



THE ANZ

PRIVATELY-OWNED BUSINESS BAROMETER

RED MEAT KEY INSIGHTS 2015





ON THE BRINK

We believe the Red Meat industry is at a tipping point. The returns being achieved by the best performers show the considerable potential that exists within the sector.

There is a wide range of profit performance amongst Red Meat farmers. The challenge – and the opportunity – is finding ways of achieving the same level of results as the upper echelons across the industry. If that can be achieved, Red Meat can once again become a driving force in the New Zealand economy. One of the issues driving the disparity in performance is belief. High performers have confidence in the future of the industry and they back their ability to make a difference to the productivity of their farming business. That confidence is demonstrated by a willingness to invest in improvements that deliver superior returns.

This year's Barometer though, shows that the level of confidence across the industry varies. For a number of reasons, reluctance to invest or to implement proven management practices is preventing many farmers from realising the opportunities that exist. Building confidence is perhaps the biggest challenge the industry faces.

There's certainly plenty to be confident about. The world wants what New Zealand Red Meat farmers produce.

Increasing demand for protein and the continued growth of new and affluent markets provide a solid foundation for growth.

There are issues - an ageing farmer population, ongoing discussion about the post farm-gate structure of the industry – but these can, and are, starting to be addressed. We continue to be confident about the future of the industry and the potential for it to achieve a real step change in performance.

We look forward to being a part of it.

A handwritten signature in black ink, reading 'Graham Turley'.

Graham Turley
Managing Director — ANZ Commercial & Agri



A STATE OF CHANGE

INTRODUCTION

Confidence and momentum is crucial now.

This report is the second Red Meat specific insights paper to be produced from the ANZ Privately-Owned Business Barometer.

The first report, in 2014, revealed that after years of being seen as a 'poor cousin' to dairy, there was a surprising level of 'quiet confidence' in the sector. This was driven by:

- Productivity gains despite a reduction in stock numbers and land area
- The best producers generating returns that are the equal to other farming types.

In light of those findings, the report identified the key challenge for the industry as helping more farmers to achieve those superior returns.

This year's report is an opportunity to review how the sector is meeting the challenge, and deepen the themes we explored in the 2014 report.

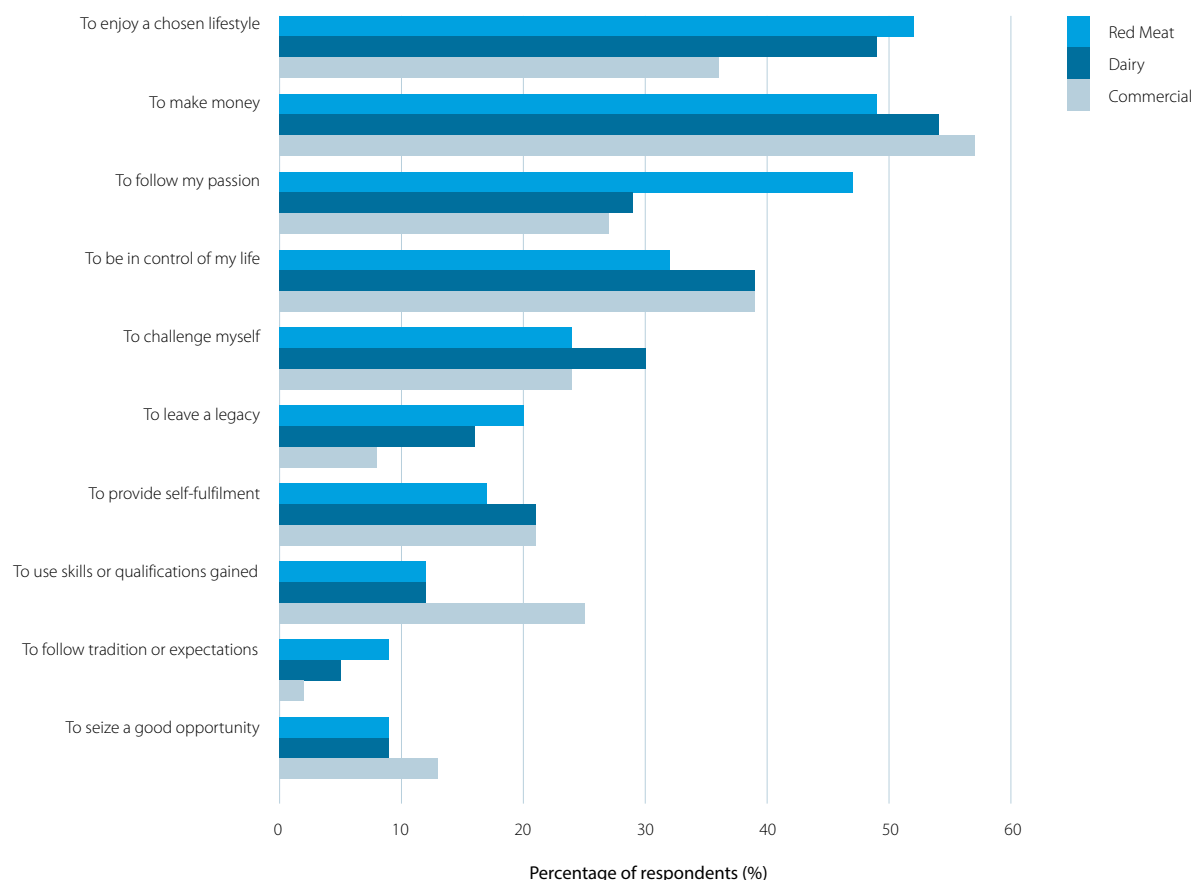
What we found was that while the opportunities for the sector remain as great as ever, a number of factors are hindering the realisation of those opportunities. One of the biggest barriers is a lack of confidence and a subsequent unwillingness to invest.

In an industry where the average age of Red Meat farmers is headed toward 60, that's perhaps not surprising. An investment with a seven year payback looks quite different to a 60 year old than it does to a 40 year old.

Red Meat farmers also face a range of new pressures which are contributing to stress and low confidence. These include increasing compliance requirements in areas such as the environment, health & safety, staff conditions and livestock welfare. All of these require farmers to have a more formal business management approach, and usually, more use of technology.

Other barriers to realising the opportunities in the sector include a reluctance or inability to implement proven successful management strategies, lack of integration in the Red Meat supply chain and the low rate of succession in the industry.

RESPONDENTS' REASONS FOR BEING IN BUSINESS



PROFIT VS. PASSION

One of the questions we asked business owners in the Barometer was why they were in business. For red meat farmers, this is much less about making money and generating profit, and more about lifestyle, passion for the industry and leaving a legacy for the next generation. That may also be a contributing factor when it comes to weighing up opportunities, and making investment decisions that increase debt and risk.

SEIZING THE OPPORTUNITY

Plenty of older farmers are adapting to the changes in the industry and the business environment. But realistically, to capture the opportunities the industry will need to introduce more talented young people with the ability, energy and interest to engage with these changes, and drive productivity and profit. The industry needs to find better ways to put talented young people at the sharp end of farm business decisions. To do this, they will need to share the benefits.

In an industry with a wide span of business performance, mostly driven by differences in management skills and confidence to invest, there are gains to be made. However in contrast to other industries such as dairy, there is limited awareness by red meat farmers and professional advisers of the business models that can achieve those gains. The new generation of farmers will need to be operating at a level above their predecessors to realise the full potential of the industry.

The issue is not just one of succession however. Skills gaps are another barrier, particularly in terms of understanding what information is useful for decision making and how to effectively gather and interpret it. We find high performing red meat businesses combine talented management with good business information and decision tools to drive top performance. The Red Meat industry is well supplied with purpose built information resources, but they are not consistently exploited.

While the meat industry, its critics and red meat farmers agree on the need for more integration between farmers, processors and the market, we find that there is insufficient progress towards this. We describe supply models which are operating now to increase value capture.

