

Red Sky Farm Performance Analysis



Department of
Agriculture and Food



Red Sky Agricultural Pty Ltd

P.O. Box 956, Bacchus Marsh, VIC 3340
Ph +61 3-5367 4445 Fax +61 3-5367 4449
email : fiona@redskyagri.com

10th November 2011

B. & A. Pitt-Jolie

Private Bag
Los Angeles
CALIFORNIA



Dear Brad & Angelina,

RE: RED SKY FARM PERFORMANCE ANALYSIS FOR YEAR END 30th JUNE 2011

Thank you for allowing us to undertake this review of your beef business. We have appreciated the opportunity to detail some of the options available to you for ongoing business development, and we hope that this information can assist you in realising your personal goals.

Summary of Results:

PROFITABILITY MEASURES	Your Farm	Western Aus Average	Western Aus Top Quartile
Return on Capital	-0.4 %	0.4 %	3.1 %
Operating Profit per Hectare	-\$ 33	\$ 28	\$ 192
Return on Equity	-1.0 %	-0.7 %	2.3 %
Pasture Harvested (tDM/ha)	3.4	2.7	3.2
EFFICIENCY MEASURES			
Beef Produced per Hectare (kgLW/ha)	225	220	285
Pasture Cost per tDM	\$ 178	\$ 170	\$ 123
Feeds/Supplements Cost per DSE	\$ 1.68	\$ 2.50	\$ 1.39
DSE per Full Time Staff Equivalent	6,234	7,595	11,098
Management & Staff Costs per DSE	\$ 7.51	\$ 6.37	\$ 4.48
Core per DSE Cost	\$ 5.12	\$ 6.25	\$ 5.56
Core per Hectare Cost	\$ 191	\$ 149	\$ 143
RISK MEASURES			
Operating Profit Margin	-8 %	7 %	37 %
Cost of Production per kgLW Meat	\$ 2.05	\$ 1.73	\$ 1.16
SOLVENCY MEASURE			
Equity %	90 %	87 %	81 %

KPI's – Profitability

<i>Return on Capital</i>	-0.4%
<i>Operating Profit per Hectare</i>	-\$33/ha
<i>Return on Equity</i>	-1.0%
<i>Pasture Harvest</i>	3.4 tDM/ha

Return on Capital

*The most important measure of profitability is **Return on Capital**. This is calculated by dividing your Operating Profit by the total value of all assets under your control (both owned and leased). The lease costs associated with any leased assets are included in the Operating Profit calculation.*

Red Sky Farm Performance Analysis

Your **Return on Capital** is lower than the Average. Your significantly higher capital base (i.e. total asset value per hectare) means that your Return on Capital compares less favourably with the benchmarks.

Operating Profit per Hectare

Your **Operating Profit per Hectare** is lower than the Average. This is not as sound a measure of profitability as Return on Assets, as Operating Profit per Hectare is highly influenced by the quality of the land being farmed.

Return on Equity

*Return on Equity is the most important indicator of **nett wealth growth** – but it cannot be used for comparison with other farmers as it includes debt servicing, and is therefore influenced by each individual's level of debt.*

Your **Return on Equity** (excluding capital gain) is lower than your Return on Capital. Businesses that have a Return on Capital that is consistently above their cost of funds (nett financing costs) are stronger and more secure as this would result in their Return on Equity being factored up on each dollar they have borrowed. In general your Return on Equity can be improved by:

- increasing operating profit; and/or
- decreasing finance costs (i.e. borrowing at a lower rate).

When your Return on Equity (excluding capital gain) is less than your Return on Capital, it generally means that your cost of finance is greater than the operating return being made on your total assets. Your negative Return on Equity means that after receiving a reasonable remuneration for your time and after maintaining your plant and machinery as well as paying all interest due, that you are potentially eroding the equity that you have in your business. Although this may be compensated by increases in capital values of your owned assets, it is important to have your business deliver a positive Return on Equity over time.

Pasture Harvest

***Pasture harvest** is a key indicator of profit. The most dominant factors impacting on pasture harvest are weather and soil type/contour, which are both outside the control of farm management.*

In general pasture harvest is improved by an increased stocking rate and/or better pasture management. An increase in pasture harvest has the effect of reducing the cost of pasture and hence the overall cost of production.

Your pasture harvest result of 3.4 tDM/ha is marginally higher than the Top Quartile.

