Sheep for Profit ® Newsletter

July 2007

Unlocking the potential for you to make it happen

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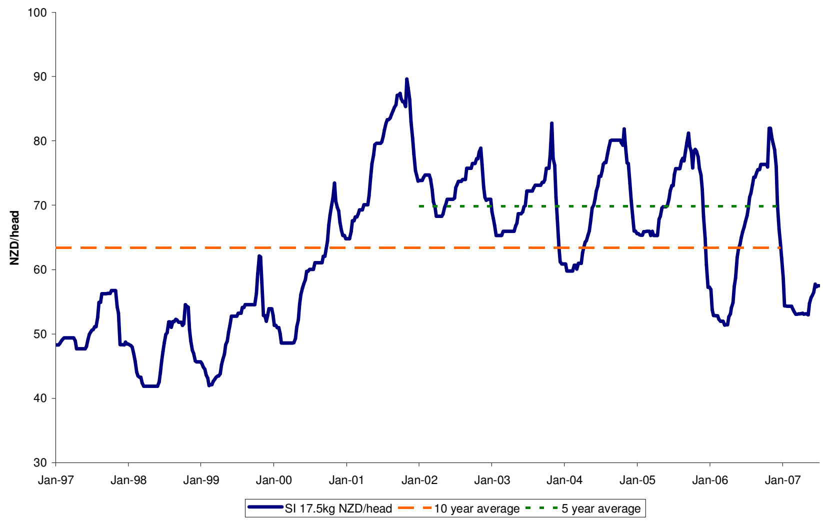
Rabobank comment by Hayley Moynihan

New Zealand sheep farmers are feeling the impact of a lamb schedule price that has fallen from an average NZD 410/kg in 2004/05, to NZD 368c/kg in 2005/06, and NZD 360c/kg in the 2006/07 season to date (July). However, the averages understate the overall impact for most farmers as price volatility has been greater over the past two seasons with a significantly deeper seasonal price trough, which has lasted longer, at the peak of the processing season (Figure 1). Prices have held around the 10-year average level, but remain 10% below the average over the most recent five years.

Rabobank remains positive on the outlook for sheep meat and the prospect for improving returns to New Zealand sheep farmers.

Figure 1: South Island 17.5kg YX Lamb Prices, 1997 - 2007



Source: NZX Agri-Fax, Rabobank, 2007

The drivers for declining lamb prices and greater price volatility included:

- lower international sheep meat prices;
- appreciation of the New Zealand dollar;
- intense procurement competition for supply, and;
- variable seasonal conditions.

These factors are primarily New Zealand domestic market conditions, however international markets for sheep meat have altered significantly over the past five years.

On the demand side of the market, prior to 2002 sheep meat traded at a similar level to its nearest substitutes, beef and pork. From 2002 to 2005, sheep meat (particularly lamb) prices accelerated sharply and opened a wide premium (Figure 2). This was driven initially by lamb's favourable health and quality attributes relative to disease events occurring within other meat categories, combined with a UK supply shortage due to Foot and Mouth Disease.

At the price peak key consumer groups, such as restaurant, food service and retail outlets, reacted by taking lamb off the menu or reducing the quantity on offer in favour of more profitable alternatives. Lamb prices have since corrected and now attract a much smaller premium over beef, its most obvious competitor.

On the supply side, Australian lamb production levels have increased rapidly lifting by around 18% over the past five years. This has heightened competition for New Zealand lamb in non-quota markets such as the US and Asia and placed downward pressure on prices. The impact was accentuated by the 2006/07 drought conditions in Australia, which increased slaughter rates.

Additionally, European markets have been reacting to the reform of subsidies by reducing

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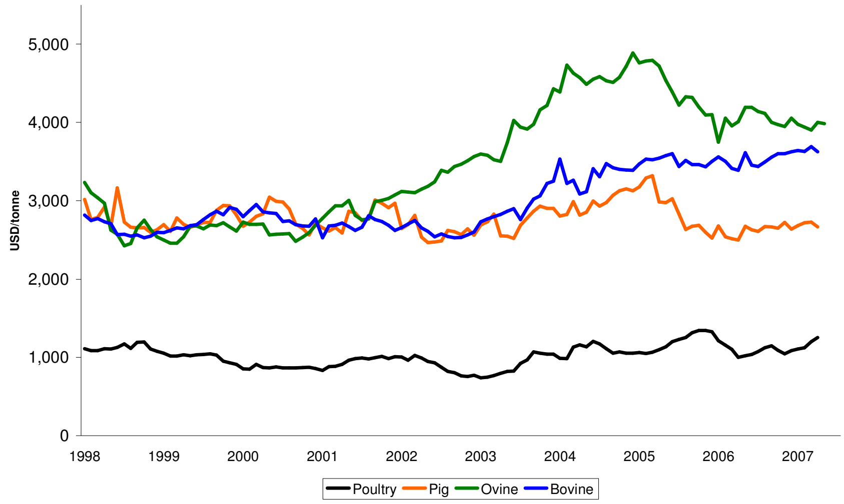
their sheep flocks, which has increased sheep meat availability in the short-term.