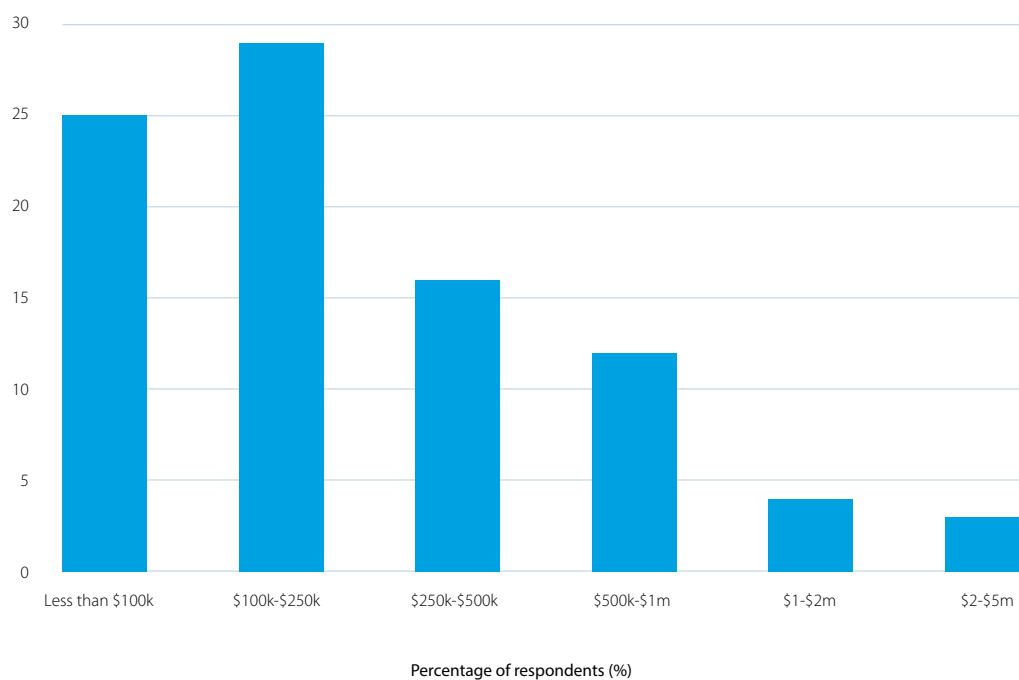
We see the Red Meat industry as part way into a real success story. The challenge remains how to get greater uptake and follow through on the initiatives to take it the rest of the way.

The critical issue is building the confidence and momentum to do so across the sector.

A SNAPSHOT OF RESPONDENTS

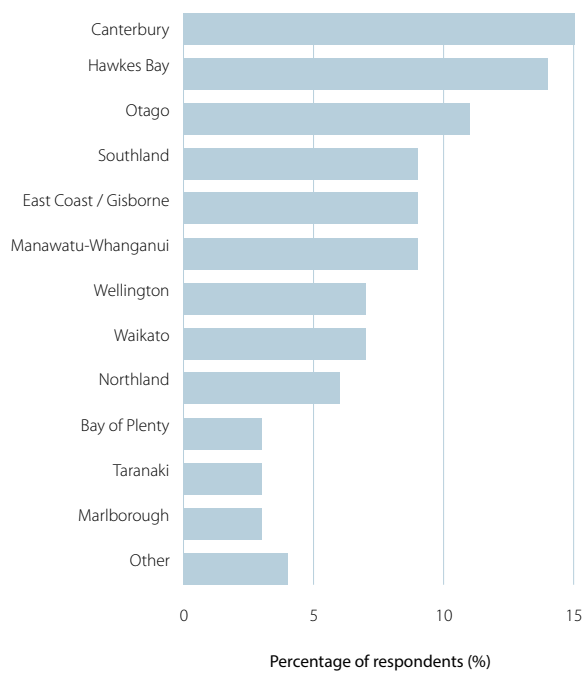
275 red meat businesses completed the 2015 ANZ Privately-Owned Business Barometer, compared to 374 in 2014. They varied in location, size and structure. The survey was followed up by focus groups with red meat farmers around New Zealand.

FARM PROFIT (EBIT) OF RED MEAT RESPONDENTS

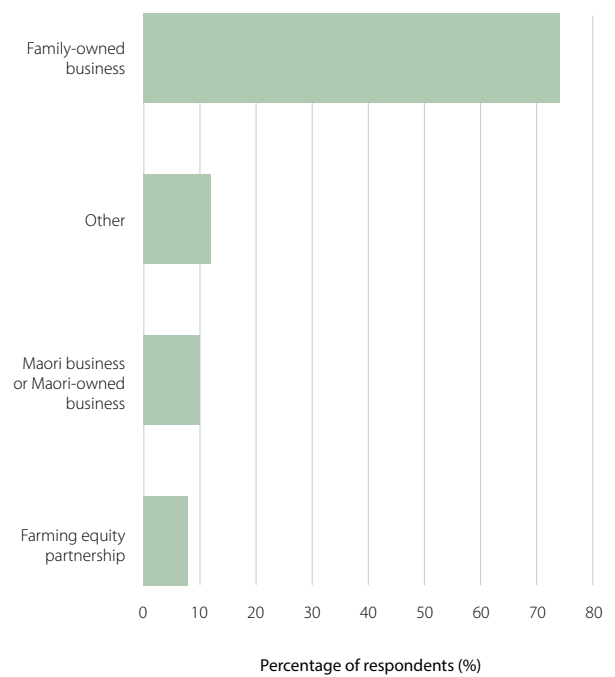




LOCATION OF RED MEAT RESPONDENTS



BUSINESS STRUCTURE OF RED MEAT RESPONDENTS





THE BIG PICTURE

INSIGHT ONE: AN INVESTMENT OPPORTUNITY

New Zealand's Big Red Meat Farm and the investment opportunity.

In focus groups held with red meat farmers as part of the Barometer process, a common topic of discussion was the returns that can be achieved when people are prepared to invest.

THE SIZE OF THE NATIONAL OPPORTUNITY?

One way of quantifying it is to look at the industry as a single 'Big Red Meat Farm'.

To model this, we've used data from Beef + Lamb New Zealand's Economic Service which identifies all land, stock and production of New Zealand red meat farms (including land employed in other activities, such as dairy support).

HERE'S WHAT NEW ZEALAND'S 'BIG RED MEAT FARM' LOOKS LIKE

The New Zealand 'Big Red Meat Farm' (based on 2013 data):

- Area in Sheep and Beef Farming: 8.4 million hectares (down from 12.1 million hectares in 1993)
- Value (land, stock and plant): \$66 billion
- Debt: \$9.6 billion
- Average Stock units/hectare: 6.1
- Number of Farms: Approximately 11,000
- Production: 1.06 million tonnes meat and fibre

Earnings:

- Total sales (127 kg/hectare): \$5,188,910,917
- Sales/hectare: \$615
- EBIT/hectare: \$370.24
- Cost to Income ratio (CTI): 60.2%

If that's the current situation on the Big Red Meat Farm, what then is the opportunity?

Proven management practices and new techniques for pasture renovation, farm management and animal genetics are utilised by some to drive their step change in performance. The challenge is to get wider adoption to drive an industry wide step change.

Results achieved by high performance farm analysis show that investment in management, fencing, water, pasture renewal and livestock genetics result in much improved productivity and generate a return well above the cost of capital, so investment increases profit, and the payback period is relatively short.

When farmers invest in these areas, livestock per head production typically increases significantly, as does feed conversion efficiency as a result of things such as higher lambing percentages and faster growth rates.

Farmers gain increased flexibility to react to changing signals in markets, and climatic conditions, have a flatter supply curve, and can establish more predictable supply arrangements, leading to better processor efficiency, and potentially higher and more stable earnings.

In 2012, ANZ commissioned Greener Pastures, a research project into New Zealand's Soft Commodity opportunity. For red meat, the report estimated if the sector were to spend \$900 million per annum on productivity it could realise a significant growth opportunity.

This amount applied over a five year period to say around a third of the 'Big Red Meat Farm' would equate to an investment around \$1,500/ha.

Investment into areas such as pasture renewal, subdivision to smaller paddocks and stock water, which cost around \$1,000-\$1,500/ha (depending on range of factors) have shown a 10-30% return on the marginal investment over a five-year period. This is a wide range as there are many different factors to consider, but the common denominator is production of additional pasture and the effective utilisation of it.

Normally a proportion of new investment would be funded from cash and retained earnings, as well as debt. But in this case, such investment may need to be front loaded, which means in the majority of situations the investment will be debt funded.

In the 'Big Red Meat Farm' example many would wonder if it's realistic to take on this additional burden of \$2.77-\$4.16 billion. Looking at the high level "debt affordability" metrics for the 'Big Red Meat Farm' shows it wouldn't be a stretch.

Farm debt would increase from \$9.6 billion to \$12.37-\$13.76 billion in year-one and the loan to value ratio increase from 15% toward the early 20% (assuming no change in property and stock values). The marginal return exceeds the medium-term cost of capital (and by a significant margin at the top end of the return on investment range), which we estimate is around the early 7% mark for agri investments. This would mean debt serviceability metrics (i.e. interest cover ratio) would improve too.

The initial investment is assumed to be paid-off in 2.2-3.5 years from the generation of additional returns. In year five the additional EBIT after paying back the initial capital outlay would range from \$454-\$954/ha. Over the five-year period this would equate to an annual average return of \$90-\$191/ha, which across the entire industry it would add \$30-\$60/ha.

It's clear that there is an investment opportunity, but whether or not it is taken up is really up to farmers. Of course each farmer's circumstances are different, to consider if that investment is suitable for you, you may want to obtain your own professional advice.

Because the average age of red meat farmer owners is around 60, this increased investment in productivity and profitability will often be about creating succession solutions.

However, motivation and confidence are key – and the lack of these is a barrier for the industry to realise its full potential.