KPI's – Efficiency

Beef Produced per Hectare	225 kgLW/ha
Pasture Cost/tDM	\$178 per tDM
Feeds/Supplements Cost/DSE	\$1.68 per DSE
DSE/Full Time staff Equivalent	6,234
Management & Staff Costs/DSE	\$7.51 per DSE
Core per DSE Costs	\$5.12 per DSE
Core per Hectare Costs	\$191 per hectare

Beef Production

Your **Beef Produced** per hectare is 2% below the Average, and 21% below the Top Quartile. The factors contributing to this are:

- beef produced per DSE of 11.9 kgs beef that is 20% below the Average; and
- stocking rate of 18.8 DSE/ha that is 15% above the Top Quartile.

In this situation production per DSE is the most significant limiting component of the "per hectare" equation and should be addressed first to increase total beef production. However, consideration should be given to at least maintaining stocking rate to ensure there is no erosion in pasture harvest.

Red Sky Farm Performance Analysis

Pasture Cost per tDM

The cost of pasture has three components:

- 1. Direct costs – including pasture maintenance and renovation (including greenfeed costs), fertilizer (including nitrogen), weed and pest, irrigation and the direct hay and silage costs for pasture conserved on the home area.*
- 2. Variable costs – a proportion of some farm working expenses that should be attributed to pasture production e.g. labour, repairs & maintenance, and vehicle expenses.*
- 3. Capital costs – costs attributed to owning capital items required for pasture production e.g. the land for growing pasture.*

The Cost of Pasture is strongly influenced by a) the pasture harvest, and b) the value of land, which is outside the control of the operator.

Your **Cost of Pasture** of \$178 per tonne dry matter is marginally higher than the Average. It is being negatively influenced by your higher land value and overall level of capital investment, and high Direct Pasture Costs (which includes pasture renovation, greenfeed crops, fertiliser, weeds & pests and hay & silage conservation on farm). This is offset slightly by your high pasture harvest.

Cost of Feeds/Supplements per DSE

*The **Feeds/Supplements Cost per DSE** is particularly influenced by seasonal variations in pasture growth and the resultant need to supplement livestock. If these costs were included in some of the Core Cost ratios outlined below in this report then it would be difficult to monitor the real impact of management on maintaining cost control in the business. As a result they are analysed separately.*

*Total **Feeds/Supplements Cost per DSE** must also be considered in light of the level of beef production being achieved as well as the stocking rate being run.*

The **Feeds/Supplements Cost per DSE** for this business is marginally higher than the Top Quartile, which indicates that moderate amounts of feed were purchased or made on-farm.

Labour Efficiency

Labour efficiency is an area that holds significant potential for improvements in profitability as it is a highly 'elastic' cost, and one of the largest expenses on the farm. These ratios include an allowance for the owner's time as well as an allowance for other people who are completing work but not drawing a monthly wage. As a result improvements in these ratios can lead to either cost savings or for more time to be available to pursue other interests.

Your **Labour Efficiency** of 6,234 DSE farmed per full time staff equivalent (DSE/FTE) is lower than the Average. This suggests there is a significant opportunity to improve this ratio, which will lead to improvements in profitability as well as the freeing up of time.

Your **Management & Staff Cost per DSE** (including imputed or "unpaid" labour) is higher than the Average. This is a potential area for substantial profitability gains.

Core Costs

*Pasture-based farming has a high proportion of variable costs. In businesses such as this there are not significant opportunities to increase revenue (i.e. meat or wool production) to "water down" the impact of high costs. Effectively businesses with a high proportion of variable costs have no alternative but to **control costs** if they are to improve profitability.*

Core per DSE Cost is calculated from (Animal Health + Breeding + Electricity + 50% Nitrogen + Freight + Other Expenses + 50% Repairs & Maintenance + 50% Vehicle Expenses + 50% Depreciation) divided by Total Stock Units.

Core per Hectare Cost is calculated from (Administration + 50% Nitrogen Fertiliser + Phosphate & All Other Fertiliser + Irrigation + Pasture Maintenance & Renovation + 50% Repairs & Maintenance + Standing Charges + 50% Vehicle Expenses + Weed & Pest + 50% Depreciation) divided by Effective Area.