Figure 2: Indicative World Wholesale Traded Meat Prices, 1998 - 2007



Source: FAO, Rabobank, 2007

Rabobank remains positive on the outlook for sheep meat and the prospect for improving returns to New Zealand sheep farmers. This is based on a number of factors:

- the European lamb supply deficit, combined with steady consumption levels;
- relatively low level of stock held in the marketplace;
- growing demand for animal protein in developing countries as increased wealth drives consumers away from grain-based diets;
- increased intensive livestock production costs due to the structural change in grain markets resulting from bio-fuels;
- forecast 2008 lamb production from Australia reduced by 5% post-drought, and;
- the reputation and positioning of New Zealand lamb in comparison to other meats.

International prices have shown signs of firming over recent weeks in Europe and the US, with increased interest reported from importers and wholesalers. The market re-balancing that has occurred over the past two years is now largely over and many of the driving factors for lower prices have subsided. While the influence of the New Zealand dollar has kept the farm gate schedule price subdued, the outlook for the coming season indicates improvement.

Rabobank has a long history of supporting the rural sector and farmers around the world. As an agribusiness banking specialist Rabobank understands the volatility that can be evident in agricultural markets around the world and through its Food and Agribusiness Research division enables specialists to form a long-term view of sector trends.

The Rabobank group is also experienced in working with farmers through tough trading and climatic conditions. The bank worked closely with Australian clients during the 2002-2007 drought, the worst in Australia's history. Rabobank has been rated the best agribusiness bank in Australia for two year's running by Merrill Lynch. In New Zealand, Rabobank customers rate their bank more highly than customers of all other major banks[1]. Research reported by *TNS Market Research* shows that Rabobank holds the leading position in the majority of performance attributes measured including value for money, knowledge, expertise and strong relationship building.

Rabobank has a good understanding of the pressure New Zealand sheep farmers have experienced over the past two years. We continue to have a positive outlook for the sheep meat sector and look forward to supporting our existing and future clients.

[1] TNS BFM, Agribusiness market, June 2007. Comparing ratings (of 9 or 10 out of 10) by the Main Bank customers of the six major NZ banks.

Productivity v. adding value?

Abridged from the leading article by Jacqueline Rowarth in the June 2007 "Grassland News" – the NZ Grassland Association newsletter.

Some concerning figures have come out of a Primary Resources Forum held recently.

The agriculture sector has had high productivity gain but not such high GDP growth

The agricultural sector's 2.2% annual productivity gain compares favourably to 1.5% for the whole NZ economy. However, our GDP growth has been 1.6% per year compared to 3.4% total GDP growth.

The improved productivity has been associated with increased labour efficiencies rather than increases in value-added products.

Cameron Bagrie, Chief Economist, ANZ Bank says the four legs to economic growth are:

1. Science leading to innovation
2. Reliable banking sector
3. Information technology (enabling sale of products)
4. Property rights (ensuring that development rewards the owner)

David Skilling, NZ Institute focussed on revolutionising our “high-weight, low-value” economy.

NZ gains $1500 for every tonne of goods sent overseas compared to $3000/tonne gained by Iceland. What’s more we haven’t been increasing that since the year dot and Iceland have been improving 4.5% per year!

He suggested five steps to the future:

1. Increase expenditure on research and development
2. Increase investment in the education system, particularly at university level
3. Improve communication infrastructure
4. Create a pipe-line for company growth
5. Increase foreign direct investment

Andy West, CEO AgResearch was positive about the increasing global demand for high quality food produced from a friendly environment where animal welfare is regarded as important. He was another to highlight the absurdity of the current rate of investment in R&D.

Graeme Harrison, Chairman ANZCO Foods is very upbeat about the future “More than ever in the next decade, agriculture is going to be New Zealand’s Silicon Valley, but we spend so much time as a country trying to find other ways not to enhance that. We go about trying to encourage this or that little industry instead of saying, ‘This is what we’re really good at, let’s get behind it’”.

His message to sheep and beef farmers is “to hang in there because the high cost of feed that is lifting prices for grain-fed pork, poultry and beef around the world will also lift prices for grass-fed produce that is being sold in the same markets.”

