not necessarily offset by higher prices. In fact, often lower prices result as farmers offload sheep.
* **Management risk** – there is a need to employ very good sheep managers that can perform in the top 25%, to generate sufficient returns to cover risk and the overheads of a larger business (as per many of the models in this report).
* **Opportunity cost of alternative land use** – potentially higher returns in cropping in some years.
* **Management of complementary land use** – there is sometimes timing conflicts between the cropping and sheep enterprises on the farm (for example around the break of the season) and these need to be well managed.
* **Political risk** –there is some risk that production, markets and supply chains can be impacted by Government regulation that may change in response to the political influence of lobbyists in areas such as animal welfare, food safety and/or disease outbreak risks.

# Section 1: alternative finance and management structures to expand sheep production

This section discusses how to increase the sheep enterprise by adopting alternative financing and management structures.

The optimal way to manage sheep for maximum returns will depend on the farmer’s sheep management skills, their desire to manage sheep and time available to allocate to sheep. Some alternative management strategies to cater for these variable factors and increase sheep production include:

* Co-operative farming with other farmers – for those wanting to allocate their time to the enterprise they like and are best at managing. This could be sheep or cropping.
* Contracting out sheep management – for those wanting returns for the sheep but don’t want to do any of the day to day running of the sheep.
* Contract with processors or customers – for those wanting to know prices so as to confidently invest in building their sheep flock and associated infrastructure.
* Contract with breeders – for those wanting to accelerate and outsource management of breeding.
* Leasing land (stubble, marginal, saline) from crop businesses – for those looking to increase stocking rates and cover the feed gap over the summer and autumn period.
* Contract lamb production – for those that don’t want to own the breeding stock nor want to take market risk on lamb. Lamb is produced according to terms of the owners and the return is the cost of managing ewes and lambs plus a margin.

There are also a number of financing options, other than debt finance, worth considering when looking at expanding the sheep enterprise. These include, but are not limited to:

* Sell and lease back land, which releases capital that can then be re-deployed on leasing more land and increasing the flock.
* Seek capital from an equity partner or joint venture partner.
* Lease livestock.

The potential terms, benefits, costs and risks of each of these approaches together with case study examples can be found in this section.

## Co-operative farming

### The model

Co-operative farming is where two or more producers form a company or joint venture and consolidate farms to increase efficiencies of labour, machinery and management skills. For example, one producer may concentrate on running the sheep enterprise across both farms and the other would focus on running the crop enterprise. They would also help each other out in peak times to gain labour efficiency throughout the year. This structure would allow sheep management to be a lot more focussed and thus profitable.

### Suits

Producers limited by scale and wanting exposure to well-managed cropping and sheep enterprises.

### Key terms

* A company or joint venture (JV) is incorporated with each producer having equal (or agreed) ownership share.
* Each producer specialises in an area in which they have better management skills.
* Machinery, mobile plant and sheep flock is sold to the ‘company/JV’ which is then consolidated and/or upgraded to optimal scale for the combined farm enterprise.
* Company/JV pays a lease to each producer for land.
* Each producer is paid a salary from the company/JV entity.
* Profit of the company (after tax) or JV (before tax) is distributed to each lamb producer proportioned to ownership held.
* Tax is paid at company tax rate (if a company). Company can distribute fully franked dividends to company shareholders.
* Independent advisory board established to deal with management concerns or disputes.
* Processes and policies on operation, growth and exit are agreed and written up.
* Fixed initial term needs to be agreed.

### Benefits

* Increased yields across grain, wool and lamb due to more highly skilled and focussed management.
* Introducing more sheep in the rotation increases grain yields and lowers fertiliser costs of farms predominantly cropping.
* Increased profit due to increased efficiency of plant and equipment and higher yields.
* Use of land can be better optimised.
* Work is more enjoyable as it is focussed on the enterprise you prefer.
* No change in land ownership.
* Retain exposure to both grains and sheep.
* Reduced business risk as portfolio of enterprises more balanced.
* Succession planning.
* Geographic spread.

### Costs/risks to consider

* Need to consult and agree on major decisions. For example, need to agree on how profit is to be distributed and how much is to be retained in the business. All parties need to have similar goals for agreement.
* Willingness to work with others jointly and not be ‘the boss’ of all decisions.
* Good communication and written policy is imperative.
* Risk that the other party will want to exit early.
* Lose some control of some management decisions.
* Consider taxation implications.

### Case study

Bulla Burra, South Australia

Two families in South Australia have joined their operations under a collaborative farming model and expanded further. Their organisational structure is below:

Diagram 1 Organisational structure of Bulla Burra

The Bulla Burra operation pays out lease fees to the land owners, fees for management, wages for labour and dividends to the contributors of capital. Each farmer could have received all these income streams depending on his/her involvement and contribution to the Bulla Burra business.

#### Key principles of collaborative farming

* Differentiate between agribusiness and real estate – Bulla Burra pays lease on all land back to owners.
* Utilise machinery efficiently – Bulla Burra sold all machinery and bought new machinery to optimise production of the combined larger operation.
* Create cells and replicate them – Bulla Burra has worked out optimal land area for one harvest or seeding unit and invested in multiples of that cell size.
* Create an environment of win-win – farmers work to their strengths at Bulla Burra.
* Engage specialist services – Bulla Burra use a range of consultants.
* An independent voice is needed – there is an independent director on the board.
* Be strategic – board in place that sets the strategy of the company.

#### Result

Profitability for each farmer has increased significantly since they have operated a larger enterprise together.

#### Why it works

The owners of Bulla Burra think the business works because it:

* creates cells of optimum efficiency
* maximises profitability of the enterprise
* farm and business skills are recognised and valued
* integrity and heritage of family farm is retained through land ownership
* able to access latest technology
* flexibility of involvement
* geographical spread of risk
* offers succession planning benefits
* high level of professionalism and accountability
* corporate values and principles are brought into a family farming operation
* is your farm.

## Release capital and expand farm business – sell, lease back & expand

### The model

Many farming businesses have a lot of capital tied up in land, and expansion by purchasing more land requires further capital. Without very strong cash flow it is very difficult to build up capital reserves to pursue this growth model. An alternative model is to sell some land to an investor, lease back the land and with the released capital (from the sale) expand the farming business by leasing more land and purchasing additional stock to build up the sheep flock.

### Suits

* Producers looking to release capital to expand farm enterprise and maintain management control.
* Investors looking for exposure to agricultural property with no farming business risk.

### Key terms

* Land is sold and leased back on a long term lease at either a set percentage of land value (which is revalued every five years or otherwise agreed term) or at commercial rates set by local market conditions.
* All land improvements (for example sheds, fences) to be maintained and funded by land owner (investor). General maintenance including lime (to maintain pH) to be funded by lessee.
* With additional capital, the producer expands the sheep flock and leases more land (may or may not be owned by the same investor), operating a much larger enterprise.

### Benefits

* Capital re-deployed in business, generating higher returns than land.
* Alternative finance to debt (interest displaced by lease payments – at a lower rate).
* Debt reduced and capital released to expand business (through leasing more land).
* All farm management decisions retained by the lamb producer (lessee).
* All farm business profit retained by sheep producer.
* Profit increases due to larger scale and efficiencies of scale.
* Net asset value may not change as lower land value offset by lower debt and higher stock levels.
* Leasing offers more flexibility on where and how long you farm as it’s only contracted on lease term, as compared to owned land which is more illiquid and has capital gain implications.

### Costs/risks to consider

* Finding lease land appropriate for the business can be challenging in WA.
* Security of tenure and protection from landlords.
* Forgo future capital gains on land sold.
* Interest rate environment – long term rates may in some circumstances be more attractive but need to weigh up against higher returns generated from operating a larger enterprise.
* Forgo some future borrowing capacity from banks that require land as security.
* Lease rates may increase with land value, rather than inflation or stay fixed like fixed term debt facility.
* Taxation implications.

### Recent case studies

#### Olam sells and leases back almond orchards

In late 2013 Olam Almonds Australia Pty Ltd entered into a sale and lease-back agreement for it’s nearly 12 000 hectares of almond orchards for a cashconsideration of $200 million Australian dollars ($A). The transaction with Adveq Almond Trust, an Australian trust structure owned by a group of investors led by Adveq Real Assets Harvested Resources, LP (‘Adveq’), involved the sale and lease-back of almond orchard land and trees as well as related farming and irrigation infrastructure in Victoria, Australia for a period of 18 years, which could be extended or renewed by mutual consent.

Adveq is an asset manager investing in private equity and real asset funds globally and has approximately US$5 billion assets under management. Other key initial investors in the trust include Municipal Employee Retirement System (MERS) from Michigan in the US and Danske Capital (‘Danske’) from Denmark. MERS is a public non-profit organisation serving municipalities and their employees across Michigan with US$8 billion assets under management. Danske is an international asset manager and a part of the Danske Bank Group as well as Danica, the local pension authority. Located in northern and eastern Europe, it manages in excess of 95.0 billion Euro in assets for both home market retail clients and other institutional clients across the world. The Laguna Bay Pastoral Company is also one of the investors and has been appointed the trust’s asset manager in Australia.

Olam’s Executive Director of Finance and Business Development, A. Shekhar said “The transaction is in line with Olam’s strategy to pursue profitable growth and generate positive free cash flow. Though we will no longer own the land, trees or the farming infrastructure, we continue to retain the production economics of the entire almond harvest from these orchards.” Olam will receive A$200.0 million cash, and bring down its invested capital and improve return on invested capital. [Read more on the Olam story](http://olamgroup.com/news/olam-international-announces-the-sale-and-lease-back-of-its-australian-almond-orchards-for-a200m/#sthash.Jhm0xRMx.dpuf).

#### WA farmers sell and lease land from US fund

Westchester, a US pension fund, is estimated to have invested about $120 million on grain-growing properties in WA over the period 2008-2014, and up to $900 million in agricultural land across Australia. Recent acquisitions at Grass Patch in 2014 cover about 8000 hectares (ha) with one of the former owners set to stay on to manage both farms.

Westchester's passive investment model relies on leasing the properties back to the former owners, or more commonly, farmers looking to expand their operations.

A select group of farmers have taken the opportunity to lease tens of thousands of hectares of prime cropping land and rapidly expand their operations. The model allows farmers to take advantage of increases in scale and efficiency.

The Teachers Insurance and Annuity Association of America (TIAA) has a controlling interest in Westchester, which runs the International Agricultural Investors fund. TIAA has about $450 billion in assets under management and is believed to have given Westchester a brief to invest $1.5 billion in Australian agriculture and similar amounts in Europe and South America.[[1]](#footnote-1)

## Replace debt with equity

### The model

Investor(s) contributes equity to the farm business. The funds from investor(s) pay down debt and are invested into building the sheep flock and associated infrastructure (for example shearing sheds, yards, handling equipment). Producer continues to manage the business. A proportion of profit is distributed to investor(s) as dividend. Investor may choose to purchase more land to increase the size of the enterprise.

