

October 2006

## Agriculture: When the growing gets tough...

Fruit growers have had it tough this year. From one end of the country to the other they have been constantly in the headlines: afflicted by frost across the Goulburn Valley, Yarra Valley, Sunraysia and the Coonawarra. Blown and battered by Cyclone Larry in far north Queensland. Decimated by citrus canker in Emerald. And all this whilst squinting into the face of a drought tipped by Federal Treasurer Peter Costello to be the worst this country has ever seen.



The spirit of the man on the land is being tested but there is still money to be made in agriculture. Despite the bad news, agribusiness continues to capture the attention of serious investors: the sector raised \$1.141 billion in new investment over the past year.

What we are witnessing is the steady evolution of farm ownership: away from small, family-run operations towards an increasingly corporate model of farm management, even on family-run farms. To cope with a killer drought, a force-10 cyclone or a crop-destroying frost, you need scale, deep pockets and the resources that will allow you to survive not just one bad season, but potentially several. Welcome to the age of the corporate farmer.

## Changing playing field

At Ferrier Hodgson we are increasingly seeing the agricultural playing field tip in favour of the big corporate players. Their scale often positions them to procure more favourable terms with customers. Their deep pockets allow them to swoop and capitalise when smaller players stumble – acquiring land and water rights. Their infrastructure can be shared between farms. Critically, when Mother Nature turns the elements against them, they have a greater financial capacity and geographic spread to wait for recovery than smaller farms.

Australian Bureau of Statistics data shows that the total number of farms in this country is falling while

each individual operation is growing in value. Since 1995, the number of agricultural operations in Australia has dropped 11.5 per cent – from 147,000 to less than 130,000. Perhaps more dramatically, the number of farms valued at more than \$1 million has grown 70% over the last five years, and by over 220% in the last 10 years.

These statistics dramatically underline the transformation of Australia's agricultural landscape: the playing field has changed. These days, the warm glow that comes with being able to say the property has been in the family for 80 years has to be weighed against the harsh reality of the marketplace.

The frost that hit Goulburn Valley in late September this year is estimated to have damaged fruit, particularly stone fruit and pears, worth over \$70 million. Flow-on effects are likely to raise the damage bill to over \$500 million through impacts on associated businesses such as road transport and retail. Sunraysia was hit by frost in June, destroying \$17 million worth of fruit and vines, while temperatures of minus 3.6 degrees in the Yarra Valley last week took the total cost of frost damage to Victorian wine grape growers to almost \$40 million for the last eight weeks.

In South Australia's Limestone Coast region, grape yields are expected to be down at least 60 per cent thanks to the impact of the frosts. The region is bracing itself for lost income of \$100 million. The Riverland, Australia's biggest grape-producing area, has so far been insulated from the frosts, but with irrigated water supplies cut to 70 per cent – and likely to be cut to 50 per cent – production is certain to be significantly impacted. This year it appears no one is going to get by unscathed.

One of the most common ways for a farmer to prevent frost is to keep crops moist by watering. However, with water prices reaching \$400-\$500 per megalitre – up from just \$60 a megalitre last year – for many small growers the option was simply out of reach. For their larger corporate counterparts, however – some of whom have acquired significant water rights – the decision to water their orchards or vineyards to insure their crops against frost would have been much easier.

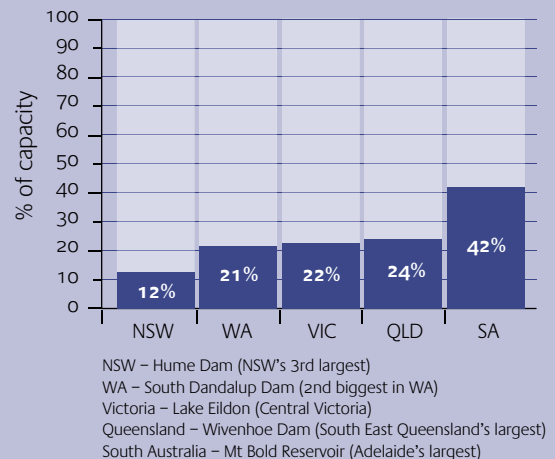
## MIS – a frequent problem

Over the last three years, Ferrier Hodgson has worked with many struggling farmers. Often these farmers share common characteristics. One of the key differentiators between good farmers and bad is the quality of their financial information and forecasts.

## Did you know...

- Between 1995 and 2005, the Australian agricultural industry lost 20% of farming operations with a value of less than \$500,000
- 60.5% of Queensland is drought declared and 97% of NSW is drought declared
- Recent government drought-assistance packages will channel a further \$560 million over the next 14 months to drought-affected farmers in 45 areas declared to be in exceptional circumstances. Assistance for rural based small business is still being considered by Federal Cabinet.

### A Dry Argument



- Ferrier Hodgson works closely with industry specialists to ensure the right advice to our clients.
  - Warwick Yates has 38 years experience in agribusiness and regularly consults to Australia's biggest agribusiness companies. His areas of speciality include beef, cotton, sheep meats, livestock production, feedlots, sugar and abattoirs. Mobile: 0411 599 882; email: warwick.yates@attglobal.net
  - Murray Najar has 33 years experience in agribusiness and specialises in the fields of stone fruit, grapes, citrus, cereal, grain and flour milling. His background incorporates extensive knowledge of agriculture, sales, marketing and business. Mobile 0418 839 372; email: primaton7@bigpond.com

Ferrier Hodgson has found too few rural businesses utilise their management information systems (MIS) effectively. Indeed, many small-to-medium sized operators have such poor MIS that the data produced is either unreliable or irrelevant. In some cases the MIS doesn't even exist.

