



RED MEAT BENCHMARKING TRACKING PHYSICAL DATA THROUGH TO FINANCIAL PERFORMANCE

PREPARED BY CLIENT INSIGHTS
COMMERCIAL & AGRI
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FOREWORD

New Zealand's red meat sector continues to look toward a future as a premium and sustainable source of meat and fibre to the global market. However, while working towards this objective the importance of improving on farm performance is critical.

Since 2013 ANZ has released regular research and insight reports identifying the key components of on farm performance and what differentiates top performers across the sector. Our 2017 financial benchmarking used financial analysis to determine some of the core drivers of success on the farm.

This report extends this analysis to include the key physical attributes of farms in order to examine exactly what drives farm profitability. The red meat sector has also often lacked a cohesive framework and analysis of the relationships between financial results, land, physical inputs and outputs.

We see improvements in capturing and using physical data to optimise farming as core to the industry's ability to evolve and maximise profitability. This paper will discuss the key drivers to success as well as other factors which determine performance. We look forward to being part of a broader and more thought provoking discussion across the sector.



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PURPOSE

The purpose of this report is to consider the link between physical data and financial performance to assist sheep and beef farms in optimising performance. The data contained in this document isn't widely captured by New Zealand sheep and beef farms.

The report also provides an approach to analysing the key dimensions of farm performance (financial, production, land) in order to identify the characteristics that more profitable farms typically exhibit. Our approach for this analysis aligns to the Red Meat Profit Partnership's ("RMPP") key performance indicators ("KPI") framework to provide a consistent approach for analysis across the sector.

We make certain statements, recommendations and draw conclusions in this report about the analysis of the data. These are our views only and you should obtain professional advice for your particular circumstances. Please see our more detailed disclaimer at the end of this document.

KEY MESSAGES

ANZ sourced financial, physical and land data from sheep and beef farms to support the sector in better understanding the key drivers of farm profitability. With this report ANZ aims to support farmers in better understanding the impact of physical metrics on financial performance.

There are clear benefits in the ability to track physical data and enable better farm decisions. Key production metrics such as stocking rates, feed supply and feed conversion efficiency are all areas which could be further understood by operators to become more productive and efficient.

Our report shows that the ability to turn energy into meat and fibre as efficiently as possible through informed farm management remains the most important aspect of farming. Maximising production alone without examining costs and quality management is unlikely to deliver profitability gains.

We found little relationship between land quality and profitability, highlighting again that profitability results more from informed on-farm management and decisions rather than the natural characteristics of the land. Most profitable farms were not necessarily on the most capable land and strong returns can also be achieved on lower land values.



FARM SAMPLE GROUP

Our sample group contains 100 farms and accounts for approximately 8% of New Zealand's sheep and beef sector.

The information was kindly provided by sheep and beef operators for the financial years 2015 to 2018.

We use a four year average to provide a more balanced analysis of performance which can otherwise be volatile on a year by year basis.

The report provides an analysis of:

- **Productivity** – stock units, feed supply and feed conversion efficiency
- **Financial performance** – revenue, expenses, profit and return on assets
- **Land characteristics** – land use capability, slope and drainage.

Other factors (e.g. weather, management styles and genetics, etc.) also play an important part in farm performance, but these metrics fall outside the scope of this report.

Locations of farms in our sample are mostly consistent with the wider sheep and beef sector. The only exceptions are Gisborne, which has a larger share, and Canterbury and Otago, which have a lower share in our sample compared to the sector as a whole (see table below).

REPORT STRUCTURE

1. **Farm KPI framework** – visual representation of the linkages between financial and production key performance indicators (KPIs).
2. **Farm KPI analysis** – reviews the relationship between production and financial KPIs to understand the linkages to profitability for our sample group.
3. **Farm operation analysis** – examples of how farms could consider optimising farm performance.
4. **Farm land & return analysis** – analysis of farm land characteristics versus profitability and other financial KPIs.
5. **Appendices** – additional analysis supporting the findings throughout the report.

STOCK UNITS BY REGION

Region	Sample (2015-18)	Sheep and beef sector (2015-17)	Difference
Manawatu-Wanganui	16%	18%	-2%
Gisborne	13%	5%	8%
Hawkes Bay	13%	10%	3%
Southland	11%	13%	-2%
Waikato	11%	7%	4%
Otago	11%	16%	-5%
Wellington	8%	5%	3%
Canterbury	7%	16%	-9%
Northland	5%	2%	3%
Other	5%	7%	-2%
Total	100%	100%	

Source: Statistics New Zealand; ANZ Analysis

1. FARM KPI FRAMEWORK

FARM PERFORMANCE IS MEASURED BY EBITR/HA

Our core measure of farm performance is profit per hectare. This is measured as earnings before interest, tax and rent divided by the effective hectares of the farm ("EBITR/ha"). Throughout the report we refer to this measure as farm profitability.

The chart below ranks farms in our sample group by profitability, from lowest EBITR/ha (left) to highest EBITR/ha (right). This ranking system is used for all charts in the following sections in order to understand how different physical and financial metrics relate to profitability.

The median four year average EBITR/ha outcome for our sample group was \$203/ha, with bottom quartile farms generating an average of \$12/ha and top quartile farms \$451/ha.

WE USE THE RMPP'S KPI FRAMEWORK TO ANALYSE THE DRIVERS OF FARM PERFORMANCE

The framework used in this report is an adaptation of the RMPP's "A core set of KPI measures for red meat farming businesses"⁽²⁾.

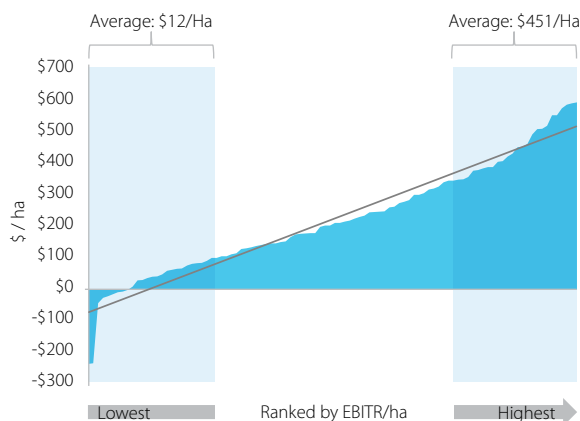
Aligning to an industry wide framework which helps analyse linkages to farm profitability is an important step in understanding where farm operation improvements could be made. This also provides a consistent approach for analysis provided to the sector.