### Suits

* Lamb producers looking to match financing costs to farm performance, expand the farm enterprise without investing more equity and continue to manage the larger farm.
* Investors looking for exposure to the farm business (may or may not include investment in agricultural land). Investors could be a group of farmers looking to expand operations.

### Key terms

* Equity contribution from investor(s) is used to reduce debt, buy some land, invest in flock and associated infrastructure.
* Producer is paid a salary/management fee to manage the farm.
* Business pays land owners a lease fee.
* Distribution and reinvestment policy needs to be agreed. For example, profit may be distributed to investor in proportion to equity contribution after agreed capital expenditure items have been deducted.
* Investor(s) is aware returns are in capital appreciation with lower cash returns.
* Remaining profit distributed to lamb producer.
* Farm business would have to regularly report to investor sufficient financial and operational updates as well as provide adequate returns to the investor.
* Producer has first option to purchase should investor(s) want to divest his/her interest.

### Benefits

* Increased profit due to expanded farm enterprise.
* Reduced debt and associated interest costs.
* Dividend to investor is linked to farm performance (not fixed).
* Can expand sheep enterprise without borrowing more money.
* Net asset value is unchanged.
* Producer paid a management fee before profit distribution is determined.

### Costs/risks to consider

* Common goals for the business and clear expectations of returns need to be agreed. For instance, how much is re-invested in the business, are returns cash or capital gain, etc?
* Will be accountable to investor and compliance (reporting) burden will increase.
* Investor will want to exit if farm business underperforms which may lead to need to re-finance again. Exit strategy needs to be arranged.
* Many investors are typically only interested in large farm enterprises. Therefore the producer will likely need to manage a much larger enterprise and may need to invest in improving their staff management skills.
* Finding investors willing to invest in a smaller enterprise may take longer to find.
* Taxation implications.
* Set up and maintenance commercial and legal costs.

Table 1 Key differences between debt and external equity (example only)

| **Item** | **Bank** | **External equity contribution from investor** |
| --- | --- | --- |
| Distribution | Fixed, regardless of farm performance | Distribution is a percentage (%) profit, so investor returns match farm performance. |
| Compliance | Annual or semi-annual review | Semi-annual or quarterly provision of accounts and operational updates, possibly more scrutiny depending on the investor. |
| Repayment | On an agreed term | Investor's equity contribution remains fixed with no repayments. However the investor will need exit options so methods on calculating ownership value needs to be agreed. |
| Cost | Depends on bank rates and credit risk | Investor likely to seek returns comparable to other assets/operations with similar risk profile. Must outperform bank interest on average. |
| Management fee | Bank paid before farmer | Farmer paid management fee before profits are distributed to investor. |
| Losses | Bank paid regardless of losses | Investor only paid if profitable year, losses may be carried over (if arranged with investor). |
| Capital gains – land | 100% to farmer | Capital gains on land are retained by owner of the land. If investor funds go towards land ownership, terms around gains need to be negotiated and asset revaluation reserve may need to be created and liquidated. Sometimes investor’s capital is only for working capital, plant and sheep. |
| Exit | Can foreclose if terms are breached | Exit terms to be negotiated with investor including valuation methodology of business and assets. May have a fixed term with option to extend. Farmer may ask for first rights to purchase. |

### Case study

Equity partnerships in New Zealand (NZ) dairy industry

Equity partnerships have become prevalent in the New Zealand dairy industry. ‘Equity partnerships’ exist where a number of people have pooled their equity to become partners. In most cases in NZ they have pooled resources to form a ‘company’. A key advantage of equity partnerships is that it enables farming on a larger scale than would be otherwise possible. Physical involvement may range from equity interest only (‘investor’), equity interest and active involvement (‘managing partner) or ‘manager’, whose employment is separate from shareholding.

Equity partnerships allow outsiders to invest in the industry; provide an entry point for managers wanting to create a stake in land ownership; and give landowners the option to release some equity, without removing themselves from their farming asset. [[2]](#footnote-2)

Shadbolt and Martin found that key factors fundamental to success of equity partnerships in NZ include:

* All equity providers have broadly similar goals.
* Clear procedures to provide for the orderly exits of equity holders, if required, in the future.
* Issues such as the basis for valuing an equity holder’s interest and the requirement for notice to be given are critically important.
* Good financial management, governance and communication policies and processes are essential.
* Roles and responsibilities of decision making processes are clearly defined.
* Dispute resolution processes clearly defined.
* Determine a common vision for the business and to agree on both cash dividend and growth expectations.

Table 2 Advantages and disadvantages of owner operator versus equity partnerships (Note: \*Perceived advantages and disadvantages of the different structures in the NZ dairy industry found through focus group research carried out by Payne et al[[3]](#footnote-3))

| **Structure** | **Owner operator** | **Equity partnerships** |
| --- | --- | --- |
| Advantages\* | Asset rich  Stable operation  Labour  Control  Simple decision making  Pride & attachment | Business approach  Spreading risk  Wider skill base  Scale  Access to capital |
| Disadvantages\* | Limited time off-farm  Smaller farms  Over capitalised  Narrow focus  ‘Eggs in one basket’  Not treated as an economic unit | Needs the right mix of people  More people in charge  Cash yield low  Governance process  Lack of emotional attachment  Lack of control |

## Leasing options – stubble, marginal cropping land, saltland pastures

### The model

Sheep producers lease stubble, non-arable, moderately saline or marginal cropping land from crop producers as alternative options for feed over summer and autumn at a lower cost to grain feed. Crop producer gains lease income as well as benefits from sheep such as weed control, stubble removal (lowers frost risk) and fertiliser. Crop enterprises may be financially better off converting marginal cropping land to pastures and leasing it out to sheep producers.

### Suits

* Lamb producers wanting to capture high prices (out of season lamb) and seeking alternative feed options that are less expensive to grain feeding by hand.
* Sheep producers looking for alternative feed sources over the summer/autumn periodthat don’t require as much labour/management as hand feeding.
* Cropping farm enterprises seeking additional income stream from non-arable and marginal cropping land.

### Key terms

These may include:

* Lease term and price per ha/head per day/month
* Fencing and water infrastructure to be provided by farm owner, maintenance to be provided by lessee.
* Term on pasture improvement, manipulation and establishment to be agreed.

### Benefits

* Sheep producer – feed source over the summer/autumn feed gap.
* Crop producer – additional income, weed control, land restoration, possibly back to cropping in future years, income for non-arable land, stubble removal, fertilizer.

### Costs

* Finding lease land appropriate for the business can be challenging in WA.
* Sheep producer – additional transport costs for stock, additional travel time to check flocks, water and fences, risk of disease.
* Pasture establishment costs.
* Additional investment in infrastructure may be required, for example fencing.
* Crop producer – risk of soil erosion if over stocked, risk of introduction of disease such as lice, ovine Johne’s disease (OJD) if already owns some sheep.

### Example

Grazing saltland pastures

Some farmers are investing in improving saltland pastures to:

* feed sheep over the autumn feed gap, which creates a saving on supplementary feed costs
* defer sheep grazing on annual pasture paddocks, which allows pasture paddocks to get established.

Some farmers use a ‘crash grazing’ strategy in autumn – high numbers of animals for short periods. The reasoning is that it should force animals to eat the less desirable species, including the saltbush, leaving the paddock evenly grazed down to the recommended dry matter level, allowing good plant recovery and reducing erosion risk once the animals are removed. Stocking rates of 25-30 sheep/ha are common but it depends on mob sizes.

Farmer case studies and trials have found that saltland pastures can provide from 350 sheep grazing days per year in low rainfall areas to more than 1000 sheep grazing days per year in high rainfall zones, depending on rainfall, soils and management.

### The opportunity

DAFWA has found that of WA’s total current saltland on cleared agricultural land (737 500ha),about 20 per cent (147 500ha) has potentially high private benefit from a change to improved pasture[[4]](#footnote-4). To date, it is estimated that 7400ha has already been treated with improved pasture.

A large proportion of these 147 500ha that are ‘high potential’ are also likely to be marginal cropping land which creates an opportunity for sheep managers/owners and land owners to work together to improve the land and generate higher income. For example, the land owner can improve and lease the land to the sheep manager over the summer/autumn period at a rate that is cheaper than supplementary feeding and higher than cropping. There will need to be investment in providing adequate water supply and fencing.

There is also unprofitable cropping land with ‘transient salinity’ (usually shallow duplex sodic soils), which may be more than 500 000ha across WA’s agricultural zone. The carrying capacity of that is likely to be at least three Dry Sheep Equivalent (DSE) per hectare if managed for pastures, and that means an additional 1 500 000 profitable DSEs, and less unprofitable cropping (win-win).

### Case studies

Some case studies on carrying capacity of saltland pasture grazing are:

* Tammin – reasonably hostile high salinity bluebush land established to rows of saltbush with low levels of understorey. The farm has progressively established small areas over the last 25 years and now has about 400ha of saltland pastures. Normal expectation for autumn feed is 25 sheep/ha for five weeks (875 sheep grazing days/ha/year).
* Broomehill – 49ha established during 2004 to very dense tall wheat grass (TWG) with low levels of legume underneath. Carrying capacity recorded during 2006 was 1595 ewe hoggets for 44 days with minimal supplementation and no change in bodyweight or condition score (1,400 sheep grazing days/ha/year).
* Katanning – 40ha successfully established to direct-seeded saltbush rows with grass understorey in 2003 on the barley grass zone just above the samphire and bare salt scalds. Recorded 470 sheep grazing days/ha in 2004 and 300 sheep grazing days/ha in 2005 (good season – did not need the feed, hence left largely ungrazed). Measurement during autumn 2006 revealed 700 sheep grazing days/ha on one plot and 1100 sheep grazing days/ha on another plot – both with minor supplementation and with no change in bodyweights or condition scores (average 800 sheep grazing days/ha/year).

On the basis of the case studies, trials and distribution of saline land, there may be a potential additional carrying capacity of about 300 000 DSEs (150 000ha multiplied by the average carrying capacity on productive saltland of two DSEs/ha). These figures are indicative only, as the management unit size required of productive saltland has not yet been assessed.

## Contract lamb production

### The model

An investor, which could also be a processor, broker or end user, establishes breeding stock to a high standard that meets the specifications of a high value customer or market. The investor owns the breeding stock and puts them on the lamb producer’s property. Lamb producer looks after the sheep and grows out the lambs to specifications. Investor pays lamb producer a fee that covers land, labour and feed costs plus a margin.