CONFIDENCE AND WILLINGNESS TO INVEST

INSIGHT TWO: TOP PERFORMERS SHARE A BELIEF IN THE FUTURE

CONFIDENCE IS LACKING

One of the things we measure in the ANZ Privately-Owned Business Barometer is optimism and confidence in the future. This year's Barometer showed that the confidence of Red Meat respondents in the future has not progressed significantly from 2014. But the real story is how confidence in the Red Meat sector compares with other industries.

Red Meat respondents are significantly less optimistic than other sectors about the New Zealand economy, their own sector, and their own business.

It's interesting to note that dairy farmers had somewhat greater confidence in the future of the New Zealand economy in March 2015, when the survey took place, whereas red meat farmers were more downbeat.

It's interesting to compare these sector expectations for the next three years to the Food & Beverage sector, where 48% were very optimistic. In the Food & Beverage focus groups, many of

the factors driving their optimism, such as increasing global demand for food (and protein in particular), and exposure to increasingly wealthy Asian consumers, were also relevant to the Red Meat industry. Yet red meat farmers were significantly less optimistic about the prospects for their sector.

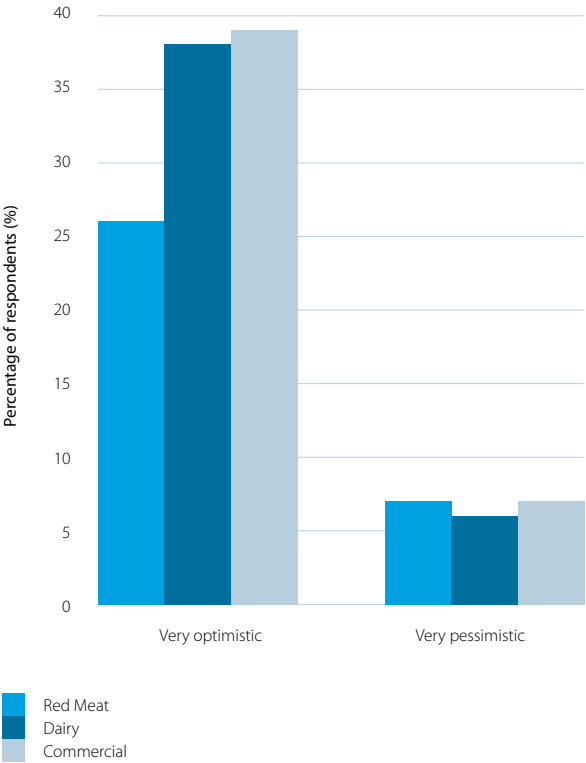
The comparison here with owners of dairy businesses is telling. Despite the current slump in milk prices, dairy farmers continue to have faith in the future of their industry. One explanation given in focus groups was that they are a cooperative industry and draw confidence from each other.

"It's hard to be optimistic about sheep and beef this year."

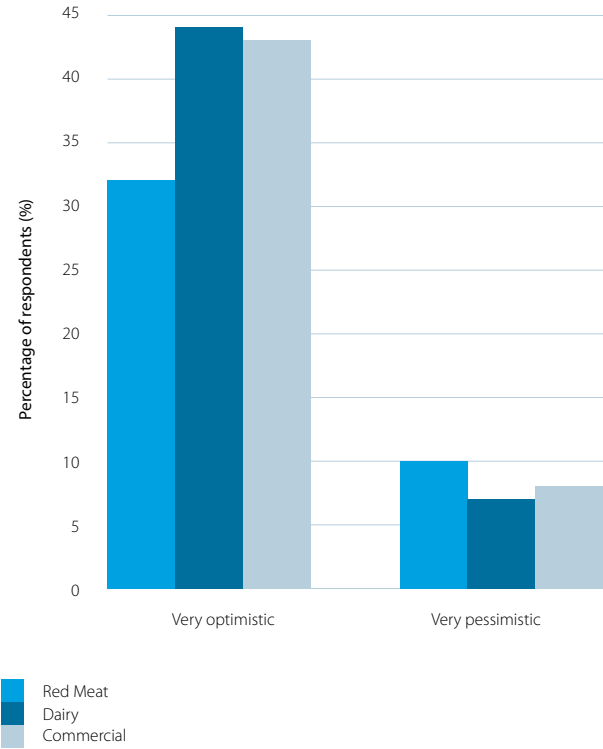
Red Meat Farmer, South Canterbury



RESPONDENTS' EXPECTATIONS FOR THE NZ ECONOMY OVER THE NEXT 3 YEARS



RESPONDENTS' EXPECTATIONS FOR THEIR SECTOR OVER THE NEXT 3 YEARS



WHY CONFIDENCE MATTERS

Confidence is important because it drives spending and investment decisions.

There's a clear correlation between confidence and economic activity. That's why economists measure confidence, through surveys such as ANZ's Business Outlook. If businesses are confident about the prospects for future sales and returns, they will be more inclined to invest in their business through plant and machinery, marketing, training and more.

Similarly, if red meat farmers are confident in the future of the industry, and their own farming business, they will be more likely to take the risk of investing in it to seize the opportunities available.

Investment decisions, of course, are made by people – and we are driven by emotion as well as logic. That's why even though there may be a clear investment case and a quantifiable return on investment; farmers may still be unwilling to invest.

BUILDING CONFIDENCE IN THE RED MEAT SECTOR

Research conducted for the Red Meat Profit Partnership (RMPP) and Beef + Lamb New Zealand by research company UMR indicates that industry confidence is quite shallow. Unlike other sectors, where long term factors carry more weight, confidence in the Red Meat sector is more linked to short term factors like product price and climatic conditions – as evidenced by peaks in confidence in late-2011 and late-2014.

But research also shows that the top performing 20% of red meat farmers have a different level of confidence. All top performers share a strong belief in both the future of the industry and their own ability to improve on-farm productivity. One of the major challenges for the industry is how to build the same long-term confidence amongst the other 80%.

Support networks

We asked UMR Research Director Marc Elliott for his observations, based on the research he has conducted into confidence in the sector. He believes good support networks and good information are key factors.

UMR research shows that farming couples where the husband and wife teams are both actively engaged in the business of farming there is invariably much more confidence in the operation.

The simple act of engaging in conversations between the two partners about ideas and farm issues makes a significant difference

to the whole demeanour of the farm business. Ideas and concerns that are left to spin around inside a farmer's head tend to spin into a downward spiral. However, whenever ideas and concerns are shared they tend to be improved and have a better chance of implementation, and concerns are for more likely to dissipate.

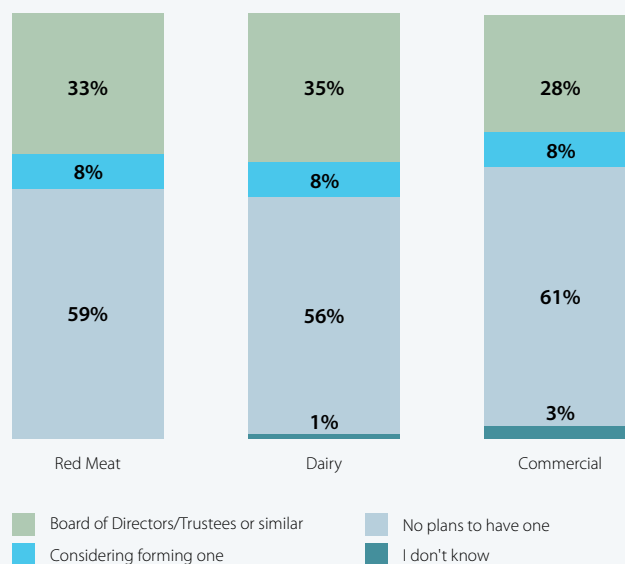
In Barometer focus group discussions, farmers also talked about the importance of having good local networks of other farmers, advisers, farm consultants, and rural bankers as a way of building confidence and a forward-looking approach to their farming business.

The Barometer survey asks about governance and advice. Farm advisers play a much more significant role in the red meat sector than other farm types, but the most regularly used adviser for big decisions is the accountant. Bankers, suppliers, family and friends and associates also play an important role.

An increasing number of farmers have boards or similar structures, often to assist with decision-making processes when more than one generation is involved.

As anyone who has ever served on a committee knows, when more are involved, more process is required. Red meat farmers are making the transition between the efficiency of individual decision-making, and the depth that comes from a greater diversity of views and expertise.