The framework classifies farm KPIs into two categories:⁽³⁾

- **Driver KPIs** - describe farm production performance (e.g. productivity, etc.)
- **Result KPIs** - describe farm financial performance (e.g. profitability, etc.).

See diagram on the following page.

Earnings before interest, tax and rent (EBITR) per effective hectare⁽¹⁾



Source: ANZ Analysis, Average 2015-18

(1) The correlation between profitability and KPIs are shown by a trend line and indicates:

Direction – if the correlation is positive (negative), profitability tends to increase (decrease) with the KPI

Strength – a weak (strong) correlation would mean profitability only increases by a small (large) amount for a significant lift in the KPI.

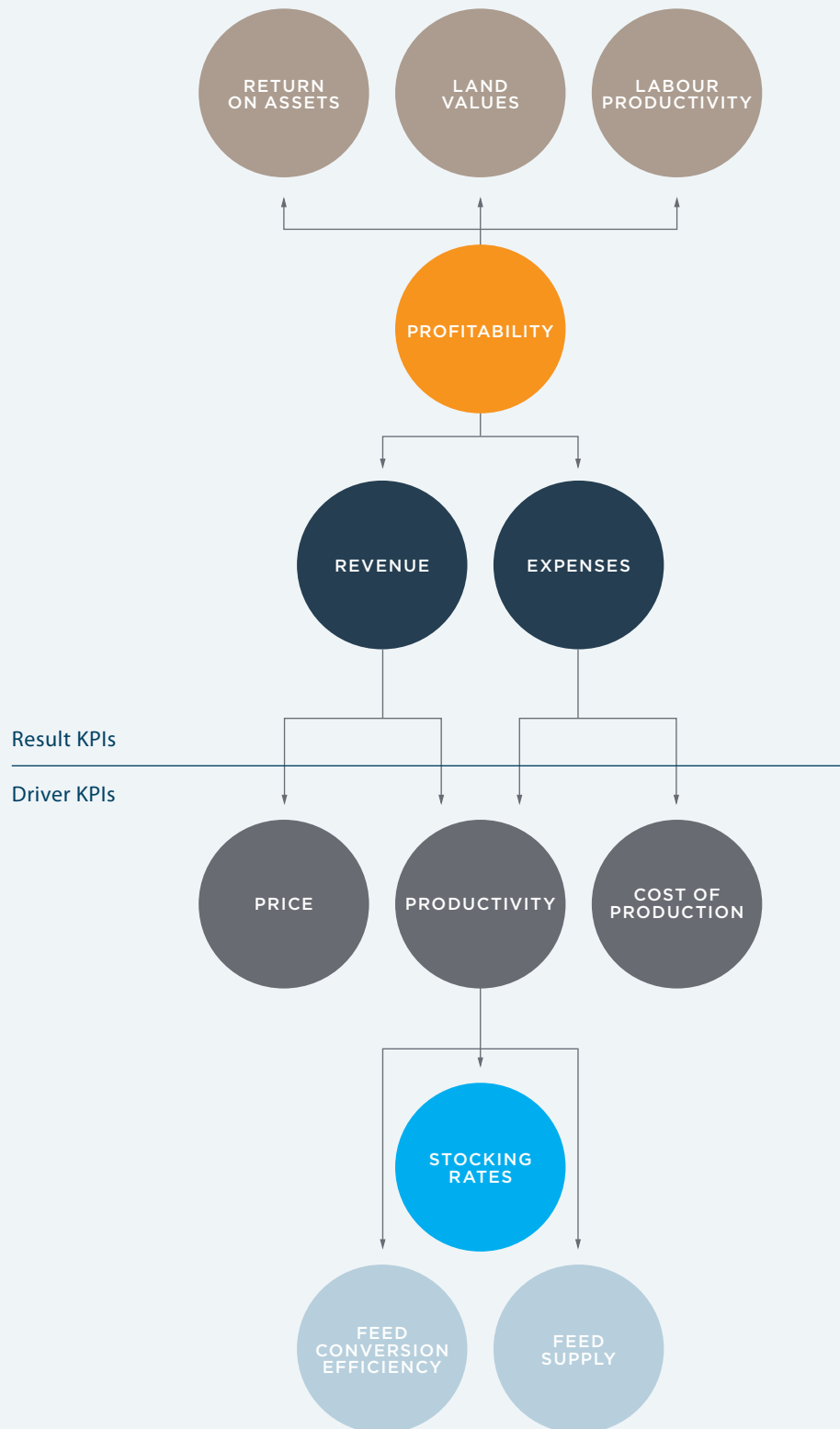
(2) Red Meat Profit Partnership, A core set of KPI measures for red meat farming businesses, November 2018

(3) Appendix 1 KPI Dictionary



ANZ is proud to be a foundation member of the Red Meat Profit Partnership.

FARM KPI FRAMEWORK DIAGRAM



Source: RMPP, ANZ

2. FARM KPI ANALYSIS

MEAT AND FIBRE PRODUCTIVITY CONTRIBUTES TO PROFITABILITY, BUT ONLY IF DONE EFFICIENTLY

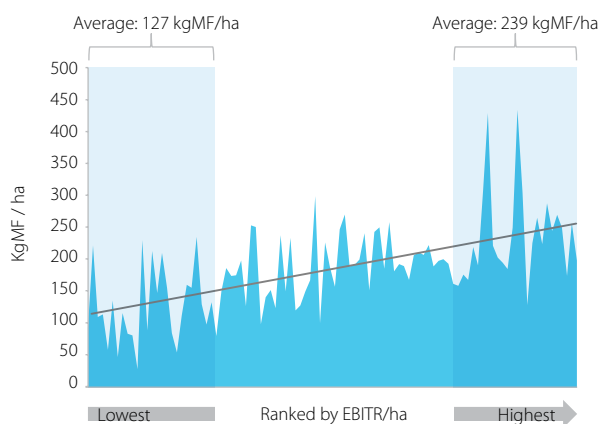
We measure farm productivity as the kilograms of meat and fibre produced per effective hectare ("kgMF/ha").

Our analysis shows that better performing farms were more productive with top quartile farms averaging 239 kgMF/ha and bottom quartile farms averaging 127 kgMF/ha. This is the result of more profitable farms exhibiting higher stocking rates, feed supply and feed conversion efficiency.

As such, production must be looked at alongside the cost to produce in order to improve efficiency. Higher productivity raises profitability but only when combined with good farm management.