### Suits

* A lamb producer that wants to produce lambs (and is good at it) and wants to make a stable income without being exposed to market or price risk.
* An investor that understands high value customers’ needs and requirements and can access appropriate genetics but doesn’t have the sheep management skill required.

### Key terms

A variety of payment terms could exist under this model. These include:

* Take or pay contract with investor/processor with agreed long term price.
* Payment on a per head basis that meets specified weight and/or condition.
* Cost recovery for land (lease) and inputs (feed, animal health) plus a management fee per head.
* Performance bonuses may be offered as incentives to increase turn-off and minimise ewe deaths.
* Need to agree terms around managing costs in poor seasons.
* Delivery dates and acceptable death/loss rates need to be agreed.

### Benefits for lamb producer

* Stable income with lower risk.
* Low capital requirement as investor may fund rams, ewe flock and/or replacements.
* Less exposure to market or price risk.
* Good lamb production is rewarded.
* Upside from favourable seasons.

### Costs/disadvantages for lamb producer

* May be required to produce lambs more smoothly over the year/out of season to meet customers supply requirements. This may lead to an increased management burden. The associated additional feed cost should be reimbursed by investor.
* Don’t receive benefits of a strengthening price for lamb. This is a cost-plus model whereby only good production management is rewarded.
* Additional management skill is required in poor seasons.
* Additional compliance such as an annual budget agreed prior to commencement, monthly reports to investor, progress on season and expenses.
* May be penalised if management doesn’t meet specifications or terms.

### Case studies

#### Allied Beef[[5]](#footnote-5)

Allied Beef, an independent company, has an established procurement network across all cattle regions in Queensland (QLD) and New South Wales (NSW) ensuring timely purchases of cattle carefully selected to customer needs. Allied Beef does not have processing, lot feeding or saleyard interests, which ensures advice is not influenced by other company agendas. Allied Beef works with its producer partners to maximise value of production off-farm for their property and financial situation. Each contract is custom made and very different. One option available to farmers with cash flow concerns is to elect to grow out cattle, owned by Allied Beef, on their farm on a cost-plus agreement.

#### Pork industry

There are numerous contract arrangements across the pork industry whereby capital costs and risks are shared across breeder, manager and processor. For example, there are farmers in WA that only own the infrastructure and manage the labour to grow out the piglets to market specifications. The processor owns the piglet, delivers it to the farm, covers all the feed and animal health costs, provides management guidance and then arranges transport when the pig has reached contract specifications. The farmer receives payment for pigs delivered to specification hence is incentivised to grow them as fast and efficiently as possible with least possible deaths, injuries etc. In this example the risks can be very low for the contract producers and due to year round deliveries there is constant cash flow. This model allows producers to invest capital in expanding facilities and labour to run much larger and more efficient operations than would have been achievable under a breeder and owner model.

There can be additional players and arrangements. For instance, processor leases sows from farmer/breeder group or processor supplies sows to breeder (paid on basis of live pigs at four weeks) and then delivers piglets to farm. Contracts can be long term, for example 10 years, to cover infrastructure investment by the farmer.

## Joint Venture (JV) with investor

### The model

Unlike a partnership, a JV can allow individuals to combine resources but retain ownership to create larger operations. Essentially, it provides the opportunity to create a business structure that will combine all operations of each of the members and provide diversification, but allows each farmer to operate on their own land. For example, a lambproducer owns sheep, labour and sells some land to the investor (JV partner). The investor purchases additional land to form a larger and more economically viable farm. The lamb producer farms the larger property with little to no debt. Efficiencies of scale and animal husbandry are maximised. The lambs are divided at an agreed ratio (based on cost contributions) and sold separately by the respective parties, the producer and the investor. Balance sheet and earnings of each JV partner are kept separate for taxation and ownership purposes.

### Suits

* This model could have application where producers have high debt and wish to reduce debt but increase scale and leverage to the lamb market. Earnings and assets are kept separate in their respective businesses – no joint ownership.
* This model suits investors or end-users, with little farm management expertise, looking for leverage to the lamb market, agricultural property or a more secure supply of lamb.

### Key terms

These may include:

* number of JV partners
* lease payment to respective land owners
* terms on how infrastructure and land improvements are to be funded and managed
* agreed budgets with reviews quarterly or monthly
* agreed method of calculating cost contributions
* lamb producer may be paid a salary/management fee which may include incentive bonuses
* term of JV
* exit strategy with first option to buy given to the other party.

### Benefits to lamb producer

* Debt reduced which lowers 'risk profile' of lamb producer.
* Equity remains constant (land asset liquidated to cash asset and offset against debt).
* Economics of scale of machinery and labour increases earnings.
* Larger purchasing power.
* Lamb producer receives salary/reimbursement for time regardless of season.
* Return on Invested Capital (ROIC) increases.
* Investor upgrades machinery and equipment for better sheep management.
* No payments need to be made to JV partner (other than their share of lambs).
* Balance sheet and earnings of each JV partner are kept separate for tax and ownership purposes.
* Title of land already owned by lamb producer remains in lamb producer's name.

### Costs to lamb producer

* Lamb producer is now managing a larger farm and may have to manage a larger labour force (shared cost).
* More compliance – monthly management reports need to be provided to JV partner(s).
* JV agreement with investor on terms needs to be negotiated.

### Case study

JV company ‘Liveringa Stations Beef Pty Ltd’ held 50/50 by the Hancock Prospecting Group and Dowford Investments

Dowford Investments, the parent of the Milne AgriGroup, and Hancock Prospecting Group, owned by Gina Rinehart, have formed a 50/50 joint venture company known as Liveringa Station Beef (LSB). The JV includes Liveringa and Nerrima stations covering 470 000ha in the west Kimberley and the currently mothballed Waroona abattoir south of Perth (previously Clover Meats). Hancock Prospecting injected $40 million for its 50% interest in the JV in mid-2014[[6]](#footnote-6).

The Hancock Prospecting Group brings capital and expertise on Asian markets and exporting while Dowford Investments brings expertise on cattle production. Together the JV company can become an integrated production, processing, packaging and marketing company developing consumer products that can support export market development of boxed beef.

The stations run Braham and Brangus herds and have bred Red Brangus cattle, mostly a cross between Angus and Braham cattle since 2003. Each year, unsold weaners (except females retained for the replacement herd) are transferred, at an average weight of 150kg, for agistment in the south of the state to be fattened up for live export or local processing. All agistment is with third parties that have surplus feed available. Agistment is generally paid at the rate of $1.00 per kg of liveweight gained which is less than the cost of retaining the weaners on the station. Apart from increasing the kilograms of meat produced, agistment extends the range of marketing options both in time to market and destination.[[7]](#footnote-7)

LSB markets limited boxed beef at present and uses third party slaughter. Processing cattle results in a large number of primary and co-products and requires comprehensive marketing to optimise returns.

LSB controls the Clover Meats abattoirs (one for cattle and one for pigs) together with a boning room facility. The abattoirs also have a by-products processing plant. These abattoirs are closed at present but are held for future demand.

## Introduce long term contracts along supply chain (for example breeders, customers or processors)

Note: customers and processors currently do not issue long term enforceable contracts at this stage.

### The model

Customers or processors issue forward contracts on a regular basis of up to three years. A forward contract is a customised contractual agreement where two private parties agree to trade a particular asset with each other at an agreed specific price and time in the future. Forward contracts are traded privately [over-the-counter](http://en.wikipedia.org/wiki/Over-the-counter_%28finance%29), not on an exchange, and are non-transferrable. It is a legally enforceable contract. To reduce the price volatility of breeding stock and speed up genetic gain in the WA flock, stud or genetics companies could start supplying breeding stock under long term contracts with farmers with pricing terms.

### Terms

A forward contract issued by WA processors might include the following terms:

* required lamb and/or sheep specifications (weight, age, breed, etc.)
* required number of animals (or allowable range)
* delivery window (week/month) and location
* price or price discovery mechanism including price grids, minimum prices, skins
* payment terms
* penalty arrangements for failure to deliver by producer
* penalty arrangements for failure to accept delivery by processor
* default procedures
* dispute resolution
* force majeure
* loyalty incentives (profit sharing, priority delivery to premium opportunities, peak season priority, first-call on future contracts, early payments or part-payments)
* advance or down payment options
* performance incentive.

### Benefits

Benefits for sheep producers and feedlotters might include:

* Knowing in advance the price and delivery period will assist producers to manage costs, margins, farming system, financial and production planning.
* Apart from price, a contract arrangement might also give priority to these producers during the main turn-off period, and lend support to their application for finance.
* Opportunity to share the price risk with processor.
* Provides opportunity for feedlotters to purchase and finish lambs for a particular delivery window and lock in a margin.
* Minimum price contracts lock in downside and offer upside if spot price is higher on day of delivery.
* Can determine whether supply of out of season lambs would be more profitable.
* Price security increases confidence to invest in their sheep enterprise long term.

Benefits for sheep processors might include:

* Can manage supply risk and supply volatility, particularly in supply constrained periods.
* Greater supply assurance and stability will optimise the relationship between processors and their customers.
* Known cost to source sheep and better planning of supply profile to negotiate sales contracts with customers.

### Costs/disadvantages

Potential costs/disadvantages for sheep producers and feedlotters:

* Still have to handle production and seasonal risk associated with meeting contract terms.
* May forgo a better (spot) price in the future – speculation.

Potential costs/disadvantages for sheep processors:

* As there is no futures market to hedge exposure to price movements, processors need to have forward sales secured before offering contracts or back-to-back contracts with customers.
* Processors operating as a cooperative may have a problem if they offered contracts that lead to members being excluded.
* Some processors may not be able to manage back-to-back farmer contracts 100% into the market because of the multiple cuts of meat going to a huge variety of customers.
* The processor would need to sell a differentiated product rather than a commodity as it is more difficult to forward sell a commodity.
* Minimum price contracts can become ‘out of the money’ if spot prices fall below contract price.

### A forward contract issued by major wholesaler/retailer

A major wholesaler/retailer such as Grand Farm (China), which may or may not have an interest in a processing facility, issues forward contracts with producers up to two years out. The customer either processes the lamb at a facility they partially or fully own; tenders and contracts out its processing requirements to WA abattoirs to match the supply contracts with producers; or exports sheep live for processing overseas. This model improves transparency and market signals between producer and customer which facilitate better supply chain responses to customer demand.

A forward contract issued by a major wholesaler would have terms similar to that of a forward contract issued by a WA processor.

Some additional costs and benefits for producers contracting with wholesalers and retailers are highlighted below.

#### Additional benefits for sheep producers and feedlotters

Note: in comparison to a contract with a processor.

* Increased number of buyers and market options may increas bidding pressure and prices.
* Can adjust supply to match customer demand that is offering better returns.
* Faster price signals on changes in market demand.
* Greater transparency on global market conditions and outlook for demand and supply.
* Producers will become committed to understanding the needs of their customer, and therefore consistently aim to deliver better value.