GOVERNANCE OF RESPONDENTS' BUSINESSES

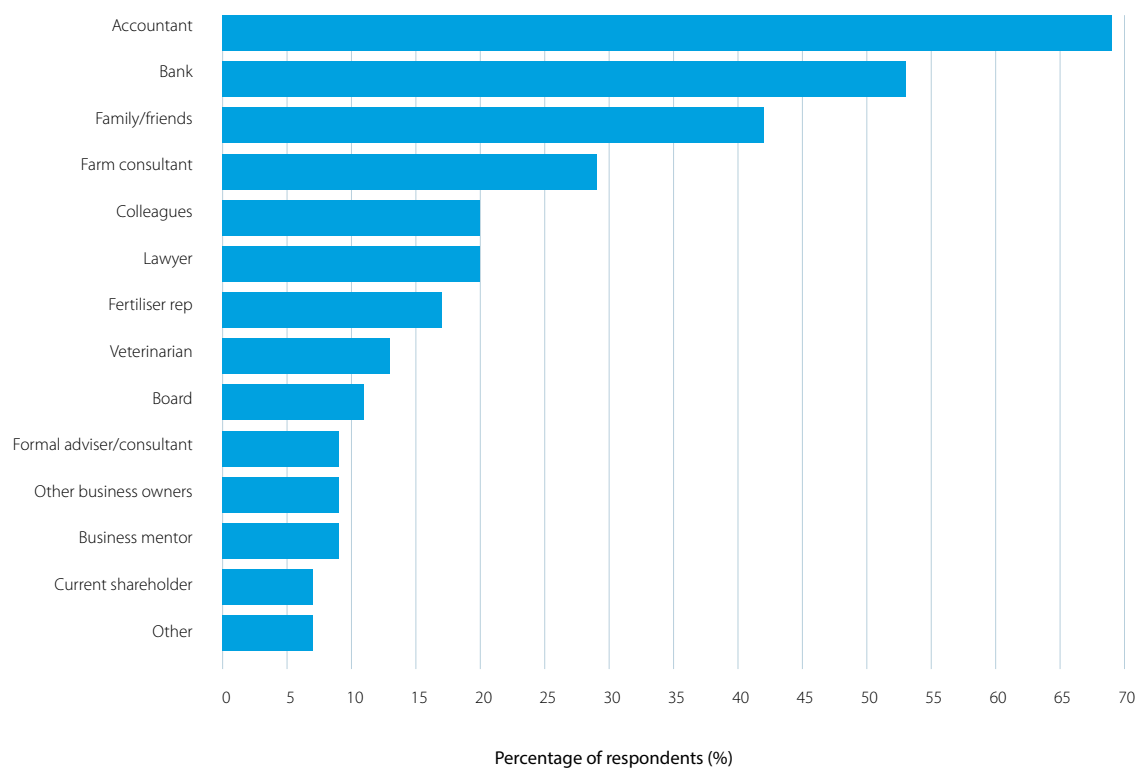


“A lot of red meat farms are family businesses, which means there's a lot more of an emotional connection, which can make decision-making more difficult.”

Red Meat Farmer, South Canterbury



**ADVISERS RED MEAT RESPONDENTS FOUND HELPFUL
IN THEIR LAST BIG BUSINESS DECISION**



SHARING THE LOAD

AGRI WOMEN'S DEVELOPMENT TRUST

ANZ is a sponsor of the Agri Women's Development Trust, and it runs a seminar series for red meat farming women called 'Understanding your Farming Business'.

The programme aims to better engage farming women as critical partners in their Farming Businesses through building business knowledge, skills and confidence.

Participants – and their partners – have reported a range of benefits including greater communication and willingness to consider options for improving the farm business.

One participant commented that "We talk much more together now about the business. We've taken a microscope to what we do – we're asking why we do that and how can we improve, rather than doing what we usually do. We're asking better questions and we're getting better results."

Others have commented on the sense of empowerment that being more involved with the farming business has given them and the increased communication with their partner as a result. Early evaluations have also shown that changes initiated by women who have taken the programme have added significantly to the farm bottom line.

For more information about the 'Understanding your Farming Business' programme go to awdt.org.nz

'THE TOP TWO INCHES'

STEVE HANSEN

All Black coach and ANZ Ambassador Steve Hansen was our guest at National Agricultural Fieldays recently.

While there he answered questions from Fieldays attendees about his experience of coaching the world's best-performing rugby team – including a question about how he builds and maintains confidence amongst his players.

Steve's response was that confidence plays a big part in performance and it's a major issue amongst high level athletes – one that's probably not talked about enough.

When good players aren't performing it's usually because they have lost confidence, not skill. He mentioned Dan Carter's early season form with the Crusaders in 2015 as an example of someone who has no lack of skill or ability, but who was simply lacking confidence after injury and playing out of position.

When players lose confidence and their performance is suffering, Steve's approach is to sit down with them and talk through the reasons why their confidence has been knocked. It might be the effect of an injury, technical issues, or something else, but whatever it is he'll work with them to understand what's driving it and work out a way to address it.

Usually once they understand the problem, see that there is a solution, and start to see some results, the confidence will begin to return – and so will their performance.

DATA AND MEASUREMENT

INSIGHT THREE: MEASUREMENT PUSHES BOUNDARIES



A big component in increasing confidence in farmers is seeing results.

If a farmer can see a measured change in performance and return this will invariably lead to a desire to push on further, invest and grow their business.

That's why benchmarking and keeping performance records are critical. Dairy farmers have a more real time indication of animal performance, but on a red meat farm this is more difficult and requires extra effort as there are multiple classes of stock, and complexities of store, breeding and finishing systems to consider. While recently developed practices for calculating meat and fibre production per hectare bring some of the clarity that dairy farmers enjoy, it appears the use of benchmarking is less effective in red meat farming. The range of land and livestock types and product outputs of red meat farms make them more complex than other farm types. Refined instincts and experience still count for a lot but there is also a correlation between the effective use of decision tools and performance.

Decision tools

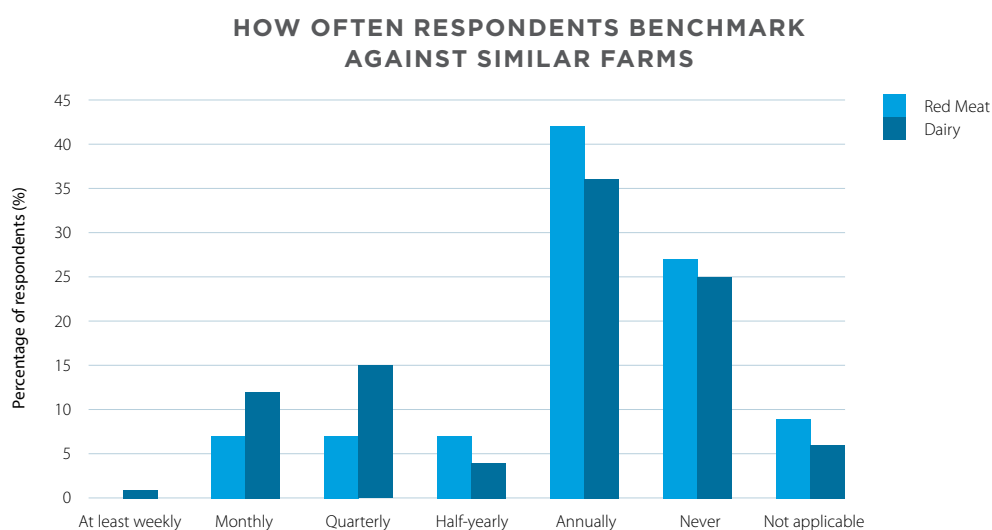
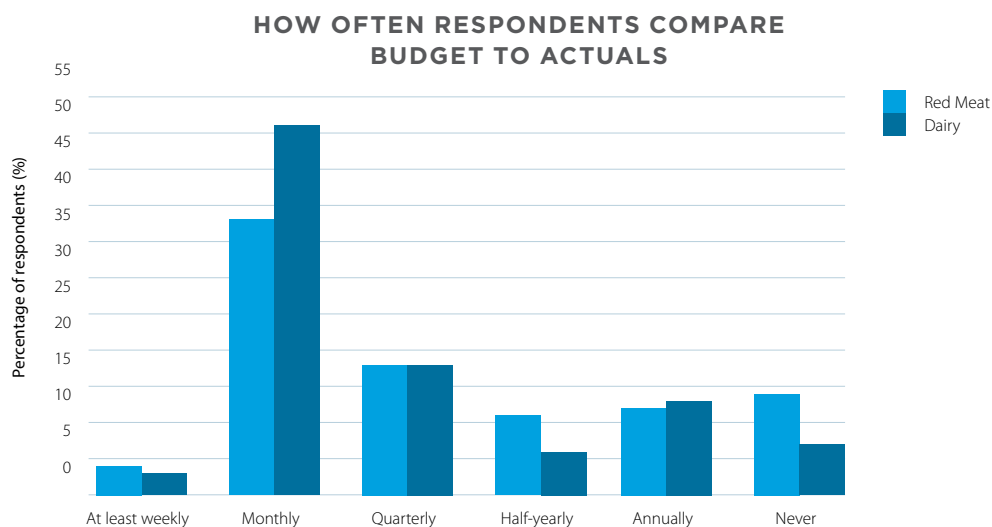
Decision tools enable red-meat farmers to monitor KPIs for both animal and financial performance. Tools mean investments can be analysed and prioritised.