This is evidenced by a number of farms in the chart below which are in the lower quartile and have production levels above 200kgMF per hectare. These farms show that increasing production doesn't necessarily guarantee improvements in profitability if Driver KPIs are not measured and optimised.

Production per effective hectare (kg of meat and fibre per effective hectare)



Source: ANZ Analysis, Average 2015-18

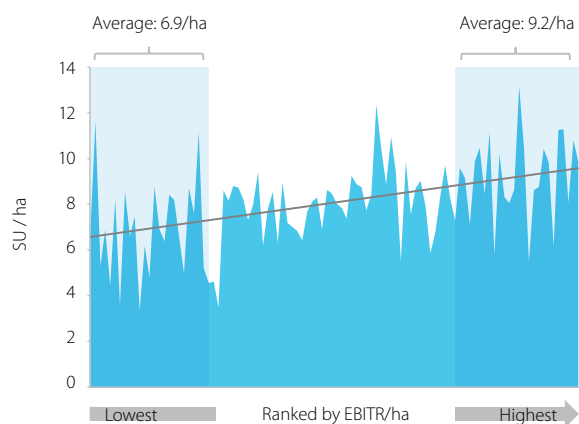
STOCKING RATES ARE IMPORTANT, BUT ARE ONLY ONE DRIVER OF PRODUCTIVITY AND PROFITABILITY

Stocking rates, measured as stock units per effective hectare ("SU/ha"), were positively correlated with profitability (i.e. more stock units per hectare had a linkage to higher profitability). However, there was significant variability in the result.

While stocking rates are a good indicator of farm productivity ("kgMF/ha") it says little about the farm's cost of production and the efficiency with which it converts inputs into meat and fibre. To get a better picture of the drivers of profitability requires analysing stocking rates alongside feed supply and feed conversion efficiency.

It is worth noting that some of the variability in profitability relative to stocking rates would also be explained through differences in land contours, soils types and weather patterns. Importantly, more profitable farms did not show a bias for having a higher sheep to cattle ratio relative to other farms in the sample group⁽⁴⁾.

Stocking rates (stock units per effective hectare)



Source: ANZ Analysis, Average 2015-18

(4) Appendix 2



FEED SUPPLY NEEDS TO BE MEASURED AND MANAGED RELATIVE TO OTHER FARM KPIS

Feed supply is measured as kilograms of dry matter (i.e. pasture grown and imported feed) per hectare. It is the amount of energy available for meat and fibre production.

Feed supply is broadly positively correlated with profitability, but this varies significantly by farm. For example, lower quartile farms exhibited a wide range of feed supply from 4,000 to 8,000 kilograms of dry matter per hectare while being less profitable. One of the reasons for this could be that feed supply is above optimal levels relative to the number of stock units.

While weather, climate and other factors make balancing feed supply and stocking rates challenging, systematically tracking these production KPIs and identifying where feed supply can be better optimised is an important step for any farm when assessing operational efficiency.

It is how feed supply is optimised within the farm management strategy that enables a farm to turn it efficiently into profit (e.g. hay and silage production, grazing and rotation strategy, etc.).

FEED CONVERSION EFFICIENCY MEASURES HOW WELL FEED IS TURNED INTO MEAT AND FIBRE

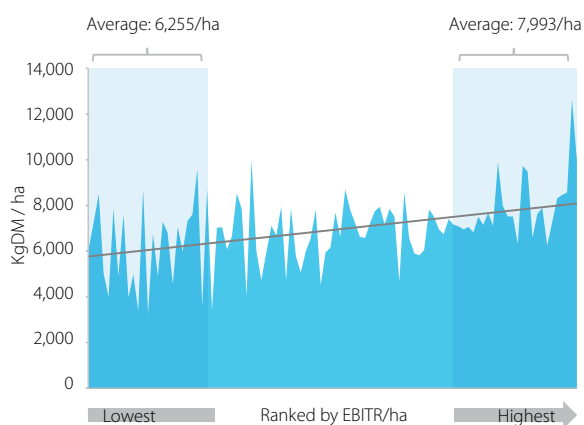
Feed conversion efficiency is measured as feed (pasture grown and imported feed) per kilogram of meat and fibre and is expressed as "kgDM/kgMF".

More profitable farms had better feed conversion efficiency. Feed conversion efficiency for top quartile farms was 38x while the sample median was 40x indicating that farms in the top quartile did not, on average, have significantly higher feed conversion efficiency than mid-range farms.

As such, higher profitability was not achieved by higher feed conversion efficiency alone but rather through the combination of higher stocking rates while maintaining high feed conversion efficiency (i.e. more stock units can assist in raising productivity and profitability as long as there is sufficient feed supply and is being converted efficiently).

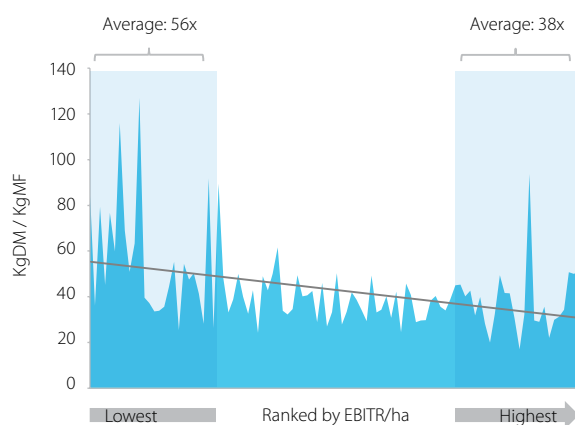
Measuring feed conversion efficiency allows us to gauge if feed supply is optimised on the farm. It also reflects other important factors such as livestock mix and lambing and calving percentages. We find a positive but weak correlation between those KPIs and profitability⁽⁵⁾.

Feed supply (feed grown and introduced per effective hectare)



Source: ANZ Analysis, Average 2015-18

Feed conversion efficiency (feed grown and introduced per kg of meat and fibre)



Source: ANZ Analysis, Average 2015-18

(5) Appendix 2

MORE PROFITABLE FARMS, WHILE RECEIVING SIMILAR PRICES, ACHIEVED A LOWER COST OF PRODUCTION BY OPTIMISING OTHER KPIS

Price ("TFI/kgMF") and the cost of production ("FWE/kgMF") make up the core components of the farm profitability equation.

We found the cost of production was negatively correlated with profitability, with the average farm working expenses for bottom quartile farms at \$4.9/kgMF while top quartile farms averaged \$3.2/kgMF - a 35% difference in cost efficiency.