#### Additional potential costs/disadvantages for sheep producers and feedlotters

Note: in comparison to a contract with a processor.

* Counter party risk and dealing with international buyers – possibly more difficult to pursue payment or damages cross borders in event of default or dispute of contract. However, this risk may be mitigated through insurance and the introduction of Australian Lamb Trade Rules by Meat and Livestock Australia (MLA), or equivalent.

### Other issues

* Price discovery and forward market indicators – if a price discovery mechanism is to be used there needs to be a market setting the price for lambs/sheep of the same specification. Lack of liquidity (low sales numbers and trades) and private sales direct to processors makes establishing a market indicator price for lamb or forward price exchange traded contracts difficult in WA.
* Timing of fixed price forward contracts – it is likely that fixed price contracts are only attractive to processors during seasons when supply is limited. Hence, there needs to be an incentive for processors to offer contracts all year round. This may come in the form of competition from forward contracts offered by overseas buyers and live shippers during high turn-off periods.
* Back-to-back contracting – some processors may struggle to offer fixed price contracts to producers because they are unable to lock in back-to-back contracts with their customers as they have many customers sharing different parts of the carcass. With the Chinese supply chain, Beaufort Meats and Hillside Meats, this should be less of a problem if they are trading full sets, or cut up carcasses (for example half, quarter).
* Price certainty, not trying to beat the market – fixed price contracts give both parties price certainty, enabling better planning and budgeting. Using them to try to beat spot prices is speculation.
* Limit contractual commitment – producers and processors should not be given the impression they should commit their entire production to fixed contracts. Producers must be aware of the possible impact of unfavourable weather or other adverse events (for example animal health issues). Processors must consider the risks to trade with their customers (such as currency, trade bans, quarantine). Either a conservative approach is required or suitable contingency clauses need to be agreed and inserted in the contract.
* Design and enforcement of contract – all contracts need to be enforceable and a dispute resolution process established. MLA has introduced Australian Cattle Trade Rules for the cattle industry that offers guidelines, consistency and transparency in contracting to reduce likelihood of disputes. There is also a dispute resolution process and if the two parties still cannot resolve the issue, MLA encourages the adoption of [Grain Trade Australia’s arbitration process](http://www.graintrade.org.au/dispute_resolution). Something similar can be adopted by the sheep industry.

### Case study

Silver Fern Farms introduces three year contracts

Silver Fern Farms, a New Zealand processor and co-operative, offers three year supply contracts to producers. By granting producers greater foresight into future production needs, these longer term contracts provide visibility and certainty for the producers. In return, Silver Fern Farms can continue with its product and brand innovation, confident that it will be able to meet the future market demand that it is trying to build.[[8]](#footnote-8)

## Livestock leasing (‘ewe bank’)

### The model

A company finances the upfront purchase of ewes and leases them to the producer over an agreed term. The producer pays monthly operating lease payments (tax deductible) and may have an option to purchase the ewe at residual value at the end of the lease. This is similar to machinery finance.

### Suits

Producers looking to rapidly expand sheep flock but don’t have the capital to purchase ewes.

### Key terms

* Payment schedule.
* Evidence on capacity to pay on application.
* Term of lease.
* Terms around default and death.
* Option to purchase at the end of the lease.

### Benefits

* Can accelerate growth of breeding flock to take advantage of strengthening prices (don’t have to wait years to build up numbers and then risk potentially losing the market opportunity).
* Can finance 100% value of the ewe.
* Cash flow implications – cover cost over its life rather than upfront.
* Could be some tax advantages.

### Costs/risks to consider

* There will be an interest component embedded in the lease payments. Producers will need to calculate the full after tax value of leasing versus buying ewes.
* Productive life span of the ewe (may be lower than expected, cost of replacements).
* Need to consider taxation implications.

### Case study

CowBank

CowBank is a small agricultural finance company which specialises in leasing cows to dairy farmers in Victoria, South Australia, Southern New South Wales and Tasmania. Since 1999 CowBank has leased more than 48 000 cows to over 250 dairy farmers.

Herd leasing is a financial tool which enables dairy farmers to lease cows (new or existing) as a means of funding their herd asset:

* Once an application for new cows is approved, the farmer finds and selects suitable cows. CowBank then buys the cows and they are leased to the farmer.
* Herd leasing is cash-flow friendly, with 60 monthly payments that are fully tax-deductible.
* After completing the five year (60 month) lease, CowBank sells the herd of cows for 20% of the original purchase price. When the client buys the herd, legal ownership is transferred to the client.

Other financiers can offer stock mortgage finance; however, this is limited to 50% of a discounted cow value. The CowBank herd lease can finance the full market value of the cow. A CowBank herd lease is not linked to a land mortgage, so farmers have the security of knowing their mortgage capacity is available to support their overdraft.

The cost of CowBank herd leasing varies depending on the size and term of the contract. The cost is fixed for the term of the contract, typically equating to ~15-20% of income per cow. Being an operating lease, the monthly rentals are deductible business expenses, which helps make CowBank very cost effective compared to traditional livestock mortgages. The herd lease contracts are typically completed with a 20% residual sale value at the end of a five year contract.

## Contract out sheep management

### The model

Expand sheep enterprise to maximum sheep numbers that can be handled by one full time equivalent (FTE) and contract out management. This may also include the improvement of non-arable or marginal cropping land to increase stocking rate.

### Suits

* Lamb producers wanting to increase exposure to the sheep market but don’t have the time, interest or skill in managing the flock for maximum returns.
* Skilled sheep managers with insufficient capital to own a commercial farm but can generate a good income where their skill is rewarded.

### Key terms

These may include:

* Land owner may be required to fund the establishment of appropriate pastures (for example salt tolerant) if on non-arable or marginal cropping land. Can be guided by expertise of sheep manager.
* Liming program agreed and paid for by land owner.
* Capital improvements for infrastructure (water, fences, yards) to be funded by land owner.
* General repairs and maintenance to be funded by manager (negotiable).
* Animal health costs funded by land owner.
* Payment can be in the form of a salary + bonus incentives (for example on a per lamb/ha sold basis).
* Terms on replacements and genetics/breeding.
* Guidelines for managing sheep and pastures during various seasons.
* Manager to provide regular reports on performance against budget and seasonal outlook to land owner.

### Benefits for lamb producer/land owner

* Gain increased returns from the sheep enterprise (via better, more focussed management).
* Increased returns from non-arable or marginal cropping land.
* No management burden so can focus on the cropping enterprise and free up time during the year for other activities.
* Maintain diversified income base which smooths cash flow and strengthens resilience of the business to changes in markets.
* Gain exposure to the buoyant international lamb market.
* Run sheep as ‘break crop’ which may be more profitable than alternatives (lupins, canola, fallow).
* Someone is around to look after livestock while away on holidays etc and also may be able to assist at seeding and harvest.

### Costs/disadvantages for lamb producer/land owner

* Need to find, attract and retain a good sheep manager; a skill set that is often rare and difficult to find. May need to pay very well to attract talent.
* Need to maintain infrastructure to run sheep.
* Risk that lamb and wool prices decline in the future.

## Summary of alternative finance structures to expand sheep production

| **Model** | **Description** | **Examples and case studies** |
| --- | --- | --- |
| Co-operative farming | Where two or more producers form a company or joint venture and consolidate farms to increase efficiencies of labour, machinery and management skills. | Bulla Burra (South Australia) |
| Sell & lease back | Sell some land to an investor, lease back the land and with the released capital (from the sale), expand the farming business by leasing more land and purchasing additional stock to build up the sheep flock. | * Olam Almonds Australia Pty Ltd sold and leased back land from group of investment funds (2013). * Grass Patch farmer sold leased back from Westchester, a US pension fund (2014). |
| Equity investment | Investor(s) contribute equity to the farm business. A proportion of profit is distributed to investor(s) as dividend. Investor may choose to purchase more land to increase the size of the enterprise. Farmer manages the enterprise for a fee and receives profit distribution. | Equity partnerships across NZ dairy industry. Physical involvement may range from equity interest only (‘investor’), equity interest and active involvement (‘managing partner) or ‘manager’, whose employment is separate from shareholding. |
| Leasing over summer/autumn | Sheep producers lease stubble, non-arable, moderately saline or marginal cropping land from crop producers as alternative options for feed over summer and autumn at a lower cost to grain feed. | WA farmers sowing saltbush, tall wheatgrass and other grasses as a feed source in marginal cropping areas. |
| Contract lamb production | An investor, which could also be a processor, broker or end user, establishes breeding stock to a high standard that meets specifications of high value customers. The investor owns the breeding stock and puts them on the lamb producer’s property. Producer looks after the sheep and grows out the lambs to specifications. Investor pays producer a fee that covers land, labour and feed costs plus a margin. | Allied Beef, QLD & NSW  Pork industry in WA |
| Joint ventures (JV) | A joint venture can allow individuals to combine resources but retain ownership to create larger operations. The lambs are divided at an agreed ratio (based on cost contributions) and sold separately by the respective parties. Balance sheet and earnings of each JV partner are kept separate for taxation and ownership purposes. | Liveringa Stations Beef Pty Ltd, a JV held 50/50 by the Hancock Prospecting Group and Dowford Investments (parent of Milne Agrigroup) |
| Contract or partner with processors, customers or breeders | Customers or processors issue legally enforceable forward contracts out on a regular basis up to three years so producers can invest confidently in their sheep enterprise. Breeders or genetic companies can also issue contracts with farmers to speed up genetic progress across the flock. | Silver Fern Farms, a New Zealand processor and co-operative has offered three year supply contracts to producers. |
| Livestock leasing | A company finances the upfront purchase of ewes and leases them to the producer over an agreed term. | [CowBank](http://cowbank.com.au) provides a leasing facility for dairy cow herds. |
| Contract out sheep management | Expand sheep enterprise to maximum sheep numbers that can be handled by one full time equivalent (FTE) and contract out management of the sheep. | No example provided |

# Section 2 – alternative options to add or create more value from sheep

This section is targeted at those producers looking to value-add their product by partnering with investors to extract further value from feedlotting, processing or marketing lamb. A range of business models are discussed including:

* commercial feedlotting where ownership may be retained by the sheep producer
* sheep producers and investors partnering to produce, process and market lamb
* creation of niche marketing companies for lamb
* franchising a breeding line and production system to produce consistent, premium quality lamb
* dedicated supply chains from paddock to plate.

Some case studies from New Zealand, United Kingdom and the Australian beef industry are included to illustrate how these models can deliver value.

