

## **Market Intelligence**

Recent signals about the prospects for Dairy are consistent with the sentiment I have picked up through local and international contact in recent months. It confirms a fundamental change to the dynamics of international food markets and offers some of the best news for the primary sector has had some years. Its impact on asset values and sustainability needs to be carefully assessed to avoid over reaction and opportunity lost. It signals a real opportunity for consolidation and perhaps an ideal time to look off farm for new investments.

This positive forecast reflects a fundamental shift in the focus of major economies. They are encouraging production and protection of energy locally - rather than food. Combined with expansion of Asian demand and general wealth across many economies this means a solid foundation for low cost dairy producers. Add to this reduced supply from drought affected Australia and there is real strength in the market - at least for the short term.

This all adds up to strong outlook for dairy that should logically flow through to other primary sectors. It demands a re-think where dairy businesses should head and inevitably throws strategic direction and capital structures into the spotlight.

If the industry responds as it has traditionally, many will be tempted to an expansionary mode to drive up land and stock values.

A word of caution however! This is not only a time for optimism - it is a time for prudent decision-making. That includes clear thinking about what are appropriate capital values.

Many professionals and commentators have been recently critical of farmers for paying too much for land. My view has always been that markets are generally good at anticipating potential for improved returns and capital growth. Rather than dismissing the trends I have encouraged my clients to understand what might be driving them and encouraged them to participate.

The drivers of recent gains in values have been pretty evident. Trade reform, growth in Asian economies, wealth in Western countries and pressures on costs of production for domestic focused dairy nations all suggested reform would occur at some stage. The regular flow of expert opinion that I have had access to has collectively forecast this outcome. The only uncertainty was when it would happen!

The challenge now is to understand how to balance and benefit from this favourable outlook. I'm convinced the land market was aware that growth in revenues would occur and was prepared to invest at prices that reflected these prospects. For that reason caution is needed to ensure new product prices are not seen as justification for further increases. I see them as better directed to a period of consolidation to deliver the profit needed to justify past prices paid.

It may be a good time to consider investment off farm. One of the "joys" of farming is that rural businesses are first to be affected by downturns in export prices or exchange rates. Our future looks positive despite the challenges of currency and rural operators are likely to hit recovery mode while those in the city who are being driven to negative thinking in the interests of economic stability – especially through pressure on city property prices.

Harvesting the profits from the rural sector and investing prudently in town could be a good recipe.

Any change in strategy will only make sense if farmers use this positive environment to drive debt down and achieve a better balance between equity and asset values. A milk price closer to \$5.00 has potential to generate more realistic returns on investment. At this level, settling for traditional returns on equity of around 3.0% would mean land prices rise again. More sensible is to achieve nearer 8% (at least the cost of borrowing) and hold values where they are now for a sustainable future.

Finally, regular assessment of the impact of incomes is essential to ensure these long awaited gains remain in farmers' balance sheet rather than Dr Cullen's. What looks like a significant spike in farm revenues will require timely tax management.

Farmers whose grey hair as much reflects their past appetite for risk as it does advancing years should concentrate on realising sustainable rewards for all their hard work. That's what prudent in my mind. It's all about market intelligence!

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