This is the result of good farm management achieved by optimising three key Driver KPIs (stocking rates, feed supply and feed conversion efficiency).

Price remained relatively constant for all farms at around \$5/kgMF regardless of profitability, with prices generally outside of a farmer's control other than improving the mix of sheep versus cattle and the timing of sales.

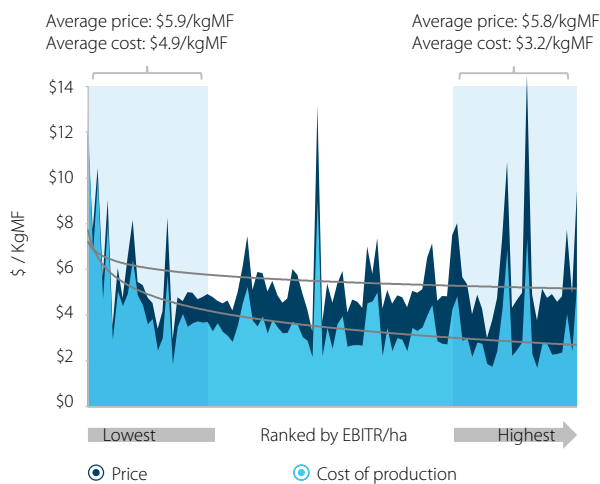
MORE PROFITABLE FARMS MAKE BETTER USE OF LABOUR

Labour productivity is the relationship between wages and profitability and is measured as "EBITR/wages"⁽⁶⁾.

More profitable farms had higher labour productivity meaning that more profit was generated for every dollar spent in wages. Top quartile farms achieved EBITR of \$3.05 per \$1.00 of wage expense.

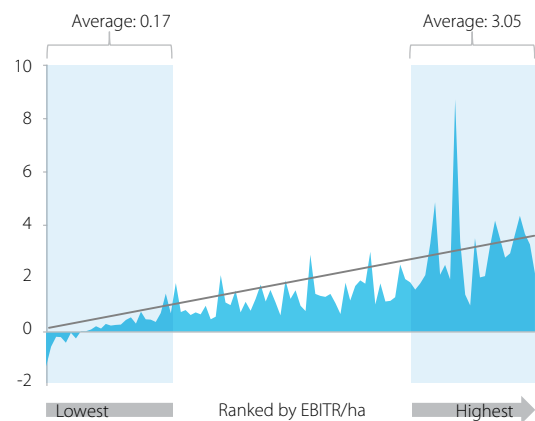
More profitable farms pay similar wages per worker as other farms in our sample group, hence higher labour productivity is more likely to result from better overall farm management, including how to use labour efficiently.

Price and cost of production per kg of meat and fibre



Source: ANZ Analysis, Average 2015-18

Labour productivity (EBITR/Wages)



Source: ANZ Analysis, Average 2015-18

(6) Corporate overheads are excluded from wages to ensure consistent benchmarking across farms in our sample group.

BETTER FARM MANAGEMENT IS ULTIMATELY REFLECTED IN HIGHER REVENUE AND BETTER COST EFFICIENCIES

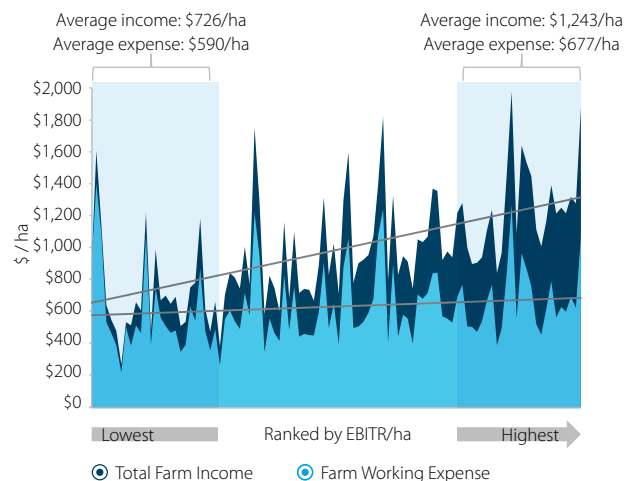
The performance of the Driver KPIs provided in the previous pages translate into the financial performance of a farm.

When analysing the sample groups income and expenses, we found that more profitable farms on average spent slightly more per hectare, but they were able to generate significantly more income as result of better management and optimisation of farm KPIs.

The top quartile farms in our sample group spent +15% more than the bottom quartile on farm working expenses ("FWE/ha") while generating +71% more total farm income ("TFI/ha").

Our analysis of individual farm working expenses showed that more profitable farms tend to spend more on labour (higher wages per hectare) but that there was no significant relationship between profitability and imported feed, cropping and contracting expenses⁽⁷⁾.

Total farm income and farm working expenses per effective hectare



Source: ANZ Analysis, Average 2015-18



3. FARM OPERATION ANALYSIS

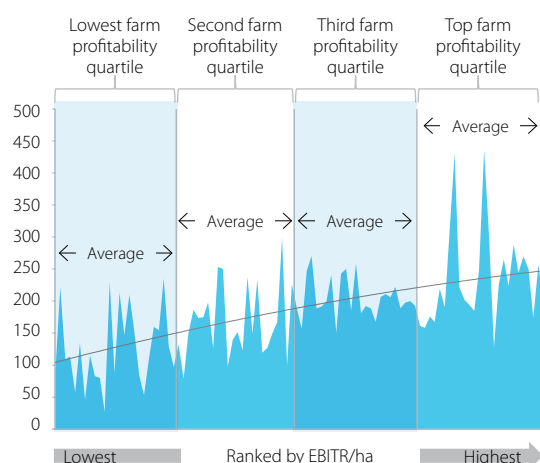
IDENTIFYING AREAS WHERE FARM PERFORMANCE COULD BE OPTIMISED

Based upon the analysis provided so far we have created four example farms to model some of the potential responses farms could consider.

The chart below illustrates how we have created each example farm and is based upon the average results for each quartile. The farms are ranked by profitability with lowest quartile (left) and highest quartile (right).

This approach suggests generic areas where the example farms could optimise their performance, however, we acknowledge that farm managers will know how to get the best out of their resources.

Quartile groups for farm operation analysis



Source: ANZ Analysis, Average 2015-18

FARM PERFORMANCE COMES FROM OPTIMISING KPIS RELATIVE TO EACH OTHER

The table below summarises the KPIs for each quartile. Alongside each KPI is an up, down arrow or equal symbol to signal what change to the KPI could yield improvements in profitability.