## Commercial feedlotting

### The model

Capital is raised or used to build a commercial feedlot that has contract arrangements with processors for specific weights in specific periods. The feedlot can source lambs that have just been weaned from farmers to feed to weights that ‘add value’. Lambs can be purchased direct as store lambs or a ‘feedlotting service’ can be provided where farmers retain ownership of the lamb.

### Suits

* Farmers that don’t have the scale, feed or time available to get lambs to higher weights for market can use commercial feedlots to increase value from their store lambs.
* Investors looking to build a feedlot to a commercial scale that has lower per unit costs and increased bargaining power with processors.
* Investors looking to control quality so as to match market specifications demanded by premium markets.

### Key terms

These may include:

* Ownership – does farmer retain ownership of the lamb throughout feedlotting, does it pass to the feedlotter or pass straight through to the processor or customer?
* Price – terms around pricing need to be negotiated. Is it cost plus, market rate, or fixed fee?
* Marketing – which party is in the best position to market well and extract maximum price for all/other parties?
* Payment terms – when does payment take place? Is there part payment? How are counter party risks managed?
* Term of feedlotting/minimum weights need to be negotiated.
* Management of feed costs – is it rise and fall, fixed or market rates?
* Terms on what happens in the event of force majeure, death and failure to deliver to contract specifications.

### Benefits

* Supply of lambs is pooled at the feedlot which increases bargaining power for price negotiation with processors and exporters. This could lead to higher, more stable pricing and forward contracts.
* System can facilitate forward contracts as more information on future quantity and quality is known.
* Increase kilograms of lamb marketed per hectare.
* Increase business turnover and profitability.
* Increase scale of business without additional capital outlay on feedlot or new property.
* Develop a more consistent and reliable market with consistent product to match market specifications.
* Increased access to, feedback on and knowledge of premium markets.
* Increase carcass and feedlot performance feedback to assist planning and management of an improved breeding and/or backgrounding strategy.

### Costs and risks to consider

* Counter-party risk – for example, default on contract, solvency of the buyer etc.
* Establishing a price discovery mechanism.
* Cash flow implications.
* Risk of death while at feedlot.
* Animal health, feed and transport costs which may be paid out of proceeds.

### Case study

Mort & Co cattle feedlotting with retained ownership

Mort & Co offers to feedlot graziers’ store cattle under a retained ownership structure whereby Mort & Co finance the associated lot feeding costs for the entire feeding period, with the owner (grazier) receiving the net proceeds directly after the sale proceeds have been received.

By retaining ownership of feeder cattle and finishing them through lot feeding with Mort & Co, graziers are able to increase returns by adding value to their store cattle.

Mort & Co is one of Australia's most experienced and professional managers of lot fed cattle and manages and markets in excess of 150 000 head of cattle per annum. Given this volume, Mort & Co is in constant contact with major processors which ideally positions the company to market prime cattle effectively and maximise returns to cattle owners.

Table 3 The retained ownership process (Source: [Mort & Co](http://www.mortco.com.au/our-business/lot-feeding.html))

| **Steps** | **Process** | **Information flow** |
| --- | --- | --- |
| **1** | Mort & Co investigates forward price options, feedlot space and ration price, and offers graziers the opportunity to retain ownership through the lot feeding stage. | Mort & Co advises the ideal cattle entry weights and types for feeding to meet various target markets and provides budgets. |
| **2** | Grazier agrees to lot feed their cattle with Mort & Co, completes necessary forms and sends cattle to feedlot. | Cattle Management Agreement and associated forms. |
| **3** | Cattle are inducted and commence feeding. | Induction report. |
| **4** | Regular monitoring of cattle by Mort & Co livestock coordinators. | Fortnightly reporting to grazier on ration consumption, sickness and expenses as generated through the company designed reporting system. |
| **5** | Mort & Co supervises cattle market conditions to stay abreast of the market. | No data |
| **6** | As the cattle approach targeted feeding period they are inspected to ascertain ideal marketing options (if the cattle have not been forward sold). | No data |
| **7** | Mort & Co negotiates sale of cattle and presents the grazier with alternative sale options (if desired). | No data |
| **8** | Cattle delivered to the processor. | No data |
| **9** | Net proceeds are advanced to grazier. | Feedlot and carcass performance is provided to grazier as are recommendations for future cattle supply & feeding. |

#### Smaller scale alternative

Feedlot sheep on farm

If water is available, lamb producers could consider investing in feedlotting lambs with forward contracts set up with processors, whereby the additional cost of feed, labour, husbandry and margin is captured in the forward price. This strategy should result in higher kg/ha produced. To assist in calculating the profit of feedlotting there is a web-based [gross margin feedlot calculator](http://www.sheepcrc.org.au/resources/psm-software-feedlot-calculator.php) developed by Dave Stanley and Geoff Duddy of the NSW Department of Primary Industries (available on the Sheep CRC website). This calculator enables the user to enter different real time production, economic and feeding scenarios to estimate likely profit for a lamb feedlotting enterprise.

## Add processing and marketing

### The model

A business (could be a co-operative or company) is formed whereby a key shareholder (investor) funds construction and operations of a new processing plant whilst a group of lamb producers are shareholders of the business and agree to supply lambs on a long term basis. A sales and marketing team is employed to develop a marketing strategy and seek out premium markets. The idea is that the whole may be better than the sum of its parts as parties are working together rather than competing to get a bigger slice of the pie.

### Suits

* Producers seeking access to premium markets and looking to have more knowledge and control on which markets their lamb is sold into.
* Investors seeking to supply lamb to premium paying customers and working on a long term basis with producers to secure premium quality lamb on a consistent basis.

### Key terms

These may include:

* Specifications on timing and quality (breeds/weight/meat quality) of lamb delivery.
* Agreement around genetics and breeding. For example, there may be an option to source genetics and production expertise for the whole group.
* Open book arrangements are established where producers supply at an agreed cost and the processor slaughters and pack at cost.
* Need to establish a cost management or price discovery system.
* Sales and marketing professionals are employed to seek out niche high value markets and brand the product (funded jointly by producers and processor).
* Agreed terms on profit distribution. For example, profit per lamb could be distributed to lamb producers and processor in proportion to capital investment per lamb supplied (producer) or processed (investor in processing plant).

### Benefits to shareholders of integrated business (lamb producers and investor)

* Allows producer to supply exact specification required by the buyer and, where possible, extract a price premium for it.
* Control over the cost of the supply chain (don’t lose value through ‘middle man’).
* No unequal bargaining power between processor and producers as they are motivated to work together.
* Increased influence on how much lamb is sold for and into what markets.
* Can invest in niche marketing and product branding to increase value.
* Can better service smaller, high end customers.
* Pain/gain of seasons and processor utilisation is shared.
* More transparency and increased confidence in market.
* 100% flock not locked in, only what lamb producers commit long term. Can sell a portion of flock into other markets.
* If it is a co-operative there are tax benefits.

### Costs to shareholders of integrated business (lamb producers and investor)

* As it is imperative that this system is well-managed, there is a risk in not getting the right management.
* Need to ensure lamb supply is kept up to ensure maximum utilisation of processing plant. Risk that not enough lamb is committed/contracted to the supply chain to make it work for everyone.
* Increased counter-party risk of customers which may be smaller and overseas. This can be mitigated with prior shipment payment terms.
* Working capital required upfront as profit not distributed until end of financial year, not when lamb is sold.
* Opportunity cost of not selling to other processors/live exporters that may be offering higher prices at certain times. However, if the marketing team do well, the prices achieved (inclusive of profit paid later) over the long term should at least match if not be higher than competing processors/exporters.
* Future growth strategy needs to be agreed and a representative board established. Growth strategy may require further investment from investor(s) and producers.
* Increased management costs, compliance and reporting requirements.

### Example

Open book policy between farmer and processor to jointly sell the lamb to niche markets

Below is a hypothetical example of how the costs and profit could be distributed when the processor and lamb producers work together on an open book basis and jointly fund the employment of a marketing and branding team that extract premium prices in niche overseas markets.

#### Key assumptions

* Farmer is running a self-replacing flock at 9DSE/winter grazed hectares (Wgha) on land valued at $3250/ha. There are 5.1 lambs sold per ha and $100 000 management fee incurred per 9000 ewes managed. Lambs sold when carcass weight estimated at 22kg.
* Processing plant is built at cost of $40 million, with capacity to process 500 000 lambs per year, operating at 75% due to seasonal nature of sheep turnoff. Assume lamb average sale price is $8/kg delivered (based on carcass weight).

#### Result (costs are hypothetical)

| **Cost type** | **Cost in $/head** |
| --- | --- |
| Lamb production cost | $95 |
| Processing – slaughter & box | $36 |
| Total cost per head | $131 |

| **Cost type** | **Cost in $/kg** | **Other notes** |
| --- | --- | --- |
| Cost per kg lamb (carcass weight) | $5.94 |  |
| Freight | $0.23 | $4-5/carcase |
| Marketing | $0.12 |  |
| Cost per kg including freight | $6.29 |  |

| **Cost type** | **Cost in $** | **Margin percentage** |
| --- | --- | --- |
| Sale price | $8 | No data |
| Margin per kilogram | $1.71 | 27% |
| Margin per head | $37.68 | 28% |

| **Cost type** | **$ for 375 000 lambs processed** | **$ per lamb** |
| --- | --- | --- |
| Sales | $66 000 000 | $176.00 |
| Lamb purchased | $35 618 257 | $94.98 |
| Processing costs | $13 375 000 | $35.67 |
| Freight | $1 875 000 | $5.00 |
| Marketing cost | $1 000 000 | $2.67 |
| Earnings before interest and tax (EBIT) | $14 131 743 | $37.68 |
| EBIT margin | 21% | No data |

| **Investment per lamb** | **Farmer** | **Investor** |
| --- | --- | --- |
| Lambs sold/processed | 7 650 | 375 000 |
| Capital (land & ewes/processing plant) | $5 415 000 | $40 000 000 |
| Capital cost per lamb sold/processed | $707.84 | $106.67 |
| Split – investor/farmer | 87% | 13% |
| EBIT distribution per lamb | $32.75 | $4.94 |
| Return on assets (ROA) | 4.6% | 4.6% |

| **Comparison of returns to farmer** | **Per hectare** | **Per lamb** |
| --- | --- | --- |
| Sheepmeat EBIT  (under open book policy) | $167.02 | $32.75 |
| Wool income  (costs captured in sheepmeat production) | $201.83 | $39.57 |
| Total sheep EBIT  (under open book policy) | $368.85 | $72.32 |
| Total sheep EBIT traditional way selling at $4.50/kg (as per current supply system) | $222.32 | $43.59 |
| Improvement EBIT (%) | 66% | 66% |
| Improvement EBIT for sheep enterprise ($) | $146.53 | $28.73 |

## Access premium markets by establishing a structure for niche sales agents/brokers/marketing companies to operate

### The model

Sheep producers have the option to sell lambs directly to an overseas customer or a marketing company that specialises in marketing WA lamb and seeking out premium markets or high paying customers. The marketing company may arrange the processing either in WA or overseas, at whatever processor is most competitive on price and quality of service. Otherwise the company could be aligned to a processor either by way of part-ownership or contracted slaughter space. The dedicated marketing company could be in the form of a farmer co-operative. The lamb is either delivered to a local processor or port, for live shipment where payment is made to the producer and ownership transfers to the marketing company. If the marketing company is not aligned to a processor this model may require export accredited processors in WA to process lamb on a contract basis to specifications at competitive rates.