Tools include:

- financial management tools such as CashManager Rural, and Figured
- benchmarking resources from Beef + Lamb New Zealand accountants and farm management consultants
- farm system modelling and management tools such as Farmax and FarmIQ
- environmental analysis tools such as Overseer
- budgeting and financial projections, and investment analysis
- operational management tools to track and record farm activity – for staff management, environmental compliance and health and safety

It's how these tools work in combination that creates benefit. This is an area that the industry is well aware of and the Red Meat Profit Partnership is working on information standards to enable better integration between these tools.

Currently information is inconsistent and resources often do not "talk to" each other. This is a bugbear for high performing farmers because they need to reload information in each.



Technology

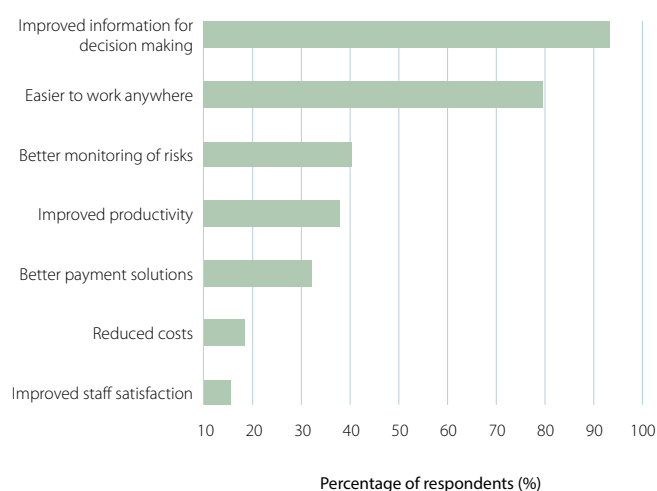
The move of farm management information to cloud systems provides the opportunity to integrate information between systems and tools – an opportunity IT providers and the Red Meat Profit Partnership are engaged with, along with the dairy industry. Work towards integrating tools is now paying dividends. Specialist sector IT providers say farmers will see results in 2015 and 2016, but the question is the extent to which tools are used across the industry.

Better information systems can also help reduce the stress of managing new compliance regulations. Many farmers report concerns about the impact of meeting health and safety, environmental and staff management compliance requirements. All of these require better planning, oversight and extensive record keeping, which is increasingly more easily enabled by cloud based systems.

For a number of reasons, including broadband access, red meat farmers are low users of social media for business purposes, and this may be an indicator of rate of adoption in cloud applications.

However, broadband access is stepping up, and provides opportunities and resources to deal with many challenges for red meat farmers.

MAIN BENEFITS FROM MOBILE TECHNOLOGY



WHAT DO HIGH PERFORMERS FOCUS ON?

Another characteristic of high-performing red meat farmers is that they actively seek out – and act on – information. While there is a lot of information out there, the question is what to focus on and how to use it.

To provide a first-hand perspective, we asked a high-performing operation for their thoughts on the key drivers of profit, and what information they focus on, and how they use it to manage their business.

LONE STAR FARMS

Lone Star Farms is a sheep and beef cattle farming enterprise consisting of eight properties – one in the North Island and seven in the South Island of New Zealand.

Collectively, the business runs about 130,000-140,000 stock units, primarily sheep (80%) and cattle (20%). The farms and the head office (in Nelson) employ 40 permanent staff.

Lone Star Farms Finance Manager Tim Wanklyn provided some key insights on their experience:

You can't manage what you don't measure

Lone Star Farms' approach is data-driven. They collect and use actual data to provide predictions on things like feed grown or animal production, and then measure the results. The key is using actual data – for example, their feed budgeting is based on demonstrated growth rates – “in rough terms, if you know your pasture area, and you know how much stock eat, and how many you have, the difference is growth.”

The value of accurate data is that it enables you to model different scenarios and make more informed management and investment decisions – for example:

- If we spent X dollars, on improving pasture, what return would we get?
- How does that return compare with spending the same amount on something else?
- If it continues to be dry how much additional feed will be required, or does destocking need to take place?

While there's a lot that can be measured, the key is understanding what will really help you increase your bottom line. Key measures that Lone Star Farms focuses on include:

- Lambing percentage
- Weaning weight

- Condition score of ewes and
- Kg Dry Matter grown

It's important to understand what's behind your key metrics and what influences them. For example, while you can't always manage lambing performance and weaning weight directly, you can invest in better ways of looking after ewes.

It's a relatively simple process of understanding what basic information you need to monitor, gathering it consistently, and using it as the basis for all your management and investment decision making.

Turning information into action

Once you understand the key drivers of profit in your business, the important thing is to understand what you can influence and break them down into manageable day-to-day actions. Having a written plan is important – “the difference between thinking about it and writing it down is often the difference between ‘might do’ and ‘have done.’”

For all discretionary investments such potential developments and efficiency improvements, Lone Star Farms goes through a return on investment process based on their data, and prioritises the investments that will deliver the best return.

To do this Lone Star have developed simple excel spreadsheets that calculate returns from fencing, water, regrassing, additional fertiliser and so on.

It's important to question existing assumptions and practices, as the best returns are not always where you expect them to be. For example, an investment in reticulating a stock water system on one of Lone Star's farms has resulted in a huge increase in lamb growth rates as a result of better pasture utilisation in areas away from where water was previously.

For larger investments, Lone Star Farms will also often have their calculations peer reviewed to ensure their assumptions are correct. They also find benchmarking information useful, but are careful to ensure they are comparing like for like.

Having made an investment, it's important to evaluate it (which is something that many farmers - and many businesses in general - fail to do). Did you achieve the targeted return on investment? If not, why not – and what lessons can be learned for the future?

“Farmers have more alternatives now, and they're more hard-headed about their decisions.”

