



# Equity Partnerships

17 NOVEMBER 2008

Farm syndication has proved to be very popular over the last ten years and it's worth reviewing what has changed during that period with regard to returns and asset growth. In addition, we will review the trends in farm working expenses and incomes on New Zealand farms and the ramifications this may have to investor returns.

## Historical Returns

For purposes of exploring the trends we have utilised the National Dairy Model and National Sheep and Beef models as prepared by Ministry of Agriculture and Fisheries (MAF) each year. Each national model is established using a weighted average of the respective dairy, sheep and beef properties that are monitored across New Zealand each year. While these models do not necessarily reflect what has happened to an individual business in any one location, they do provide a trend.

Based on this data the following dairy trends have been apparent for the last eight years:

- The average scale of dairy farms is increasing
- Farm Working Costs/kgMS have increased
- Total Capital Employed has shown a significant increase (Opening Values in each year)
- Even the higher payouts for the 2007/08 season have not been able to match the Returns on Assets from the period at the beginning of the millennium.

Productivity per cow and per hectare has also increased during this period.

The trends within the sheep and beef industry are similar to dairy. The difference is this industry has not enjoyed the same resurgence with rising commodity prices in the last two years.

Based on this data the following trends in sheep and beef have been apparent:

- Average farm size is increasing
- Income per stock unit has been relatively constant with the exception of the 2001/02 years.
- Farm working costs/stock units are trending higher
- The total value of assets has continued to increase
- Returns on assets has been trending lower
- Total stock units farmed has reduced. This can potentially be explained by changes in composition of this model with an increasing reliance on crops and grazing.

While the EBIT/kgMS in the dairy model is certainly greater in the 2007/08 years, the significant lift in asset values over the last eight years has meant farmers have not been able to maintain the higher Return on Assets they enjoyed at the beginning of the century. The rise in asset values has largely been created by potential future lifts in income being capitalised into the value of land and livestock. This begs the question, "Have we become too focused on gains in land value at the expense of cashflow?"

MAF National Dairy Model Trends									
	00/01	01/02	02/03	03/04	04/05	05/06	06/07	07/08	08/09 proj
KGMS	74,000	79,000	90,500	104,000	102,000	117,000	127,000	130,000	138,000
Cows	231	247	271	313	322	351	360	380	383
\$ Inc/Kg	\$ 5.48	\$ 5.95	\$ 4.18	\$ 4.29	\$ 4.77	\$ 4.57	\$ 4.46	\$ 7.87	\$ 6.66
\$ FWE/kg	\$ 2.44	\$ 2.77	\$ 2.89	\$ 2.46	\$ 2.80	\$ 2.77	\$ 2.91	\$ 3.61	\$ 3.72
EBIT/Kg	\$ 3.04	\$ 3.18	\$ 1.29	\$ 1.83	\$ 1.97	\$ 1.80	\$ 1.55	\$ 4.26	\$ 2.94
Tot Cap.(,000)	\$ 1,631	\$ 2,125	\$ 2,505	\$ 3,123	\$ 3,565	\$ 4,219	\$ 4,802	\$ 5,942	\$ 7,017
Tot Cap/kg	\$ 22.00	\$ 26.90	\$ 27.70	\$ 30.00	\$ 35.00	\$ 36.10	\$ 37.80	\$ 45.70	\$ 50.80
Return on Assests	13.8%	11.8%	4.7%	6.1%	5.6%	5.0%	4.1%	9.3%	5.8%

Source: MAF Pastoral Monitoring reports 2001 – 2008

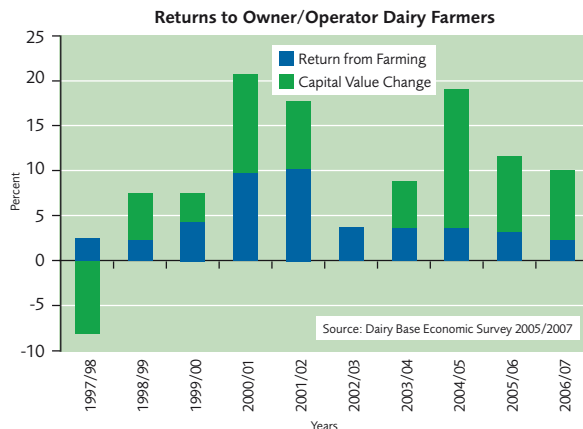
MAF National Sheep and Beef Model Trends									
	00/01	01/02	02/03	03/04	04/05	05/06	06/07	07/08	08/09 proj
Ha	613	586	627	636	660	708	708	705	705
su	4642	4268	4869	4893	5014	4438	4528	4484	4286
\$ Inc/su	\$ 67.07	\$ 79.69	\$ 67.08	\$ 65.34	\$ 69.86	\$ 63.47	\$ 64.29	\$ 64.18	\$ 76.08
\$ FWEsu	\$ 31.79	\$ 40.55	\$ 36.38	\$ 36.99	\$ 39.45	\$ 39.52	\$ 37.78	\$ 40.14	\$ 45.23
EBIT/su	\$ 35.28	\$ 39.14	\$ 30.70	\$ 28.35	\$ 30.41	\$ 23.95	\$ 26.51	\$ 24.04	\$ 30.86
Tot Cap.(,000)	\$ 1,614	\$ 1,930	\$ 2,411	\$ 2,704	\$ 4,219	\$ 3,846	\$ 4,252	\$ 4,468	\$ 4,776
Tot Cap/su	\$ 348	\$ 452	\$ 495	\$ 553	\$ 841	\$ 867	\$ 939	\$ 996	\$ 1,278
Return on Assests	10.1%	8.7%	6.2%	5.1%	3.6%	2.8%	2.8%	2.4%	2.4%