### Suits

* Producers looking to extract more value from overseas market opportunities, rather than selling direct to WA processors.
* Producers of high quality lamb looking to sell into premium markets.
* Producers looking to produce lamb aligned to tastes and preferences of premium overseas markets.

### Key terms

These may include:

* Forward (enforceable) contracts with marketing agent to supply specified quality of lamb (weight, meat quality, breed) at a specified time period at a specified location for a contracted price.
* Need a price discovery mechanism.
* Contract or partnerships arrangements between marketing company and processors.
* Penalties for breach of contract.

### Benefits to lamb producers

* Better access to niche overseas market opportunities.
* More buyers of lamb in the market so increased competition for lamb.
* Higher prices.
* Better and faster price signals for lamb – quality and time of year.
* More transparency on prices and demand in overseas markets.
* May be able to specialise lamb production to meet specific requirements of premium markets.

### Costs to lamb producers

* Counter-party risk of marketing company – default risk, breach of contract, solvency.
* If lamb producers choose to specialise in lamb production for a particular market and that market’s demand falls substantially, the product may not be sold as easily or as profitably into other markets or to alternative buyers.

### Case study

The New Zealand Merino Company Limited (NZM)

The New Zealand Merino Company Limited (NZM) is an integrated sales, marketing and innovation company focused on transforming the country’s Merino sheep industry. It is similar to the model described above but involves more collaborative behaviour with supply chain participants to develop a unified brand for NZ Merino. NZM was started in 1995 by Merino growers who wanted to lift New Zealand’s Merino wool out of the commodity basket through marketing and differentiation to reduce price volatility and increase value of NZ Merino wool.

#### NZM business strategy

* Differentiated the product – through extensive market research and grower involvement, it defined a unique identity for its offering (key attributes) and differentiated its product from other fibres and other Merino wool.
* Found the target markets – identified leading brands in its targeted market segments and then matched the needs of those companies to the attributes of its wool.
* Developed a brand – crafted a marketing story that would support a price premium at retail that could be shared among players in the supply chain. NZM also developed an ‘ingredient brand’ called ZQ. Wool that meets ZQ standards is the highest quality natural Merino fibre available in New Zealand.
* Boosted consumer demand through research and development (R&D) – invested heavily in R&D and market development activities that would help retailers and brands boost demand for products made with New Zealand Merino wool.
* Introduced long term forward contracts – once retailers are convinced of the superior attributes of the NZM offering and its other associated benefits, they are willing to enter into and honour long-term contracts to ensure their supply. These contracts are not priced directly in relation to historic and forecast commodity prices, rather the price-points are negotiated between NZM and its brand partners at a level that allows growers to receive a fair, equitable, and sustainable return for their fibre and manufacturers to be successful over the long term. The premium nature of the product gives NZM the leverage it needs to make this model work. Growers under contract supply wool to one or more brand partners according to clear specifications at a fixed price – generally, one to three years in advance.
* Managed seasonal risk – if due to seasonal risk growers cannot meet their contractual obligations, NZM sources wool on the commodity auction market to fulfil the requirements. If the commodity price of the wool is less than the contract price, the growers are paid the difference. If it is higher, then the growers compensate NZM accordingly.
* Aligned the supply chain – farmers generally worked in isolation from wool buyers (and vice versa), and this lack of visibility characterised all of the other relationships between players in the ecosystem (shearers, processors, designers, and manufacturers, among others). NZM had to persuade them that there was more to be gained by openly sharing information and working together to benefit the industry overall.
* Convinced growers to pay for its services – to cover its costs, which included marketing New Zealand Merino wool as a premium product, developing relationships with prospective buyers, negotiating long-term supply contracts, and performing R&D to help its retail and brand partners succeed, NZM would have to charge nearly twice as much as traditional brokers. It was up to NZM to justify that differential by persuading growers that, over time, they would generate a lot more revenue for them.

#### The result

More than a decade after its founding, NZM transacts approximately 85% of all Merino wool grown in New Zealand with turnover of more than US$85 million. More than 50% of this volume changes hands through direct supply contracts, some of which extend up to five years in the future.

As a result, NZM growers have greater price stability that allows them to more effectively manage their farms and make important capital investment decisions. In exchange, NZM’s brand partners receive sustainable pricing, guaranteed supply, consistency of supply, traceability, and fit-for-purpose processing consignments.

In 2010 the New Zealand government committed more than US$10 million to further their work. NZM and its supply chain partners contributed another US$15 million to the five-year initiative.

In the financial year 2014 (FY14), NZM recorded a net profit after tax of NZ$1.9 million, which represents a return of 22% on average shareholders’ funds and declared its first dividend of NZ$0.95m. NZ growers are the shareholders of NZM. In 2013 NZM set the target to double the value of the company in three years. Contracts continue to underpin the NZM model with 67% of bales being sold through this mechanism during FY14, a similar percentage to the prior year. These contracts continue to provide certainty for the company, its grower suppliers and its brand partners.

During that year further meat contracts were also rolled-out through Alpine Origin Merino Limited, NZM’s joint venture programme with Silver Fern Farms Limited, for SILERE alpine origin Merino.

#### The future

The New Zealand Sheep Industry Transformation program, referred to as NZSTX, has multiple objectives. However, its top priorities are to expand the international market for Merino wool, grow New Zealand’s fine wool supply base, and drive greater wealth to the country’s sheep farmers by extending the NZM model to their other sheep-based products, such as meat, leather, and lanolin.

Source: [New Zealand Merino website](http://www.nzmerino.co.nz/)

## Franchising

### The model

A business establishes a breeding line and production process to produce high quality lamb to meet a specific premium market. The business contracts farmers to raise and grow out lambs to set procedures to meet set market specifications. Prices are contracted in with a processor. Business invests in marketing the quality of the product to premium customers.

### Suits

* Farmers looking for a low risk model for sheep production.
* Farmers that don’t have time to breed genetics or do the marketing.
* Farmers with facilities and resources to feed under contract.

### Key terms

* Terms around quality assurance and animal welfare conditions on farm.
* Franchisee adheres to the prescribed procedures to grow out animals as set out by franchisor.
* Purchase price of weaned lamb.
* Minimal value of finished lamb.
* Weight specification for turnoff.
* Technical services (for example vet, agronomic, nutritionist) provided by franchisor to franchisee.
* Franchise fee/commission paid by franchisee.

### Benefits to lamb producers

* To reduce risk, fixed price contracts can be taken for concentrate feed.
* Can lock in three key financial variables – purchase price, selling price and feed cost – and therefore predict with some confidence a likely minimum margin for every group of lambs.
* Having a defined system to follow, with advice available when needed from experienced specialists, provides security and confidence.

### Costs to lamb producers

* May need to increase investment in infrastructure to meet quality assurance and welfare conditions.
* May be some increase in compliance costs for traceability purposes.
* Loss of control and flexibility over breeding and feeding.
* Prices are locked in under contract so can’t speculate on any future prices.

### Case study

Blade farming, franchising, UK

Blade Farming Limited (Blade) uses a farm franchising structure to supply consistently high quality British beef to retailers and their customer, the consumer. Blade works closely with farmers to help them rear and finish cattle to a consistent and high specification for high value markets. The result of this consistency is that retailers can see the key benefits of using beef produced through the network of Blade farms and are able to use Blade beef in their pillar brands.

Blade has 11 staff and is involved in genetic improvement, calf selection, calf rearing, beef finishing, farm finance, technical assistance, animal health and raw material sourcing to ensure all cattle are fed correctly. Blade works closely with [partners](http://www.blade-farming.com/farm-partners.htm) to ensure that animals are managed safely and effectively.

Blade buys young calves from dedicated dairy farmers. Calves are reared through dedicated contract rearing units to a strict protocol using one veterinary practice to manage all of their calves the same way. All calves coming through the units are screened for bovine viral diarrhoea (BVD), with problem calves being removed from the system, and if appropriate are DNA tested for breed verification. The reared calves are measured throughout the growing process to ensure they meet growth rates and are healthy at all times. The result is that finishers have a good quality animal that has the potential to grow into a profitable finished animal.

Blade runs a contract calf rearing model where farmers can rear calves under contract to exceptionally high standards to meet the demands of Blade’s contracted beef finishers. The rearing operation is financed by Blade and the [calf rearers](http://www.blade-farming.com/our-calf-rearers.htm) are paid a management fee for calves that are reared to Blade’s standards.

The contract finishers then follow specified finishing protocols to produce high quality beef which is very specific to Blade’s customers’ requirements. Calves arrived with a health certificate confirming all vaccinations given. Blade Farming Ltd is a franchise business for the beef finisher which means that farmers sign forward price commitments backed by the abattoir they supply and pay Blade a franchise fee as the cattle are slaughtered. Beef finishers have a full range of forward pricing mechanisms available that are guaranteed for the lifetime of the animal signed to the [contract](http://www.blade-farming.com/contracts.htm).

Blade now has in excess of 20 000 head of beef cattle in operation making it one of the largest beef farming operations in England, and the demand for beef produced through the Blade franchise is increasing.

Source: [Blade Farming website](http://www.blade-farming.com/index.htm)

## Dedicated supply chain from paddock to plate

### The model

This involves the partnership of businesses along the whole supply chain so that the consortium includes lamb producers, abattoir, marketing, butcher and retailer. They all are motivated to work together to operate a highly efficient and profitable chain. This way the success of the whole chain benefits each individual segment. Note that no one segment needs to commit 100% production to this supply chain.

### Suits

* Sheep producers willing to produce lambs to specification under conditions required by the end-user.
* Supply chain members that are open and transparent to ensure information flows.
* Supply chain participants willing to make a medium term commitment on price and quantity.

### Key terms

These may include:

* Formalised commitment to supply a specified quantity and quality of product in line with the end-user needs.
* Agreement to work co-operatively to increase value along the supply chain.
* Details of required information flow.
* Longer term and more stable price agreements.
* Need to determine a price discovery mechanism.

