

# Kerry Ryan & Associates Ltd

**CONSULTANTS TO PRIMARY INDUSTRY**

## **Volatility or Victory**

Current optimism from forecasts of very strong product prices across the primary sector contrasts starkly with the human and economic consequences of local and international events. In my view these happenings are almost certain to fuel volatility in our national and farming economy. Farming businesses need to be wary of jubilation (or even worse complacency) as milk, meat and fibre prices rise to record levels.

Market uncertainty driven by economic fallout from earthquakes, food safety concerns and political unrest in oil producing countries has real potential flow through to cost structures. Assessment of business prospects based solely on income risks inadequate response to cost pressures and possible challenges around interest rates.

For these reasons, I am challenging those involved in agribusiness to focus less on product prices and more on profit margins. I have experienced a number of business cycles where premature declarations of victory based buoyant product prices have resulted in missed profit opportunities.

International milk prices look particularly strong at present. As in the past these will almost certainly be accompanied by upward pressure on key input prices. Unplanned or unjustified exposure to feed, fertiliser and energy costs can quickly erode trading outcomes.

Priority must be for farming operations to focus on their competitive advantage and apply maximum effort to areas within their control. The first focus area must be to optimise the profit performance of pasture based systems.

Successful operations continually strive to capitalise on their natural advantage. It is critical that the benefits of reliable rainfall or irrigation water, a temperate climate and ability to grow significant feed on farm are maximised. These can be manipulated to generate tighter control of operating costs and protect profit outlook. Taking the easy option of simply purchasing feed to fill deficits and generate production (often for the sake of it) will not allow farmers to capture the opportunity that lies ahead.

Challenging climatic conditions and improving product prices have resulted in much higher use of purchased feed in many operations this season. This is having a severe impact on margins. My preliminary analysis of clients' 2011 financial results suggests costs are running 10% to 20% higher than originally budgeted.

Other high risk cost areas are those where payments are made for services based on percentage of revenue rather than being linked to profit margin. In particular, sharemilking contracts need to be managed proactively. Unless these are monitored to ensure a sustainable result there is a risk they will lose contact with the economic realities the business faces.

I have been involved in a number of situations over recent months where farm owners have invested in feed to protect production only to hand over much of the benefit to sharemilkers who may not have shared in this cost. This is particularly the case where share farming agreements are predominantly for labour and don't share the wider production costs of the farming operation.

It is also important to closely monitor trends for interest rates. The economic shock of international and local adverse events is still being absorbed by markets. Given this comes hard on the heels of the global financial crisis it is highly likely reduced ability for banks to access funds and impact of international credit ratings will come into sharper focus.

Current lower floating interest rates may be helping many cash flows at present. However, locking down a proportion of debt to eliminate exposure to interest spikes may be timely -- especially for those who are still working hard to consolidate their balance sheets.

It makes economic sense to assume that higher farm incomes will mean greater competition for limited resources including farm inputs and finance. Celebrating product prices is only one side of the equation. It is essential there is an equivalent focus on assessing the benefits of farm inputs so the cost price margin remains balanced. All of this needs to be done against a backdrop of sound financial structure and interest rate management.

Now is the time to about this with advisors, financiers, staff and suppliers if you are to convert volatility to victory.

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