Source: MAF Pastoral Monitoring reports 2001 – 2008



## Total Returns

The "Returns from Farming" typically only makes up a part of the return available from an Equity Partnership. The chart below shows the relative returns to an Owner-Operator dairy farmer from the farming business and that from changes in the value of the business.



This graph highlights that the return to dairy farmers from the change in Capital Value (Land, Dairy Co. shares, livestock etc.) has on average been greater than that of the cash return from farming. In addition the Capital Gain from assets has been an increasing proportion of the total return since 2001/02.

Economic theory explains the value of an asset to be based on the net present value of future (net) income streams. The growth since 2001 in land values relative to the cash return from farming would suggest that buyers have built future capital gains into the price paid for property.

When Information Memorandums have been reviewed for farming investments over the last two years, it is apparent most have been structured with a high level of debt. This has been done to allow "leverage".

Leverage provides an opportunity for an investor to achieve a higher potential return on their equity as values accrue to the owner of the property and not the lender. The greater the leverage, the greater the return on equity from increase in values, but also, the greater the risk if values decrease.

The level of Cash Surplus forecast for Equity Partnerships in the last two seasons have been similar to levels proposed in opportunities from 2000/01, but the level of total capital employed is two to three times the previous levels and therefore the equity is higher. Lower cash returns require more equity to make the cash flows balance.

In most instances these proposals have been successful in securing investors and most have been very pleased with the overall results.

The question remains, what is the impact on land values if cash returns remain low?

## A Projection

Farm Working Expenses (FWE) have risen by 48% from 2001 – 2008 in the dairy industry and by 26% in the sheep and beef industry (based on the figures in the MAF tables earlier).

The MAF dairy model shows an expected increase in FWEs for the 08/09 season to \$3.72/kgMS, an increase of 11c/kgMS on the previous year. Add to this that Fonterra have announced a forecast reduction in payout from \$7.66/kgMS in 07/08 to \$6.60/kgMS for the 08/09 season. On a cashflow basis (1 June to 31 May) this means the average price received for milk will fall from approximately \$7.24/kgMS in 07/08 to \$6.12/kgMS in 08/09, or by \$1.12/kgMS.

The net result of the drop in income combined with the increase in costs is a reduction in EBIT of \$1.24/kgMS. On this basis the EBIT will reduce to \$3.02/kgMS and the Return on Assets back to 5.9%, assuming values remain static.

The situation in the sheep and beef industry is different. The expectations are for an improvement in beef and lamb receipts, which will restore their profitability. The reality is still that this is coming from a low base and costs are forecast to rise.

Never has there been a better time for farmers and investors to analyse their business in detail to ensure they have the appropriate financial disciplines in place. The following questions should always be asked:

1. Am I happy with the budgeted result and return for my business?
2. Does every dollar spent provide an adequate return on the value of our business?
3. Am I aware of our break-even position for milk, beef or lamb?

If you can not satisfactorily answer any of these questions, this would be a good time to talk with your local Rural Manager or other trusted adviser.

## Existing Equity Partnership Opportunities

These opportunities are not an offer of securities for sale or subscription to members of the public in New Zealand in terms of the Securities Act 1978. The minimum subscription for each of these opportunities is \$500,000.

- Dairy farm investment in South Australia. The property comprises a 630ha property milking 950 cows on a self contained basis. It's irrigated by six pivots with an 800 megalitre water licence.
- An Equity Manager and also Investor for a new dairy conversion. The property is situated in the Maniototo district of Otago and is due for commissioning for the 2009 season. The property will comprise a total of 296ha and will milk 800 cows. The property is irrigated by a combination of three centre pivots and the balance by a K-Line system. Additional land is available adjoining this property for the rearing of drystock, and for provision of additional feed.

- A 50% share in a dairy drystock and deer operation at Becks, in Central Otago. The property comprises 784ha and has an existing Equity Manager. The property has the ability to graze 400 young dairy stock on a year round basis and in winter 1200 cows. In addition the property will maintain a herd of 500 breeding hinds.
- A 9000su sheep and beef property in Hawkes Bay. This is an existing equity partnership from which the majority shareholders are wanting to divest their shareholding. The property is situated at Marumaru in Northern Hawkes Bay and totals 1,118.5 hectares. The existing Equity Managers are keen to remain and currently hold approximately 9% of the equity in the business.

We often have clients looking for a dairy Equity Manager. If you are in sharemilking and considering selling cows to take advantage of high cow prices and moving to become an Equity Manager, then please make sure we have your email contact details.

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