We summarise for each group the suggested changes to move closer to the top quartile:

Lowest

These farms exhibited high average prices but also high production costs which hindered profitability. They also had, on average, lower stocking rates and less efficient feed conversion. They could consider improving the balance between feed supply and stocking rates.

Second

These farms had a lower average cost of production and better feed conversion than the lowest quartile farms. They could consider optimising the operation further by lifting stocking rates and feed supply, provided it improves feed conversion efficiency and lowers the cost of production.

Third

These farms performed well across the range of KPIs but could benefit from raising stocking rates, provided there is sufficient feed supply. Maintaining the same conversion efficiency and production cost while increasing stocking rates could further optimise profitability.

Top

These farms performed best across most KPIs. However, feed supply might be slightly elevated as signalled by less efficient feed conversion than the third quartile.

FARM OPERATION ANALYSIS⁽⁸⁾

Improving profitability →				
KPI	Lowest	Second	Third	Top
Driver KPIs				
Prices	\$5.9 (=)	\$5.4 (=)	\$5.3 (=)	\$5.8 (=)
Production costs	\$4.9 (↓)	\$3.7 (↓)	\$3.3 (=)	\$3.2 (=)
Productivity	127 (↑)	170 (↑)	204 (↑)	239 (=)
Driver (production) KPIs				
Stocking rates	6.9 (↑)	7.7 (↑)	8.5 (↑)	9.2 (=)
Feed conversion efficiency	56 (↓)	41 (↓)	36 (=)	38 (↓)
Feed supply	6,255 (↑)	6,400 (↑)	7,136 (↑)	7,993 (↓)

Source: ANZ Analysis, Average 2015-18

(8) (=) signals the KPI is at or close to an optimal level; (↑) (↓) signals respectively raising or lowering the KPI could improve profitability

4. RETURNS & FARM LAND ANALYSIS

RETURN ON ASSETS IS STRONGLY RELATED TO PROFITABILITY BUT REMAINS LOW FOR THE SECTOR OVERALL

Return on assets ("RoA") must be considered alongside profitability in order to maximise investment value. We measure return on assets as EBITR divided by total assets⁽⁹⁾.

RoA for the sample group was low compared to alternative primary industries with the median farm RoA at 2.2% and bottom and top quartiles averaging 0.3% and 4.1% respectively⁽¹⁰⁾.

RoA analysis raises questions around the potential performance of land of different qualities with recent examples of farms considering partial land use changes to improve performance (e.g. forestry). These require additional capital outlay and incur the ongoing costs related to obtaining new staff, skillsets, management and meeting other regulatory requirements.

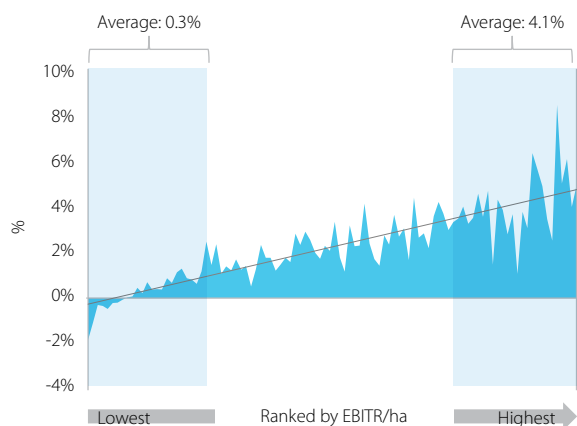
FARMS ARE ON MIDDLE TO LOWER QUALITY LAND

We used Landcare Research and Land Information New Zealand (LINZ) to analyse the land characteristics of 38 farms from our sample group and identify potential linkages between land quality and farm KPIs.

We measure land quality by Land Use Capability (LUC)⁽¹¹⁾. The chart below summarises the overall capability of the land of the farms in our sample.

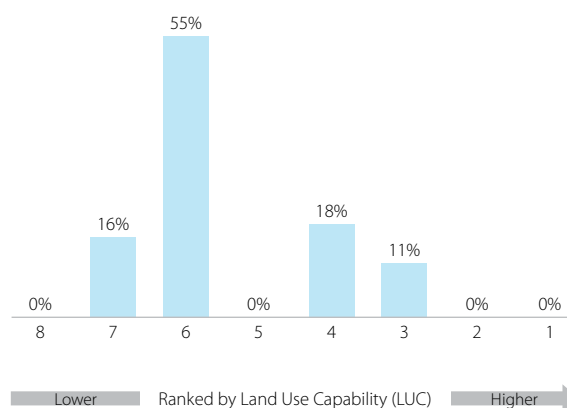
The majority of farms have land capability at the middle to lower end of the spectrum (e.g. LUC four and above). A description of land capability for each level is provided in Appendix 6.

Return on assets (EBITR / Total Assets)



Source: ANZ Analysis, Average 2015-18

Land use capability (LUC)



Source: LINZ, Landcare Research⁽¹²⁾, ANZ Analysis

(9) Total assets or total going concern is the total of land and building, opening stock and plant

(10) To ensure consistency between leased and owned farms any rental expenses have been capitalised using a rate of 2%

(11) The Land Use Capability (LUC) classification classifies land by general characteristics for productive use (e.g. landform, soil, erosion potential, etc.). The higher the LUC, the fewer limitations for different uses of the land such as arable, pasture and forestry use.

(12) Creative Commons Attribution 4.0 International and New Zealand Land Resource Inventory (NZLRI).