### Benefits to lamb producers

* Reduced exposure to market price volatility and therefore more resilience to market shocks.
* Can increase productivity as there is more certainty around price and product requirements.
* With more timely market information producers can respond more efficiently to changes in market requirements.
* Can work with processors to reduce costs in the supply chain.
* Lower risk, more stable business model will improve access to capital.
* Increased access to premium, high value markets
* Rewards of branding and marketing of quality product.

### Costs to lamb producers

* May be some increase in compliance costs to match quality, sustainability and safety requirements and protect brand.
* A portion of sheep are dedicated to this supply chain and cannot be sold into spot market.
* Risk that market may change or decline and other markets may not want this type of lamb product. Lack of alternative markets.

### Case study

ANZCO’s producer groups and Waitrose dedicated supply chain

ANZCO Foods is one of New Zealand's largest red meat exporters with sales of NZ$1.3 billion and more than 3000 employees worldwide. ANZCO is jointly owned by Itoham Foods, Nippon Suisan Kaisha, and the directors and management of ANZCO Foods. ANZCO owns eight offshore offices, seven local slaughter/boning facilities, three local food manufacturing sites, three local retail sites and sells retail products online.

The key difference to WA lamb exporters is ANZCO’s focus on quality and partnerships with producers and customers. Producer groups have been introduced to build long term partnerships between selected beef and lamb producers, the company and strategic international customers. A testament to the success of these groups is the many long term partnerships that have developed as a result and the strong growth in membership of these groups.

One producer group, a selected and dedicated group of sheep producers in NZ, has become the sole supplier of New Zealand lamb to Waitrose, UK's leading food supplier, through ANZCO. This producer group has been supplying ANZCO Foods and Waitrose since 1996. By working closely with Waitrose and producers, the supply chain is much better understood and by working collaboratively they innovate product offerings so that they remain flexible and responsive to the ever-changing consumer demands.

The producer groups focus on:

* Continuous improvement – collectively, the producer groups achieve continuous improvement through recording best practices, business development projects, taste testing, benchmarking and collective learning. Producers also receive feedback from ANZCO and its customers, ensuring a strong market focus is maintained.
* Communication – through working together to understand each other’s strengths and challenges, individual producer groups can network and develop in this unique environment.
* Customer interaction – members appreciate the chance to spend time with the customer and hear first-hand what is happening in the market place and what flow on effect it is likely to have in New Zealand. Equally, producers are able to let the customer know what is influencing decisions made behind the farm gate.

Critical to the success of the groups has been the producer group committees, made up of a combination of producers and company personnel, which have been established to ensure producers are involved in decision making around developments of the groups’ direction.

All producer group programs ensure best practice in animal welfare, environmental sustainability and food safety with full traceability.

Source: [ANZCO Foods website](http://anzcoproducers.co.nz/livestock/producer-groups)

## Summary of alternative options to add or create more value from sheep

| **Model** | **Description** | **Examples and case studies** |
| --- | --- | --- |
| Commercial feedlotting | Investors build a commercial feedlot that has forward contracts with processors for specific weights in specific periods. Lambs can be purchased from farmers direct as store lambs or a ‘feedlotting service’ can be provided where farmers retain ownership of the lamb. By retaining ownership, farmers are able to increase returns by adding value to their store lambs. | Mort & Co offers to feedlot graziers’ store cattle under a retained ownership structure whereby Mort & Co finance the associated lot feeding costs for the entire feeding period, with the owner (grazier) receiving the net proceeds directly after the sale proceeds have been received. |
| Add processing or marketing | A business (could be a co-operative or company) is formed whereby a key shareholder (investor) funds construction and operations of a new processing plant and a group of lamb producers are shareholders of the business and agree to supply lambs on a long term basis. A sales and marketing team is employed to develop a marketing strategy and seek out premium markets. | Hypothetical open booking working example provided with indicative figures. |
| Create a market environment that fosters the development of niche marketers/brokers | Sheep producers have the option to sell lambs directly to an overseas customer or a marketing company that specialises in marketing WA lamb and seeking out premium markets or high paying customers. | The New Zealand Merino Company Limited (NZM) is an integrated sales, marketing, and innovation company in NZ, with growers as shareholders. NZM transacts ~85% of all Merino wool grown in NZ with two-thirds through direct supply contracts, some of which extend up to five years. |
| Franchising | A business establishes a breeding line and production process to produce high quality lamb to meet a specific premium market. Farmers contract to raise and grow out lambs to set specifications. Prices are contracted in with processor. Business invests in marketing to receive premium price. | Blade Farming (UK) works closely with farmers to help them rear and finish cattle to a consistent and high specification for high value markets. Farmers sign forward price commitments backed by the abattoir they supply and pay Blade a franchise fee as the cattle are slaughtered. |
| Dedicated supply chains from paddock to plate | Involves the partnership of businesses along the whole supply chain so they all are motivated to work together to operate a highly efficient and profitable chain. | ANZCO Foods, one of New Zealand's largest red meat exporters, has formed producer groups that are dedicated to supplying and working with its customers, for example Waitrose. |

# Section 3 – potential investor group structures/investment models

This section highlights some structures on how capital could be sourced, pooled and invested across the supply chain to grow the sheep industry in Western Australia.

Examples include:

* Setting up a research and development (R&D) company that invests in genetics, technology or processing to increase productivity and also benefits from R&D tax concessions.
* Giving Australians the option to elect to invest superannuation into an agricultural or regional development fund. Funds can then be invested in sheep enterprises that can provide a commercial return.
* Establish syndicates to pool funds from retail and wholesale investors which is then used to purchase a farm and employ a manager.
* A processor or customer sets up an equity partnership trust whereby it sources funds on a long term basis from investors such as sovereign or pension funds and then invests directly into farms to increase production. In return the farmers commit to sell to the processor or customer.

Some case studies from New Zealand are provided to demonstrate how some of these models may be applied to the sheep industry in WA.

## Investors establish a Research & Development (R&D) company

### The model

A group of investors may set up an R&D company that invests in the sheep industry with a view of profiting from successful innovation resulting from the R&D and also maximising any R&D tax concessions that may be available. R&D could be in the form of genetics, labour saving technology, testing and monitoring equipment etc.

### Suits

* geneticists
* sheep breeders
* innovators
* investors.

### Key terms

These may include:

* Partnership arrangements with farmers, processors and end-users.
* Investment commitments to research in on-farm productivity and consumer preferences to produce a premium product.

### Benefits to lamb producers

* Accelerated genetic gains.
* Increased productivity – more kilograms sold per hectare.
* Increased efficiency through labour saving technologies.

### Costs/risk to consider

* Establishment costs – compliance and accounting.
* Annual fees associated with genetics or technology
* The drive to increase volume or meat yield may lead to ‘tougher’ meat which may be less desirable in some markets.

### Case study

Focus Genetics, New Zealand

Focus Genetics, owned by Landcorp Farming Ltd, is New Zealand’s largest red meat genetics business with 17 breeding partners throughout New Zealand. Focus Genetics serves more than 750 commercial farm operations. In 2013 the company sold over 4000 rams, 800 bulls and 400 stags to farmers in New Zealand and overseas.

Focus Genetics offers Primera®, Lamb Supreme and Texel as terminal sires and Highlander®, Landmark and Romney as maternal sires. The sheep breeding programs are focused on increasing farm productivity through increasing kilograms of lamb weaned per ewe mated. For example, some productivity targets include ewe lambs must get in lamb as a ewe lamb, ewe hoggets must be lambing at a high enough level to remain competitive with alternative livestock, ewes must remain an optimal weight weaning lambs equivalent to at least her body weight (for example 70kg ewe weaning 35kg twins) and ewes must remain structurally sound and last longer (less replacements). The paternal traits targets are around meat production, eating quality and meat quality.

Focus Genetics’ plan is that over time, discerning customers will demand meat created from their genetics because of their taste profile and from that a sustainable premium should be derived. For example, Focus Genetics already has a partnership arrangement with processor Silver Fern Farms to exclusively supply prime lambs to Tesco’s UK supermarkets for its Tesco’s Finest program. Marks & Spencer’s has also selected NZ lamb based on genetics satisfying eating quality.

Feedback on eating quality and desirable traits from the consumers and retailers gets fed straight back into the genetic breeding program so there is continuous genetic improvement to match market trends.

Source: [Focus Genetics](http://www.focusgenetics.com/sheep/breeding-objective/)

## Community investing (akin to community banking) using superannuation

### The model

Community/Australian citizens invest a portion of their superannuation into an ‘agricultural fund’ or ‘regional development fund’ which can invest into an Australian based sheep-related business looking to grow, which could be operating in the area of research and development, lamb production, lamb processing, lamb marketing or lamb wholesaling/retailing. The business needs to provide commercial returns to the fund.

### Suits

* Australian citizens looking to invest in Australian agriculture on a medium to long term basis.
* Sheep related businesses seeking capital to grow.



Figure 8 Potential model for investing superannuation into regional agricultural projects

### Key terms

These may include:

* minimum investment size
* indicative profitability and growth projections
* management contracts
* reporting requirements
* terms around exit or transfer of the investment.

### Case study

FarmPath lease to own, New Zealand

This is the type of investment structure that might be attractive to a ‘regional investment fund’.

FarmPath created an opportunity for approved NZ dairy farmers to lease and part-own a farm with the remainder owned by FarmPath’s institutional investors. Farmers have an ownership stake in the leased farm alongside FarmPath’s investors. Every year the farmer pays 5% return to the investors. Farmers have an option to increase their ownership stake at the original purchase price. After eight years, the farmer will have the opportunity to buy-out the FarmPath investors at prevailing market rates.

## Set up syndicates to invest in farm enterprises

### The model

Funds from a number of investors are pooled to purchase a working farm and a manager is employed to run the day-to-day operations. Investment can be direct for sophisticated wholesale investors or indirect for retail investors. A trading platform can be set up as a secondary market to trade parcels.

### Suits

* Large and small Australian or international investors looking to invest in Australian agriculture on a medium to long term basis.

### Key terms

These may include:

* limited liability
* shareholders agreement and constitution
* voting rights
* exit strategies
* minimum investment amounts and terms
* established track record of farm and farm manager
* adequate supervision of farm manager
* compliance obligations.

### Case study

MyFarm, a farm investment company based in New Zealand

MyFarm provides syndicate investments in high quality, large scale properties, and manages these investments and their performance. MyFarm originated 25 years ago in dairy and now also invests in sheep and beef.

MyFarm Sheep & Beef is a joint venture between MyFarm and the Marshall and Duncan families from the Rangitikei district in the North Island (NZ). Together they provide the capability, experience, and accountability to successfully manage investment capital in this sector. To date the JV has invested over NZ$60 million in sheep and beef farms, livestock and farm development, on behalf of local and international investors.

They offer a range of investment options ranging from full ownership to parcels in syndicates (minimum parcel size NZ$250 000) for wholesale investors through to smaller investment parcels of NZ$20 000 for retail investors via Collective Investment Vehicles (CIV).