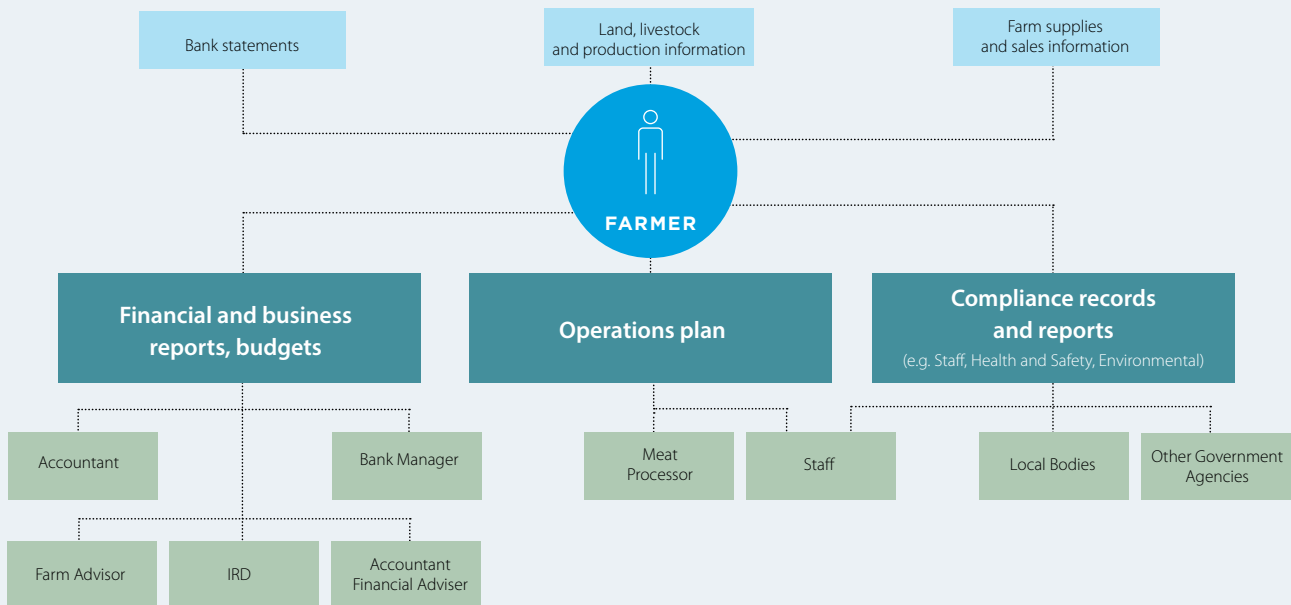
Red Meat farmer, South Canterbury

INFORMATION

FLows IN AGRICULTURE

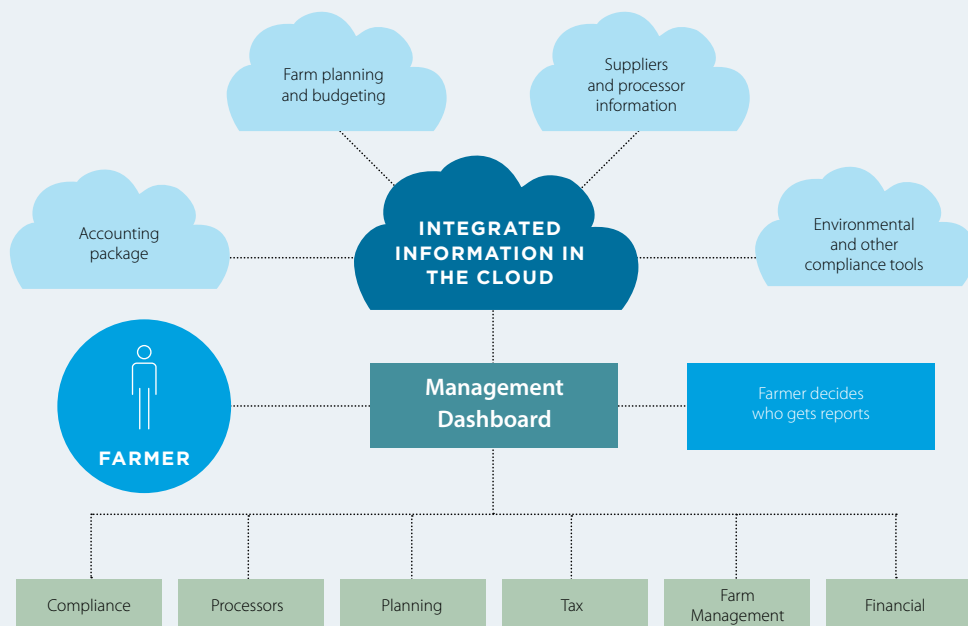
CURRENT STATE

Farmers are responsible for keeping records and furnishing reports to meet a range of needs, using much of the same data.



EMERGING STATE

Data is shared in the Cloud, between the variety of sources and applications. Reports are created and directed where required.



FOCUS ON WHAT YOU CAN CONTROL

In farming, of course, there are always many things farmers can't influence, like the weather and market fluctuations. However that doesn't stop many farmers worrying about them anyway – which leads to further erosion of confidence. The best performers tend to focus on the things they can control, rather than the things they can't. The process of taking action and seeing tangible outcomes increases confidence in farmers' ability to control their own destiny, rather than being in the hands of external factors.

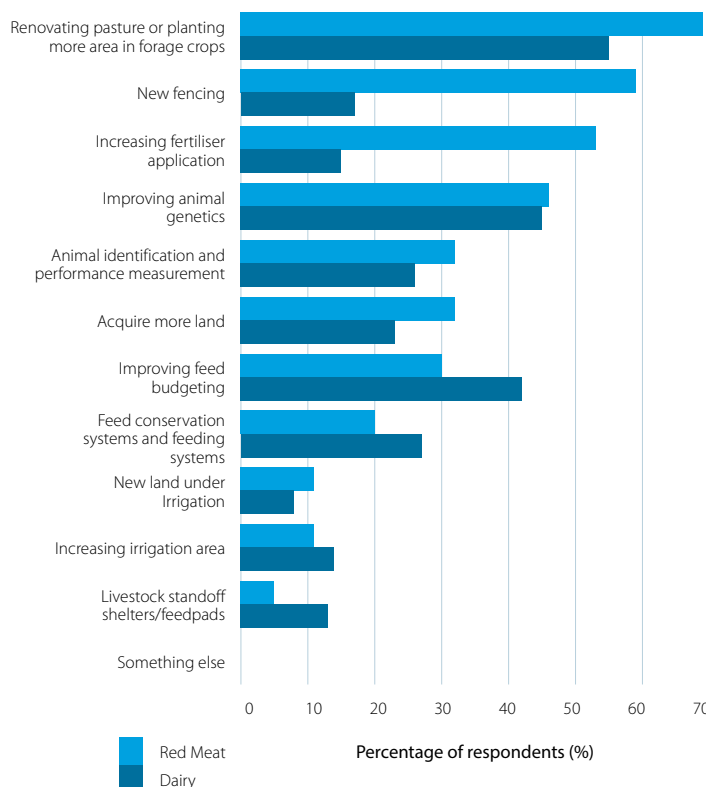
“Every farm's different – the investment priority for one won't necessarily be the same for their neighbours.” – Red Meat farmer, Hawkes Bay.

WHERE ARE FARMERS INVESTING?

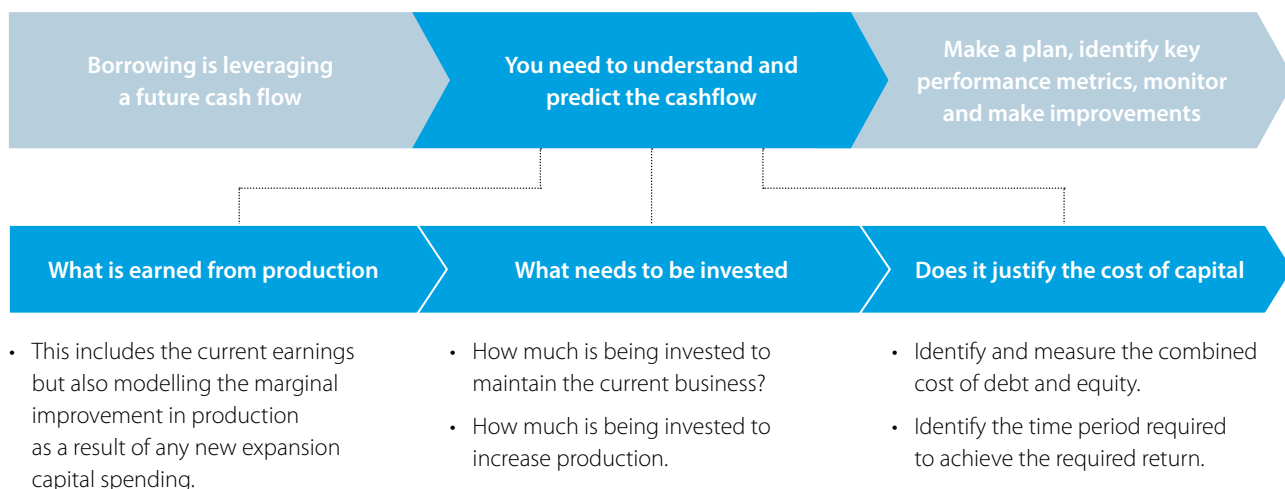
The majority of investment by red meat farmers is in areas that will increase production – in particular:

- Pasture renovation or forage crops
- New fencing
- Improving fertiliser application
- Animal genetics
- Technology
- Infrastructure

HOW RESPONDENTS ARE INVESTING TO INCREASE FARM PRODUCTION



AN INVESTMENT-DECISION MAKING MODEL



THE ROI CALCULATION

Increase in EBIT for the investment period

Investment required to achieve the increase

The % return on investment

$$\boxed{\text{Increase in EBIT for the investment period}} \div \boxed{\text{Investment required to achieve the increase}} = \boxed{\text{The \% return on investment}}$$

HOW DO YOU VIEW PROFIT?

How profit is measured influences investment decisions. Simplified, the choices are to report and budget projections on a cash, tax or management/accrual basis. It's important to understand the positives and negatives of each approach:

	CASH	TAX	MANAGEMENT ACCOUNTS
Positive	It is essential to understand and predict cash movement, so cash is controlled, and funding requirements met.	This is required for legal compliance and to appropriately manage tax.	<ul style="list-style-type: none">• Expenditure is matched to the period income is received in.• Better demonstrates business performance, resilience and opportunity.• It is a better basis for understanding the effect of investment decisions.
Negative	May cause investment options to be missed.	<ul style="list-style-type: none">• Doesn't show either cash, or true economic performance.• Reports individual legal entities, rather than overall enterprise results.	<ul style="list-style-type: none">• Not well understood and more complex.• Requires more complex information capture systems and analysis.
Everyday example	Regrassing not undertaken because of the effect on the overdraft, despite investment analysis of a 20% ROI over the investment horizon of seven years.	Tax summary is collected for company, trust, partnerships only, but this information isn't re-organised to assess individual enterprises within these entities true economic performance for the financial year.	Farmers following this approach have more up-to-date information on financial performance, which allows them to better respond to changing market signals.



A STRATEGIC PLANNING PROCESS

The model below is one we have presented before, but we think it's useful to include it here. We have found it an effective way to think about business planning and business management from a strategic perspective. It's also helpful in making decisions about the best use of your resources.

Evaluate

Where is your business now and where do you want it to go? What are your key goals and priorities?

Analyse

Review your options and evaluate the consequences of each, including calculating the return on different investment options.

Plan

Prepare a plan and budget for the option(s) you have selected.