GENERATING A SOUND RETURN ON ASSETS REQUIRES ALIGNING LAND QUALITY, LAND COST AND FARM PROFITABILITY

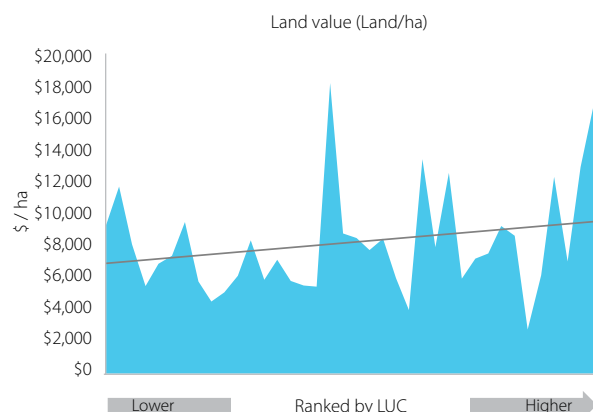
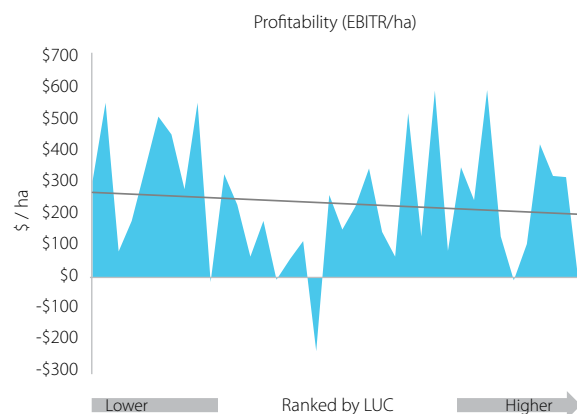
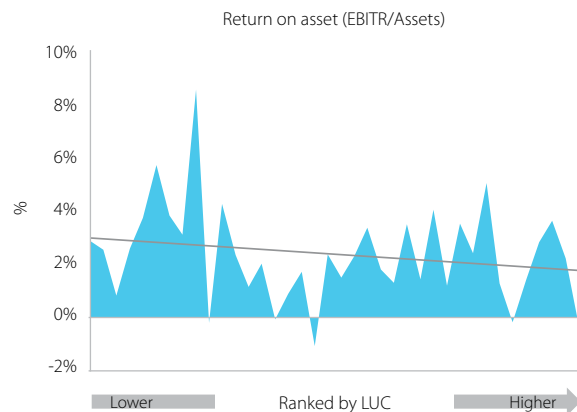
We found only weak relationships between land characteristics and profitability. This means that farm management and operational efficiency was a stronger determinant of profitability than the land the farm occupies.

For example, there was no significant relationship between profitability and slope for farms in this sample, suggesting hard-hill or hill country properties can achieve similar profitability to easy and finishing farms⁽¹³⁾.

However, land capability is more strongly related to land values. Hence, sheep and beef farms on more capable land, which is more expensive, tend to have lower RoA because profitability wasn't necessarily improved.

In order to generate sound RoA, sheep and beef farms should give consideration to profitability relative to the cost of acquiring more capable land.

Land use capability, return on assets, profitability and land values



Source: LINZ, Landcare Research⁽¹⁴⁾, ANZ Analysis, Average 2015-18

(13) Appendix 8

(14) Creative Commons Attribution 4.0 International and New Zealand Land Resource Inventory (NZLRI).

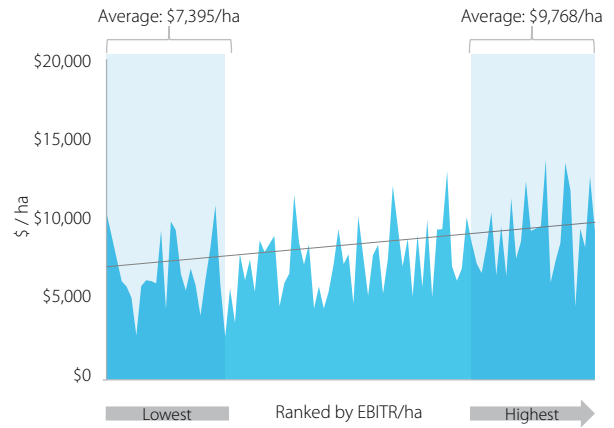
LAND VALUE IS DRIVEN BY A RANGE OF FACTORS

Land is typically the largest farm asset comprising about 82% of total assets.

There was a weak positive correlation between land value per hectare ("Land/Ha") and profitability. This suggests that farm profitability has some relationship with land values but it is likely that other factors form part of this equation (e.g. water access, slope, elevation, drainage, location, existing infrastructure, the potential for land use change, etc.).

Land valuations for the sample group fell largely between \$5k/ha and \$10k/ha. This is consistent with sheep and beef farming land values and suggests prices did not seem to be inflated by potential alternative land uses (e.g. dairy).

Land value per effective hectare



Source: ANZ Analysis, Average 2015-18



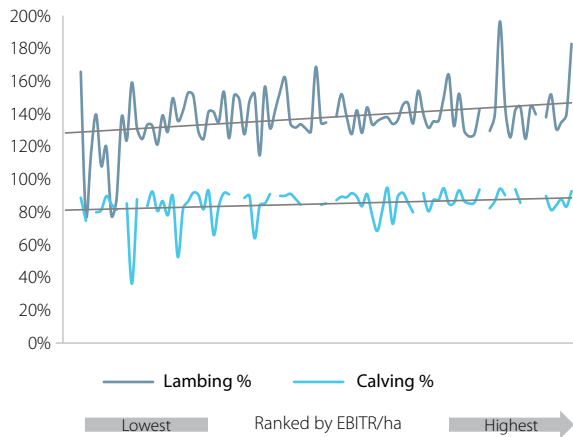
5. APPENDIX

APPENDIX 1: FARM KPI DICTIONARY

KPI / measure	Formula	Comment
Effective Area in hectares	Effective Freehold (hectares) + Leasehold (hectares)	
Total Farm Income	Net Stock Sales (Sheep + Cattle + Deer) + Wool + Velvet + Sundry + Change in stock	
Farm Working Expenses	On farm cost (Wages + Animal Health + Cropping/Contracting + Electricity + Feed + Fertiliser + Shed + Freight + Weed & Pest + Repair & Maintenance + Vehicles + Admin + Standing + Sundry)	Excludes Corporate Overheads
Earnings before Interest, Tax and Rent	Total Farm Income – Farm Working Expenses – Corporate Overheads – Depreciation	
Feed	Feed Grown (kilograms dry matter) + Feed Introduced (Total supplementary kilograms dry matter)	
Meat and Fibre Production	Meat kilograms (carcass weight) + Wool kilograms + Velvet	
Stock Unit	Sheep (opening) + Cattle (opening) + Deer (opening)	
Total Assets	Land & Building (opening) + Stock (opening) + Plant + Capitalised Rent	Rent Capitalised assuming a 2% rate
Return on Assets	Earnings before Interest, Tax and Rent / Total Assets	
Lambing	(Number of lambs tailed from ewes / Number of ewes mated) *100	
Beef Calving	(Number of calves marked / Number of cows mated) *100	