MyFarm Sheep & Beef handpicks farms that will benefit from capital investment and have significant growth potential. They establish a business plan and memorandum of information and then source an investor group with common objectives, complementary skills, and experience. MyFarm then manages the partnership formation process, including sourcing debt finance proposals, coordinating initial shareholder meetings, forming a board of directors, appointing a farm manager, and sourcing capital stock and plant.

Once established, MyFarm works with the board of directors for each farm to develop the annual budget and strategic plan, as well as setting clear, achievable and measurable targets. MyFarm reports back to shareholders on these financial and production targets on a quarterly basis. These reports have been built around the requirements of institutional investors and encompass benchmarking between farms and industry figures, local industry data and information, key performance indicator tracking and commentary, as well as profit/loss and balance sheet reporting.

In the case of institutional investors and managed funds, the senior members of the MyFarm Sheep & Beef team fulfil the directors’ roles of these farming businesses.

MyFarm has also established a trading facility for buying and selling shares. [MyFarm Trading](http://www.mfx.co.nz) is an internet-based, unregistered securities trading facility. It is a formal secondary market using the Unlisted Trading Platform for buying and selling shares in CIVs promoted and administered by MyFarm. Investors in CIVs must hold a minimum of 20 000 shares at any time. All buying and selling of CIV shares is done through approved brokers.

## Equity partnership trust

### The model

A co-operative, processor or end-user sets up a trust to pool funds from investors (for example pension funds, sovereign funds etc) on a long term basis to invest, through a farm-owning entity, directly into farms. The lamb producer would generally maintain a majority stake to retain farm ownership and to ensure the lamb producer is motivated to generate a return for the trust investors. A separate farm-operating entity would earn revenue and incur expenses, and make regular payments to the farm owning entity based on farm profitability.

### Suits

* Lamb producers looking for long-dated equity.
* Patient pension funds seeking exposure to agriculture.
* Co-operatives/processors/end-users looking for a structure to inject more capital into the lamb production sector or lock in/attract more supply.

### Key terms

These may include:

* Fund may be mandated by its trust deed to invest in farms supplying the processor/co‑op/customer and, in some cases, to invest in farms where the supplier intends to move from a competitor and supply processor/co-op/customer.
* Producers may be locked into long term management and supply contracts.
* Exit strategy and conditions.

### Benefits

* The trust could mitigate a perennial funding problem for agriculture by providing farm enterprises with long-term equity. This model provides farmers access to long, patient pension fund capital with a 30-year horizon.
* Farmers can use additional capital to invest in technology, land improvement and systems to increase productivity and farm performance.
* Farmers retain majority stake and control of their farm business.
* Allows farmers to focus on what they do best, producing lamb without having to worry about trying to be investment bankers.
* The trust could help co-operatives win farmers from rival processors/live exporters.

### Costs/disadvantages

* Increased compliance and reporting requirements.
* There may be need to increase scale (can be funded by the trust) as farm enterprises would need to be of substantial scale with a solid track record of performance to attract investment. Producer would need to invest in improving his/her management skills for a larger enterprise.
* Producer may be contracted to supply processor associated with trust or manage the farm for a contracted time and possibly under certain conditions.
* Producer may lose flexibility to sell into other supply chains which may be offering higher prices.
* Taxation implications need to be considered.

### Case study

Fonterra equity partnership trust

Fonterra is planning on establishing an equity partnership trust (the trust) that would provide a new opportunity for Fonterra farmers in New Zealand and Australia to access equity investment in their farming operations. The trust would be an open-ended, independently managed fund pooling capital from investors with long-dated liabilities such as sovereign wealth funds and pension funds to invest in land and fixtures of dairy farms through a farm-owning entity.

It is envisaged the trust would be:

* a vehicle that allows targeted investment in well-operated farms in NZ and Australia
* a collaborative partner that supports NZ and Australian farmers in financing their dairy production in a financially and environmentally sustainable way
* a pathway by which investors can gain exposure to an attractive and dynamic dairy sector, with the benefits of diversification across NZ and Australia, and across a variety of farming systems.

The trust would be a long-term partner for young farmers aiming for farm ownership, farmers planning succession, and larger established operators, enabling them to access equity tailored to individual needs and growth ambitions while reducing reliance on core bank debt to better manage earnings volatility.

Investors would benefit by accessing a unique opportunity to invest in Fonterra-supplying farms in NZ and Australia, which supply high-quality dairy products with strong long-term projected demand, particularly in China and emerging economies.

To leave farmers in control of their farm operations while providing investors in the trust exposure to long-term returns from dairy farming, it is envisaged that:

* the trust and the farmer would jointly invest equity in land and fixtures of the farm through a farm-owning entity
* the farmer would separately own the herd, farm machinery, Fonterra shares and other operating assets through a farm-operating entity
* the farm-operating entity would derive revenue and incur farm working expenses, and would make regular payments to the farm-owning entity linked to farming profitability. These payments would, in turn, be paid as a distribution to the farmer and the trust in accordance with their share of equity of the farm-owning entity.

The investors in the trust would typically seek investments of long duration (15-20 years+). However, farmers may wish to have the option to purchase the stake held by the trust within a shorter timeframe. It is envisaged that the farmer would have the option to purchase the trust’s equity at ‘fair market value’ after a defined period and with a defined notice period.

Because farmers would retain a majority interest in and control of their operations, they would be highly incentivised to achieve productivity, earnings and growth goals to the benefit of both farmers and investors in the trust.

The role of the trust would include prudent oversight of farming operations, primarily through standard reports provided to the trust manager by the farmer. It is expected that the farmer would also find these reports insightful in monitoring the performance of their business.

For more information view [Fonterra’s equity partnership trust scoping document](https://www.fonterra.com/wps/wcm/connect/97104427-2f3f-49fe-8fc0-c98af2a9b127/Fonterra+Equity+Partnership+Trust+Booklet.pdf?MOD=AJPERES&ContentCache=NONE).

## Summary of potential investor group structures/investment models

| **Model** | **Description** | **Examples and case studies** |
| --- | --- | --- |
| Establish an R&D company | A group of investors may set up an R&D company that invests in the sheep industry (for example genetics, technology on-farm or in processing) with a view of profiting from successful innovation resulting from the R&D and also maximising any R&D tax concessions that may be available. | Focus Genetics, owned by Landcorp Farming Ltd, is New Zealand’s largest red meat genetics business with 17 breeding partners in NZ. Focus Genetics breeds both for productivity on-farm and meat quality so farmers with their breed get premium price in market. |
| Community investing using superannuation | Australian citizens invest a portion of their superannuation into an ‘agricultural fund’ or ‘regional development fund’ which can invest into an Australian based sheep-related business. | * FarmPath – farmers have an ownership stake in a farm alongside FarmPath’s institutional investors. The farmer pays 5% per annum return to the investors. Farmers have an option to increase their ownership stake at the original purchase price. After eight years, the farmer has the option to buy-out the FarmPath investors at prevailing market rates. * Blue Sky Alternatives Access Fund (Australian stock exchange code BAF) has some exposure to water rights/trading and agricultural land and cotton farming. |
| Establish syndicates | Funds from investors are pooled to purchase a working farm and a manager is employed to run the day-to-day operations. Investment can be direct for sophisticated wholesale investors or indirect for retail investors. A trading platform can be set up as a secondary market to trade parcels. | MyFarm, based in NZ, provides syndicate investments in high quality, large scale properties, and manages these investments and their performance. MyFarm Sheep & Beef handpicks farms that will benefit from capital investment and have significant growth potential, matches investors and appoints a board for management. MyFarm has also established a trading facility for buying and selling shares. |
| Equity partnership trust | A co-operative, processor or end-user sets up a trust to pool funds from investors (for example pension funds, sovereign funds etc) on a long term basis to invest, through a farm-owning entity, directly into farms. The lamb producer would generally maintain a majority stake and there may be off-take agreements with co-op, processor or end-user. | Fonterra is planning on establishing an equity partnership trust (the trust) that would provide a new opportunity for Fonterra farmers in NZ and Australia to access equity investment in their farming operations. |

# Conclusion

This report has been written to broaden how the sheep industry thinks in terms of production and export growth, attracting new participants into the sector and succession plans for the family farm business.

There are a myriad of business structures and financing options that participants in the sheep supply chain can consider adopting to facilitate increased scale, volume and value of sheep product exports in Western Australia.

Most of the structures discussed in this report are concepts for the sheep industry to consider as they currently do not exist in WA. Some models may have been tried in the past in some form but may have not been successful for a variety of reasons such as management or market factors.

Right now, market signals are positive – investment appetite for agribusinesses is very high, demand for sheepmeat is growing in emerging markets, WA’s cost of production is internationally competitive and prices have been increasing at a faster rate than many other agricultural export commodities. Therefore, exceptional sheep management and committed supply chains are likely to be the key critical success factors in most of the structures outlined in this report. ‘Average’ sheep profitability will not suffice. Managers will need to be focussed on delivering above-average profitability, pay attention to detail, be able to operate a large scale enterprises, have good staff management skills and be competent in reporting performance and operational plans regularly to other stakeholders in the business.

Multiple concepts have been highlighted in the report and any one option is not necessarily better than the other as it will depend on the strengths, scale, resources and ambitions of the individual parties involved. The right option for your business will depend on your personal circumstances. It is important to know clearly what your goals are for your business before considering alternative expansion options. With appropriate professional advice you can then work towards seeking appropriate partner(s) to match or complement your business goals and form an agreed strategy forward. These partner(s) may be your bank, other investor(s), other farmers, supply chain participant(s) such as breeders, processor or customers, or an advisor network.

Success will also depend on complementary skill sets and resources as well as good communication among parties. There needs to be common agreement on policy, procedures, objectives and future goals of the business. There must be willingness by farmers to accept, implement and adhere to policies and procedures agreed to by all parties for reporting, decision making, growth strategies, capital expenditure, exit strategy, risk management, sales and marketing, dividend policy, distribution of profits etc.

When you introduce third parties into your farm business the cost of compliance should not be underestimated. The business will need to be of sufficient scale to cover any additional corporate overhead costs such as reporting, legal, accounting etc. The increased corporate overhead cost needs to calculated and reflective of the scale of the business. A detailed risk analysis will also need to be carried out. In addition it will be crucial to address the difficult issue of succession planning from the outset – a clear, professionally prepared and agreed plan is an important part of the farm business plan.

In many instances, bank debt and owner operator may continue to be the lowest cost and most appropriate option to expand your enterprise. Bank finance may also complement some of the business models and growth strategies discussing throughout the report.

There are a number of growth options available but ultimately the appropriate expansion model needs to suit your business goals, management preferences and risk appetite.

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