Activate

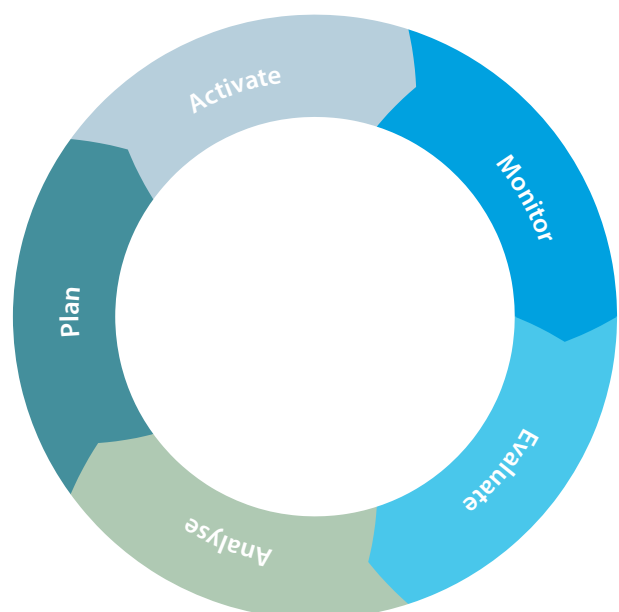
Implement your plan effectively.

Monitor

This step is often forgotten, but it's essential to review what's happened against your plan to validate your return on investment, and make any adjustments needed to ensure you achieve your objectives.

Remember

The Red Meat industry is cyclic; so should your planning process be.



CAPTURING VALUE THROUGH THE SUPPLY CHAIN



A major topic of discussion in focus groups was the opportunity for farmers to capture more value.

The Red Meat Sector Strategy's* conclusion was that "sustainable change in the industry requires informed, aligned, behavioural change on the part of all stakeholders in order to achieve coordinated in-market behaviour, efficient and aligned procurement, and sector best practice."

There has been considerable discussion about how to achieve this, including rationalisation of the industry's structure as outlined in the 2015 Meat Industry Excellence report 'Pathways to a Sustainable Future'.

This is a discussion that has been canvassed at length elsewhere; however, the discussion in Barometer focus groups was less about the ownership structure of the industry than seeking to identify opportunities for farmers to capture value through better integration between producers and processors.

Like many of their dairy farming colleagues, red meat farmers believe they are producing a premium product but don't always receive a premium return for it. A number of farmer entrepreneurs have tested this by seeking to develop direct sales relationships. They have found that increased value capture requires investment and changes back down the supply chain at the farmer and processor level, as well as at the marketing level.

A more integrated supply chain would send better signals to producers about what specific markets require (and are willing to pay a premium for). That would allow farmers to adapt on-farm practices to deliver higher value products more consistently. Better supply chain integration could also deliver greater plant efficiency through committed supply and a flatter seasonal supply curve, but the farmer has to be rewarded for the increased product cost of farming outside the grass curve.

Other key issues include things like timing and consistency of supply of livestock, markets for non-premium cuts, breeds providing required cuts, and extraction of a food safety and country of origin premium. These all require deeper connection between suppliers, processors and marketers.

What would a more integrated supply chain look like in practice? Andrew Gibbs, Deloitte Partner and Project Manager for the Red Meat Profit Partnership's Efficiency Workstream, has outlined a continuum that describes different options. Moving up the continuum brings farmers closer to the market, increases their level of integration and changes their risk/reward profile.

*Red Meat Sector Strategy Report, March 2011, Deloitte.

OPTION 1: STATUS QUO

This is the traditional model which most producers operate under. In this level producers take or negotiate the best price they can get on the day and are not committed to a particular processor.

- **Advantages** for farmers include flexibility in terms of growing what suits their conditions, business model and preferences and low cost of investment.
- **Disadvantages** include a reasonable level of uncertainty about the price they may receive for their product, no guarantee of killing space. It also provides little or nothing in the way of market signals to farmers.

OPTION 2: STRATEGIC RELATIONSHIP WITH PROCESSOR

This option is about joining forces with a processor to support a particular market offering or proposition – for example, supplying New Zealand-branded lamb to a specific overseas market. The producer will need to commit some or all of their output and the product will typically need to meet certain market specifications for which the producer will receive some premium.

- **Advantages** for farmers include guaranteed killing space, greater certainty about price and the opportunity to achieve a premium, relatively low cost of investment and lower risk.
- **Disadvantages** include the potential need to produce to certain specifications (e.g. around weight or timing), which may require changes and adaptations to existing farm management business model and practices.

OPTION 3: COLLABORATION WITH OTHER PRODUCERS

This is where producers build a relationship with another group of producers and processors with a similar proposition and a desire to break away from the status quo to achieve better returns. The collaboration provides scale to meet market demand and is typically built around a common marketing 'story' – for example meat from a specific area or breed, or from farms with similar values and farming practices, aimed at a specific domestic or overseas market.

- **Advantages** for farmers include the ability to be a price setter, rather than a price taker, and to achieve a premium, assuming the story is compelling enough.
- **Disadvantages** include a higher cost of investment, the need to produce to specifications (and the need to adapt farming practices to do so), toll processing which provides no guarantee of killing space, greater uncertainty and greater risk.

OPTION 4: OWN BRAND

This is where producers create their own brand based on a marketable point of difference – for example location, breed, or a family farm story that plays to the increasing demand from consumers to 'know where their food comes from.'

- **The advantage**, of course, is the potential to set and achieve a price premium for your product – if your brand story is compelling enough.
- **Disadvantages**, on the other hand, include the high cost of investment, and increased challenges, uncertainty and risk – for example, of being unable to meet market demands for quality or volume at certain times.

Moving along this continuum is not easy and there are a number of factors to consider. Farmers typically manage their business according to the conditions in their region, which may not necessarily produce what the market wants, when it wants it.

Achieving a more integrated supply chain relationship may require investment as well as changes to current operating models, and expose farmers to more risk. Any change requires a progression through Option 2 first to develop a deeper relationship between producers and processors.

Farmers need to weigh the value to be captured against the cost and effort of capturing it. However, there are farmers achieving good returns through moving up the value chain.



SUCCESSION

INSIGHT FOUR: NEW OWNERSHIP PATHWAYS NEEDED



With the average age of red meat farmers heading toward 60, it will come as no surprise to anyone that 70% of Red Meat respondents identified succession as an issue.

This is one of the highest percentages of any sector (and higher than the 60% of their dairy counterparts who identified succession as an issue).

"We are sitting on a time bomb." – Wairarapa Farmer.

In common with their dairy counterparts, many red meat farmers are changing their perception of themselves from land owners to business owners. That's also leading to a change in their views on succession.

Traditionally, the focus for succession has been on selling some or all of the farm assets to family members, or outside the family on the open market. That's still a significant option – 26% of Red Meat Barometer respondents saw selling some or all farm assets to family members as a step towards succession, while 22% viewed selling some or all assets on the open market as a step towards succession.

Increasingly, though, the farm business is being seen as a multi-generational family business. That's also in line with what is happening in the dairy industry. In a multi-generational family business the focus is on a gradual change of roles

"There's a change of mindset, from a way of life to an acknowledgement that it's a business."

Red Meat Farmer, South Canterbury

“Are you a custodian of the family’s farm, or the family’s capital?”

Red Meat Farmer, Wairarapa

between generations, rather than a one-off change of ownership. Some of the ways respondents were taking steps toward this that model included:

- Family members taking over management of the farm (38%)
- Owners moving into a governance role in the business (21%)
- Appointing a non-family farm manager to run the business (8%)
- Family members taking up shares in the business (25%)
- Family members taking up shares and managing the business, allowing the owner to take money out (16%)
- Owners buying a house and living away from the farm (18%)

RED MEAT PATHWAYS

In this year’s Barometer succession was identified as an issue for Privately-Owned Businesses in every sector - but the Red Meat sector has some particular challenges.

An ageing generation of red meat farmers are all considering options for exit at the same time, are looking for a reliable income stream and want to protect their assets against inflation. They currently face historically low interest rates on deposits, and most are not familiar or comfortable with other higher risk and higher return investment options such as shares or commercial property. If there is a straightforward way to hold the asset and earn an income from it, they may choose not to take their money out of the farm.

However, the red meat sector lacks the established steps that exist in the dairy industry for younger farmers to progress - such as contract milking, lower order sharemilking and 50/50 sharemilking. These all provide opportunities for talented young people to develop skills, create wealth, increase management control and progress to ownership over time.

There are matching pathways that exist in the Red Meat sector, but they are not well known. Based on a recent study by Lincoln University Kellogg Rural Leadership Programme student and ANZ Rural Manager Kirsty Stratton, and ANZ’s experience, some of the pathways currently operating in the Red Meat industry include:

- Equity partnerships
- Profit sharing
- Leasing
- Leasing with lease cost linked to commodity prices (sometimes known as a ‘Modern Lease’)
- Wages plus incentives based on performance.

All are operating with varying degrees of success; however the most successful examples share some common features:

- They are governed by simple models that are well understood by all parties
- They provide young people with the opportunity to progressively gain management control
- There is good two-way information flow so that results and outcomes are transparent to all parties
- They reward young people for achieving results.

