Growth Farms Australia
Evidence Based Advantage

Get back to basics to build ag profitability

By David Sackett, Managing Director, Growth Farms

Forget for a moment about capturing premium prices for specialist products tailor made for the cashed-up Asian retail market. Push to the side this notion that the best way for Australian primary producers to thrive is to vertically integrate, value-add and brand.

Agriculture needs to turn the current narrative surrounding the drivers of industry prosperity on its head, get back to basics and think harder about producing commodities at a low cost per kilogram rather than focusing only on capturing premiums at the retail level.

There is no arguing Australia does enjoy a number of important competitive advantages, including the ability to grow some of the highest quality, safest food and fibre in the world, and this must remain one of our most important global selling points. However, there are far simpler, more fundamental considerations which should underlie-farm management decisions for sustained profitability.

Last year was almost as good as it gets for Australian agriculture. Record farmgate prices for sheep and beef, rising wool prices, an extraordinary season for much of the country to yield a record 52 million tonne grain and pulse crop met with a low Australian dollar and new free trade deals for lower tariffs - revenues reflected this alignment of forces.

Looking ahead, the Australian Bureau of Agricultural and Resource Economics (ABARES) forecasts total farm production is will reach $59.9 billion in 2017-18. This is down slightly on this financial year and, while down slightly, is still $5 billion (or nine per cent) greater than the five-year average to 2016-17.

We have had some pretty tough years lately for many producers who are drought affected. However, unusual for a drought we have generally had very good commodity prices and so farm profits, while not great for many, have been better than in many previous droughts. Those not affected have been making good money and as a consequence land prices have shown large increases. But, as we know all too well, agriculture is cyclical and history has shown that neither the good times nor the bad last forever. So how do we make the most of the 'golden' years and seek to stabilise to ensure farm businesses stay profitable in the long-term?

Like any business enterprise, farmgate profitability is determined by a combination of pricing power, productivity gains and input control – but we have more control over some of these than others.

Producers cannot determine prices but do have clear influence over productivity and costs through their management decisions.

In our case, targeting and achieving a low cost of production is fundamental to any farming enterprise Growth Farms acquires and manages on behalf of investors. Our benchmarking shows our cost of production consistently falls in within the top 20 per cent of the most profitable producers and these have the lowest cost per unit (for example see Figure 1). This is a key and consistent focus in decision making for all of our assets under management.

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However, at the same time we ensure our focus on low cost of production does not impair ability to deliver high quality products that exceed market specifications. The two are not mutually exclusive.

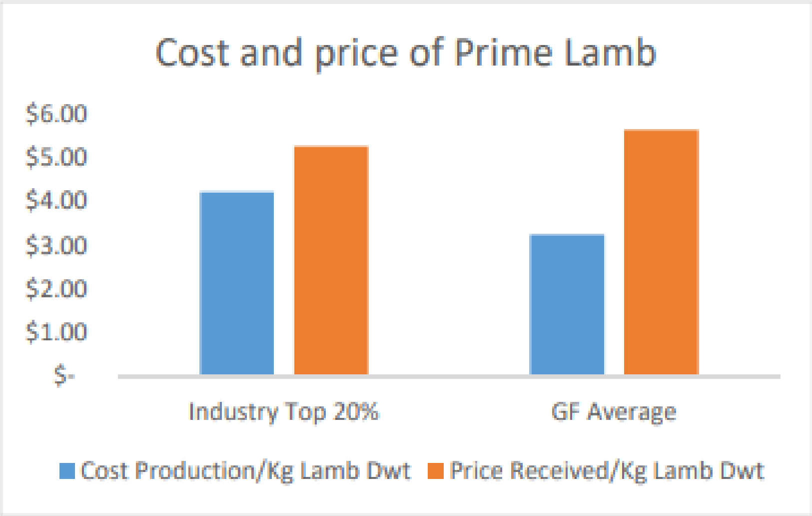

Figure 1: GF Cost and Price of Lamb compared to industry Top 20 per cent

There is no escaping achieving this increased productivity more often than not requires initial outlay of funds on long-term investments that will pay dividends later. These include labour-saving infrastructure, new machinery or better livestock genetics, or the re-design of farm systems to improve management efficiency.

But it is critical not to be diverted or distracted by things which drive costs up and undermine profitability. The most common example is when farmers chase premiums but do so at a high cost. In many cases the increase in cost of production strips away any benefit of achieving a higher price.

We also see this when farming enterprises branch out into owning butcher shops without appropriate skill or understanding of the practicalities such vertical integration entails. It may well seem like a logical way to snare increased profits by expanding reach across the supply chain, but so often the numbers just don't stack up.

By the same token, it's not about having the cheapest product and in no way am I suggesting we should be willing to compromise the quality of the world-leading commodities Australia has built its reputation upon. However, for sustainable profitability and increased business robustness we must also keep our focus simultaneously upon growing it at the lowest possible cost for each tonne of grain or kilogram of meat.

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