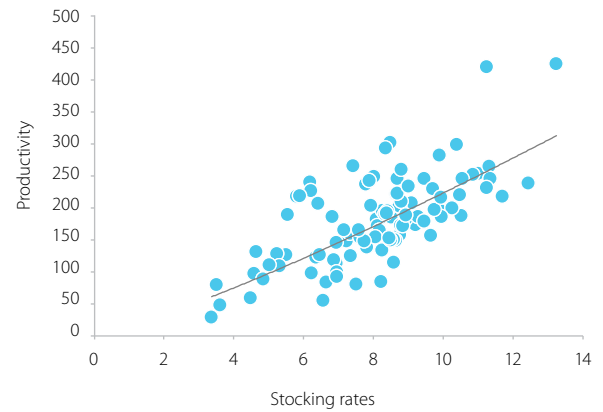
APPENDIX 2: REPRODUCTIVE EFFICIENCY (LAMING %/CALVING %) AND LIVESTOCK MIX (SHEEP / CATTLE)

Lambing and calving

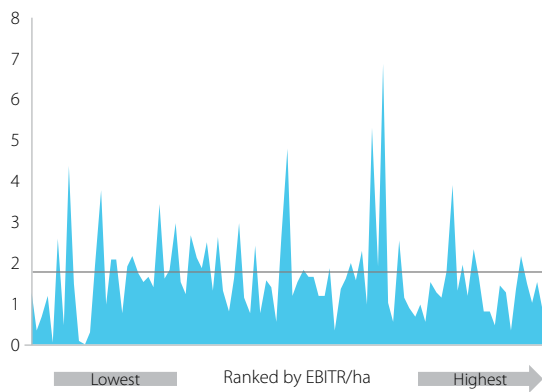


APPENDIX 3: PRODUCTIVITY AND DRIVER KPI CORRELATIONS

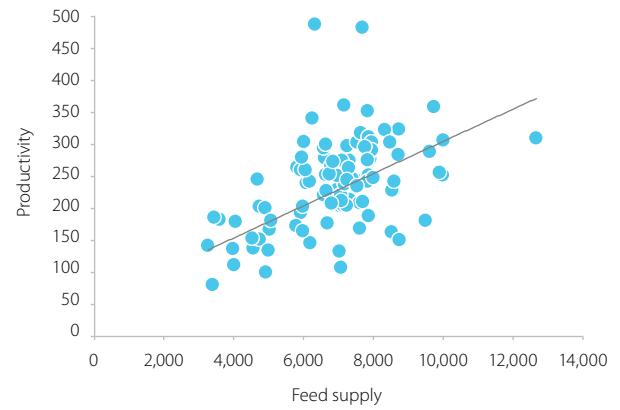
Stocking rates and productivity



Sheep to cattle ratio



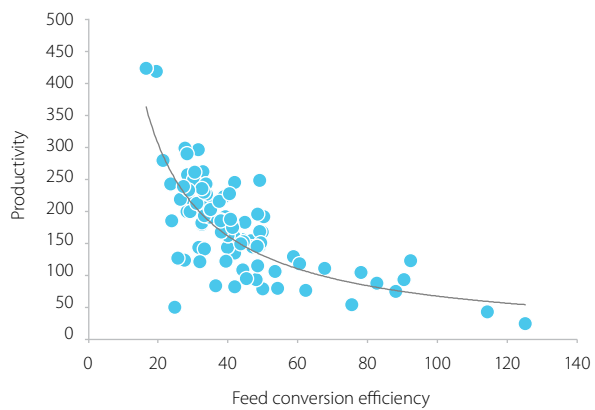
Feed supply and productivity



Source: ANZ Analysis, Average 2015-18

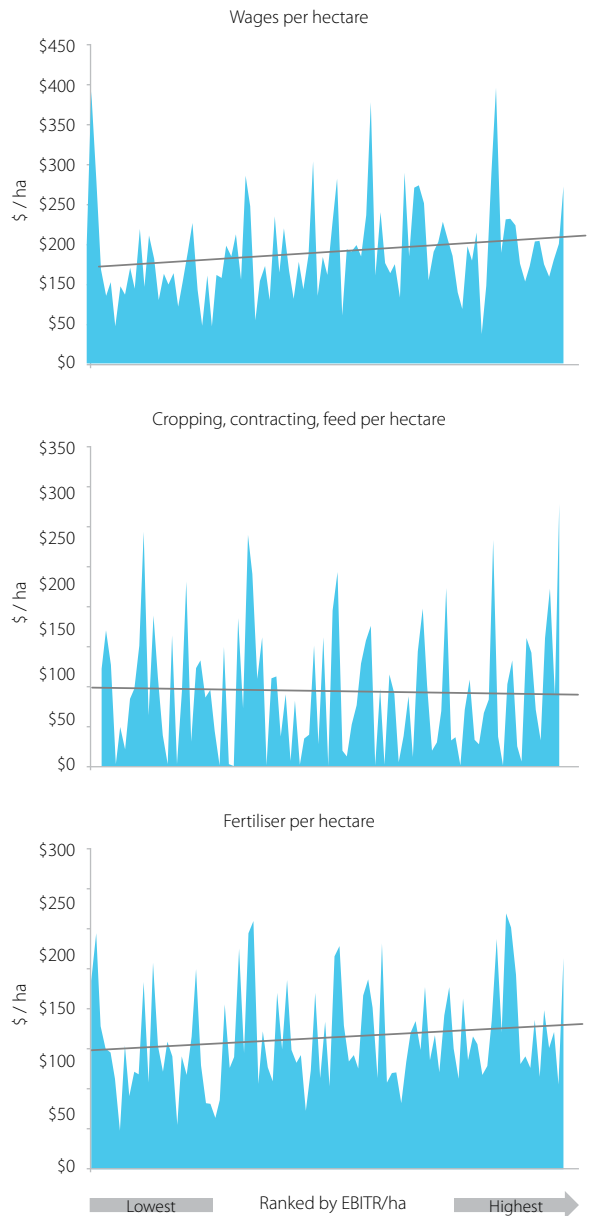
APPENDIX 3: PRODUCTIVITY AND DRIVER KPI CORRELATIONS (CONTINUED)

Feed conversion efficiency and productivity



Source: ANZ Analysis, Average 2015-18

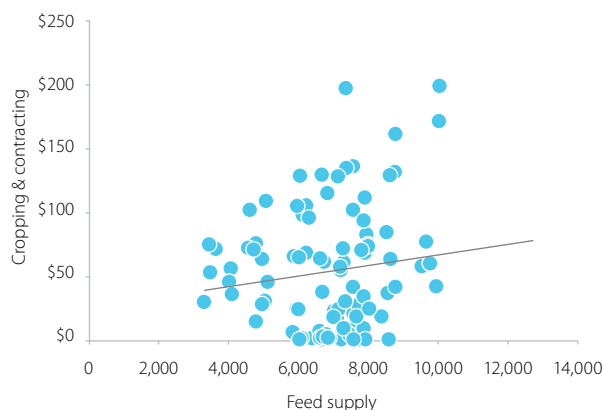
APPENDIX 4: MORE PROFITABLE FARMS TEND TO SPEND MORE ON LABOUR AND FERTILISER ONLY