One of the challenges for the industry is providing much greater visibility of successful pathways to ownership, and an understanding of the factors that make them successful.

While the dairy industry model is visible to red meat farmers, most can’t see how it applies to them. The truth is successful industries usually have an established and clearly understood basis to attract and retain talent by rewarding value creation, and a means for the retiring generation to leave capital in their business while receiving passive income.

The Red Meat industry urgently needs to discover quality models, and use them for both family and non-family succession.

Better information is an enabler. Solutions have developed in dairy because of the clarity a daily milk production sheet provides about the contribution incentivised managers can make. Red meat farmers need to understand their profit performance, and believe in the contribution others can make to increasing it, before they are willing to share it.

Because red meat farmers have better information on farm production and profit, there is increased scope for performance incentivisation models, but they are not yet widely understood or supported by professionals in the way sharemilking has been.

Farmers perhaps also need to begin planning for succession earlier, and to focus on what is needed to prepare the business for succession. As one focus group participant put it, the common denominator in most successful succession plans is profit. If the business is profitable, there are options. If it is not profitable, the options are much more limited.

Succession is a big challenge, and we urgently need to find ways to bring the next generation into farming.

“It’s really hard, because you need to meet the expectations of the whole family.” – Rangitikei Red Meat Farmer.

MAKING CHANGE HAPPEN



The industry needs to evaluate where it is in the change process.

Over the years the need for change has been canvassed at length and many options have been discussed. This report touches on some of them.

The Red Meat Sector Strategy found that “sustainable change in the industry requires informed, aligned, behavioural change on the part of all stakeholders in order to achieve coordinated in-market behaviour, efficient and aligned procurement, and sector best practice.” So how is the sector responding to the challenge of change?

To answer that question it’s interesting to view the current situation in the industry through a change management perspective. With change becoming increasingly rapid and pervasive in every area of business, managing change has become a discipline in its own right. Methodologies such as a typical Change Management Framework have provided a structured approach, based on the factors that underpin successful change. While it’s based on change within an organisation, the same principles apply to industry-wide change

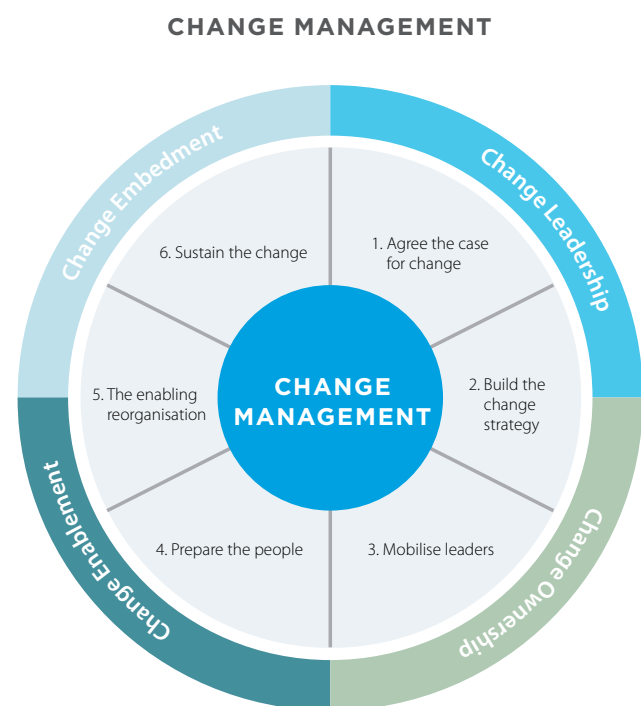
“We need changes to the industry. If we don’t change, it’ll continue to be a roller-coaster ride.”

Red Meat farmer, South Canterbury



THE STAGES OF THE CHANGE MANAGEMENT FRAMEWORK ARE:

- 1. Agree the case for change:** Change is about people – and without their commitment, nothing will change. So the first step is helping people understand why things need to change - and being willing to make changes to their own behaviour, not simply expecting others to change.
- 2. Build the change strategy:** this is about making sure everyone knows what the goal is, what change looks like, and how it will be achieved.
- 3. Mobilise leaders:** people take their cue from their leaders – so unless the leaders of the industry or organisation are 100% behind the change, it won't happen. This about making sure they are committed to change and have the skills to lead their people through it.
- 4. Prepare the people:** this is about making sure everyone involved knows what the change means for them, and what they need to do individually and collectively to make it happen.
- 5. The enabling reorganisation:** this is about ensuring everyone has the information, skills, training, resources and support to make the change happen. It also means removing the barriers that currently exist to achieving the desired outcome of the change.
- 6. Sustain the change:** this is about ensuring that things don't revert back to the status quo, and making sure the new behaviours and processes are reinforced and supported.



“People like change mainly when it’s
someone else changing.”

WHERE IS THE RED MEAT INDUSTRY?

Change is a complex and often a ‘messy’ process, so where the industry is according to this framework at any one time will depend on people’s own perspectives.

One maxim of change management is that “people like change mainly when it’s someone else changing”.

In Red Meat this may mean the meat industry ownership is discussed more than supply chain integration, simply because it impacts people less.

Another maxim is that change messages need to be simple, clearly understood, agreed and repeated often.

The change management model also shows that it’s necessary to build a solid foundation for change before actually implementing any change. Without a clear agreement on the need and the strategy for change, (Steps 1 and 2), any specific initiatives (Step 5) are likely to fail in the long run.

It’s worth considering the following questions in relation to the Red Meat industry:

- **Is there a convincing case for change?** If the Barometer focus groups are any guide, we believe there’s a clear recognition that change is needed in order to improve profitability and address the issues the industry is facing.
- **Is there a clear strategy for change?** The Red Meat Sector Strategy has provided a framework for the future and the behavioural changes that will be required from different stakeholders. How well is this understood and accepted throughout the industry?
- **Are leaders on board?** Is there a clear direction from industry bodies about what needs to be done?
- **Are key stakeholders on board?** Is there willingness amongst, farmers, processors and other stakeholders to move away from the status quo and make the changes necessary?



NEXT STEPS



The Red Meat sector is on the cusp of a significant opportunity. While realising it will require a concerted effort over time, the potential rewards are high.

This survey has highlighted some significant barriers and issues that the industry needs to prioritise and resolve.

In particular, there is a need to:

1. Increase the sector confidence and willingness to invest by profiling red meat sector success stories to farmers and the wider commercial community.
2. Support more farmers to take full advantage of the information and tools which help them identify their opportunities and reduce administrative demands.
3. Increase the professional advice and support required for farmers to prioritise their highest returning investments.
4. Increase the use of low equity business models to facilitate succession, keep capital in the industry, and attract and reward talented young people for their contribution to performance.
5. Increase the rate of implementation of more integrated and market-led livestock supply arrangements.

At ANZ, we remain confident about the future of the industry, and are committed to supporting it through initiatives such as the Red Meat Profit Partnership, and ANZ's business research and economics capacity.

Realising this potential also requires capital, and we are also committed to supporting the investments that increase Red Meat sector productivity and profit.

ABOUT THE ANZ BAROMETER



The ANZ Privately-Owned Business Barometer
is a survey of privately-owned businesses
conducted on behalf of ANZ.

We invited owners of small-medium businesses (those with turnover of less than \$2 million per annum), commercial businesses (those with turnover of more than \$2 million per annum), farmers, and Maori businesses to take part in an online survey.

To interpret the survey findings, focus groups were held across New Zealand, each representing different sectors of the privately-owned business community. These included small-medium

and commercial businesses, exporters, Maori businesses and agribusinesses (dairy, cropping and horticulture, and red meat farmers).

More information on the ANZ Barometer and this year's findings can be found at anzbarometer.co.nz

ABOUT ANZ

ANZ is proudly New Zealand's largest financial services provider, with almost half of all New Zealanders having a banking relationship with us.

We recognise that strong relationships are important for business and farming success, which is why here in our Commercial & Agri division, we support our clients with access to knowledge, insights and connections to help them grow.

Our Agri Managers are active in communities nationwide, and through them our clients have access to the largest specialist banking teams in New Zealand. This means that we can contribute an in-depth understanding to the solutions agribusinesses need to manage their payments, mitigate their risks, fund their growth and ultimately manage owners' personal wealth.

As New Zealand increasingly looks to markets across the Asia-Pacific, we provide clients with access to banking knowledge and expertise in offshore markets to help New Zealand agribusinesses achieve their growth aspirations.

For information about our services see anz.co.nz/rural

We hope you've found the 2015 ANZ Privately-Owned Business Barometer – Red Meat Insights report thought-provoking and useful. If you would like to discuss any of the findings in this report, would like to be involved in the next Barometer, or if there is anything we can do to help your red meat business succeed, please contact your ANZ Agri Manager, email barometer@anz.com, or contact one of our General Managers.

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