As with any business, it is imperative to have a thorough understanding of the operation's costs. While many farmers may argue their years of experience have served well as a guide in the past, this is no longer enough. Lenders require more. The taxman requires more.

To remain competitive in today's agricultural marketplace, farmers need to respond rapidly to increasing costs and changing market conditions – something that requires the discipline of setting and adhering to realistic budgets. Given the nature of farming, that can be difficult. We see too many farmers budgeting for a best-case scenario every year instead of being more realistic and managing the expectations of stakeholders (mostly banks).

In our experience, the best budget processes allow for a range of agronomic conditions, which are reflected by the business financial projections and cash-flow forecasts. Too few of the farmers we have worked with do this effectively, particularly when it comes to working with financiers.

## Characteristics of successful farmers

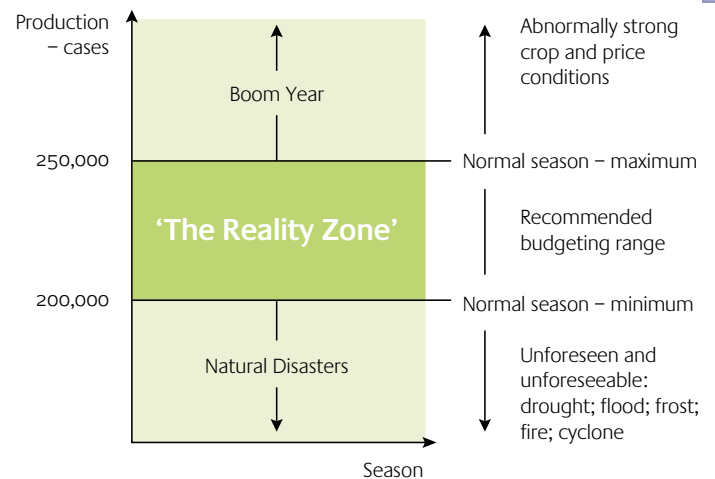
### The most successful managers of rural investments:

- Actively manage risk
- Have a conservative yet progressive management style
- Are early adopters of technology and research
- Maintain a focus on business and leadership skills
- Allocate time to manage the business – not just the farm
- Surround themselves with competent people
- Are skilled at sourcing the most recent research and interpreting and acting on the information

### Less successful managers of rural investments:

- Fail to prepare accurate financials, forecasts or Management Information Systems
- Fail to plan – particularly for foreseeable industry disasters
- Are focused on the farm rather than the business
- Are risk averse and too busy to embrace change
- Have poor management or business skills – don't actively manage the business
- Gamble on the market improving
- Struggle to identify new opportunities
- Communicate poorly with financiers when the going gets tough

### The Reality Zone – Farmers need to temper over-optimistic crop estimates



## The perfect storm

In many ways, positive farming conditions over the past decade have conspired to create the 'perfect storm' for fruit growers and smaller scale farmers. With several years of good crops, booming water values and growing investment from corporate interests, farm values (other than grapes and citrus) have risen significantly.

With the price of capital falling and the value of farms rising, many farmers took the opportunity to borrow

to invest in farm infrastructure in the hope of competing with the big players and their access to the latest technology. What they hadn't factored into their plans were the unseasonable frost, a direct hit from a tropical cyclone or a killer drought.

The farmer's primary goal is to harvest and sell his product in the most efficient manner to produce the best financial outcome. It is the same in every other business. The difference here is that in addition to the issues facing every other business, growers need to factor in the uncontrollable risks that present themselves on an increasingly regular basis. This, coinciding with the emergence of the corporate farmer armed with deep pockets and domineering scale, has made it more difficult to compete.

The future for small to medium growers lies in their ability to be intelligent about the way they approach their business and to effectively manage risk. For some farmers, the greatest challenge will be to strip the emotion out of decision making and examine everything as it relates to the bottom line. Strict financial management systems need to be in place and the constant input of strong accounting and financial advice is invaluable. Farmers need to prepare for foreseeable disasters and temper unrealistic optimism.

In the end, it may well be that in a market increasingly dominated by corporate farming juggernauts, survival and prosperity will go to those that adopt the same corporate approach. Like any business, they need to identify a point of difference – perhaps becoming a specialist – but those left standing are likely to approach farming as a business rather than a lifestyle.

For more information about our agribusiness industry services, please contact:

**Sydney:** Brian Silvia  
+61 2 9286 9999  
brian.silvia@syd.fh.com.au

**Melbourne:** James Stewart  
+61 3 9600 4922  
jstewart@melb.fh.com.au

**Brisbane:** Will Colwell  
+61 7 3831 4833  
wcolwell@qld.fh.com.au

**Adelaide:** John Hart  
+61 8 8100 7600  
jrhart@sa.fh.com.au

**Perth:** Garry Trevor  
+61 8 9214 1444  
gtrevor@wa.fh.com.au

**New Zealand:** Brendan Gibson  
+64 9 307 7865  
Brendan.gibson@ferriers.co.na

**Asia:** Rod Sutton  
+852 2820 5600  
rsutton@fh.com.hk

Or find out more at:  
[www.ferrierhodgson.com](http://www.ferrierhodgson.com)



### John Hart

Partner and Agribusiness  
Industry Leader, Adelaide  
phone: 0417 081 380  
email: jrhart@sa.fh.com.au



### Will Colwell

Partner, Brisbane  
phone: 0417 789 205  
email: wcolwell@qld.fh.com.au

[Related newsletters and articles](#) >

If you have any questions or comments about Ferriers Focus please email [Ferrier Hodgson](mailto:ferrierhodgson@ferriers.com)

CORPORATE ADVISORY

FORENSICS

CORPORATE RECOVERY