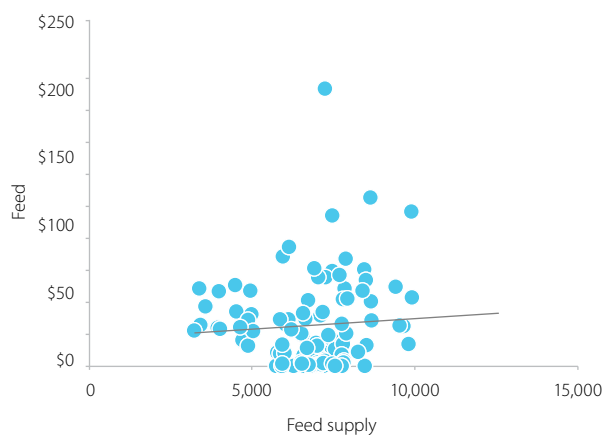
Source: ANZ Analysis, Average 2015-18

APPENDIX 5: FEED SUPPLY AND FEED, FERTILISER AND CULTIVATING/CONTRACTING EXPENSES PER HECTARE

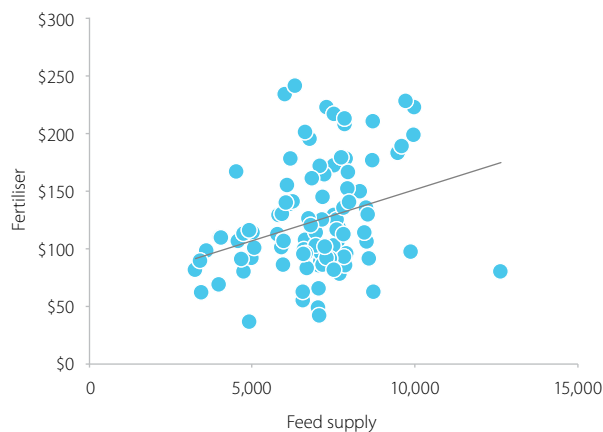
Cultivating and contracting expense per hectare



Feed supply and feed expenses per hectare



Feed supply and fertiliser expense per hectare



Source: ANZ Analysis, Average 2015-18

APPENDIX 6: LAND USE CAPABILITY CLASSIFICATION

Definition: Land Use Capability (LUC) is a hierarchical classification identifying the land's general versatility for productive use; the factor most limiting to production and a general association of characteristics relevant to productive use (e.g. landform, soil, erosion potential, etc.)

LUC Class code	Class description
1	Land with virtually no limitations for arable use and suitable for cultivated crops, pasture or forestry
2	Land with slight limitations for arable use and suitable for cultivated crops, pasture or forestry
3	Land with moderate limitations for arable use, but suitable for cultivated crops, pasture or forestry
4	Land with moderate limitations for arable use, but suitable for occasional cropping, pasture or forestry
5	High producing land unsuitable for arable use, but only slight limitations for pastoral or forestry use
6	Non-arable land with moderate limitations for use under perennial vegetation such as pasture or forest
7	Non-arable land with severe limitations to use under perennial vegetation such as pasture or forest
8	Land with very severe to extreme limitations or hazards that make it unsuitable for cropping, pasture or forestry

Source: LINZ, Landcare Research

APPENDIX 7: LAND CHARACTERISTICS CLASSIFICATION

Slope classification

Item code	Class description	Class range
A	Flat to gently undulating	0–3°
B	Undulating	4–7°
C	Rolling	8–15°
D	Strongly rolling	16–20°
E	Moderately steep	21–25°
F	Steep	26–35°
G	Very steep	>35° (36–42°)
H	Precipitous	(>42°)

Drainage classification

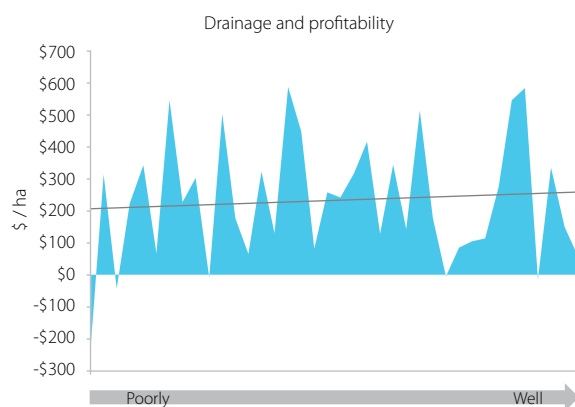
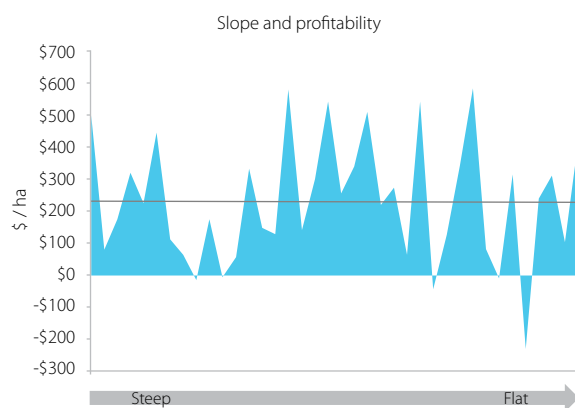
Drainage class	Class description	Class range
1	Very poor	Soils have an O horizon in place of the A horizon, and lack a distinct topsoil
2	Poor	Soils that have a gley profile form
3	Imperfect	Soils that have a mottled profile form
4	Moderately well	Soils that have either a reductimorphic horizon between 60 and 90 cm, or a redox mottled horizon between 30 cm and 90 cm.
5	Well	Soils that do not have a redox mottled horizon at less than 90 cm

Source: LINZ, Landcare Research

(15) See Appendix 7 for classification definitions, Creative Commons Attribution 4.0 International and New Zealand Land Resource Inventory (NZLRI).

APPENDIX 8: LAND CHARACTERISTICS WERE NOT A STRONG DRIVER OF PROFITABILITY

Slope, drainage and profitability⁽¹⁵⁾



Source: LINZ, Landcare Research; ANZ Analysis

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