Red Sky Farm Performance Analysis

Your **Core per DSE Cost** is lower than the Top Quartile, which is a result of tight cost control in most areas. This is a strong feature of your operation and a good base from which to increase production and profitability.

Specific Core per DSE Costs that warrant further attention include:

- *Animal Health and Breeding*: these are significantly higher than the benchmarks and should offer some potential for cost-saving. The most significant cost within *Breeding* is the breeding bulls.
- *Nitrogen*: this is significantly higher than the benchmarks and should offer some potential for cost-saving, although the additional expense does appear to be 'repaid' in higher pasture harvest.

Your **Core per Hectare Cost** is higher than the benchmarks although you will often see that the Top Quartile benchmark is higher than the Average. This indicates that this ratio does not have a positive correlation with high performance so it should only be addressed if the costs are much higher than the benchmarks.

Specific Core per Hectare Costs that warrant further attention include:

- *Phosphate & Other Fertilisers and Nitrogen*: these are significantly higher than the benchmarks, although the additional expense does appear to be 'repaid' in higher pasture harvest.
- *Repairs & Maintenance*: this is partly a "per hectare" cost and partly a "per DSE" cost, however on a per hectare basis it is higher than the benchmarks. Your comparatively high stocking rate is inflating these costs due to them having a component of variability based on cow numbers.

KPI's – Risk & Solvency

Equity %	90%
Operating Profit Margin	-8%
Cost of Production	\$2.05/kgLW

Equity

Your **Equity %** is comparatively high and indicates a comfortable position with regards to the long-term risk to your business.

Operating Profit Margin

The **Operating Profit Margin** represents the percentage of gross revenue retained as profit (for interest payments, principal repayments, tax and true 'profit'). The higher the figure, the more secure the system.

Your Operating Profit Margin of -8% is a comparatively poor result compared to your peers. This leaves no margin available for debt servicing or to absorb changes in beef prices, so it will be important to look at options to improve this ratio.

Cost of Production

Cost of Production (COP) represents the nett cost of producing one kilogram (liveweight) of beef. If gearing is high (e.g. high levels of debt) then there should be a significant gap between Cost of Production and the average value received per kilogram of beef, to ensure there is sufficient funds for debt servicing and tax payments.

Cost of Production can also be compared across years for your enterprise and against other farmers at varying beef prices as it is not influenced by beef revenue.

Your Cost of Production of \$2.05/kgLW is a comparatively poor result compared to your peers, and is higher than the Average. This leaves no margin for debt servicing or to absorb changes in beef prices given your Average Beef Price of \$1.75/kgLW, so it would be advisable to look at options to lower this ratio.

In general your risk/solvency measures are indicating a moderate level of risk, and a business that is in a satisfactory position to withstand unfavourable conditions/events.

Red Sky Farm Performance Analysis

SUMMARY

The main profit drivers of any farm system are:

- Beef production
- Pasture production
- Labour efficiency
- Core costs

How do you measure up for the 4 Key Profit Drivers?

The attached "dot" assessment reports graphically outline your performance in each of these areas, excluding Pasture production.

Your Key Business Strengths:

- *Beef Production:* you have a sound level of beef production, with this being assisted by your higher stocking rate. However there may still be opportunities to increase beef production further through increasing the level of beef production per DSE.
- *Pasture Production:* your level of pasture production is very good compared to your peers.
- *Core per DSE Costs:* your level of per DSE costs is low.

Areas for consideration and/or for further investigation:

- *Labour efficiency:* this area of your business has significant scope for improvement. These improvements could come from cost savings and/or less demand on your time from the beef business.
- *Core per Hectare Costs:* overall your per hectare costs are high. These should be examined as it is possible that significant cost-savings could be effected without reducing the productive capacity of your assets.

There are a number of opportunities identified here to improve the profitability of your system. Some may or may not be appropriate due to circumstance not obvious from a financial viewpoint. These opportunities should be discussed with your farm consultant or accountant, and then you should be in a position to select one or two key areas to focus on in the coming year.

We have appreciated the opportunity to analyse your beef business with Red Sky. If you have any queries regarding your analysis please do not hesitate to contact me. Now that we have your historical performance recorded in Red Sky it is a straightforward exercise to examine various scenarios and detail the likely financial gains from these options. We look forward to being of further assistance to you in the future.

Yours sincerely,



Fiona Smith

General Manager

Red Sky Agricultural Pty Ltd