“From an industry standpoint, the biggest issue is removing the supply risk.” He sees supply contracts as being crucial and we need to structure exports to better match the demand of overseas markets. “The biggest constraint is feeding. We can breed enough animals, it’s how well we feed them that counts.”

A few drought management reminders

It has been exciting to observe several East Coast/Hawkes Bay Sheep for Profit farms since weaning. So far scanning results are looking very acceptable and the ewe condition curves are still showing plenty of multiple ewes at condition score 3. Compare this success during very difficult times to some stories we have heard recently “the place I scanned this morning we had to lift the ewes into the crate” and “these would be the best conditioned ewes I have scanned so far”.

Well done to those who have been very proactive with early decision making and great planning. However, for many it is not over yet so we have to keep the pressure on for a while yet.

More go broke after the drought breaks than during the drought

The rain that breaks the drought does not provide more feed for some time. It makes us feel better, but it hasn’t finished yet!

Make early decisions and act on them

It’s better to make a wrong decision than no decision. Don’t procrastinate.
Confident decisions are made only when we have a finger on the pulse and know what we want to achieve.

Maximise income over the next 12-24 months

Too many farmers aim to re-purchase capital stock on a high demand, low supply market.

Consider the potential benefits of short term income replacement strategies as alternatives to rebuilding capital stock numbers.

Spend time outside the boundary fence

Talk to other farmers but more importantly talk to the people in your business team. They don’t want failure so will do all they can to help their clients get through, but only when they have confidence management strategies are in place.

80/20 rule

Better to do 80% very well than stuff it up trying to do 100% well.

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Get excellent advice

Financial planning, nitrogen or not, animal health should be high on the decision list.

Nitrogen (N) – should I use it?

Aaron Stafford, Ballance agri-nutrients

The decision of whether to apply fertiliser-N remains the hot topic for many farmers this winter, for several reasons;

1) drought resulting in sparse pastures and lower pasture covers leading into winter
2) poor winter growth as a result of excessive rainfall and saturated soil conditions
3) low beef and lamb schedules and recent increases in the price of urea
4) question marks over the N response efficiency of urea relative to other N products

- **Nitrogen will not start grass growing – it multiplies growth!**
- **Nitrogen may be better than P K S fertiliser this season**
- **Use nitrogen to get most value – better pastures, multiple ewes**
- **Urea should be a better option than N-inhibitors**

The big issue in deciding whether to use fertiliser-N is - ***if you grow the extra grass, do you have the mouths on hand to utilise the extra feed, and can you convert the extra feed into profit?*** Depending on the reason for its use, and how and where it is used, fertiliser-N still has a role to play.

With the lamb schedule as it has been, the economics of simply using fertiliser-N to carry more breeding ewes over winter is marginal. To get the best out of your fertiliser-N inputs, tactical N use will give better results. For example, only applying N over twinning blocks is likely to give a better return on investment because feed quality and utilisation should be much better due to the greater grazing intensity.

While N responses in browntop dominant pasture may often be equal if not greater than on higher quality pastures, the feed quality limitations on such blocks may mean that the extra feed generated is not particularly profitable, since stock will struggle to utilise this lower digestibility feed, and stock performance will be further limited by its low ME and low protein characteristics. A key issue to remember is that N is a growth multiplier, not a growth generator. As browntop is a winter/early spring dormant pasture species, browntop dominant pastures may not respond well to late winter/early spring fertiliser-N. In fact, what may occur is a delayed N response, hence a greater feed surplus may occur in late spring/early summer, resulting in poorer pasture quality through inability to control the surplus feed.

One of the most important factors in deciding when, where and how much fertiliser-N to apply, is constructing a feed budget so that feed deficits can be determined in advance. Where a feed deficit is projected, fertiliser-N remains the cheapest form of supplementary feed, on the basis that this feed deficit is forecast in advance, and fertiliser-N can be applied to fill the projected feed deficit before it has occurred.

Assuming best management practices are followed (eg. soil temperature is greater than 5 ºC and rising, and pasture covers are greater than 1000 kg DM/ha) there can be confidence that spring N responses in hill country will be of the order 15 kg DM per kg N applied, if not greater. At this level of response, the feed generated will cost around 10-11 cents/kg DM, much cheaper than alternative imported supplementary feeds. While it may not always be possible to apply N under such ideal conditions, even under 'less than ideal' conditions, fertiliser-N generated feed will still cost less than 20 cents/kg DM, remaining cheaper than alternative forms of supplementary feed.

Nitrogen will likely be an important tool for farmers coming out of winter in areas that have been affected by summer/autumn droughts, or by poor winter growth. Where feed will be at a pinch around the critical period of lambing to weaning, there will be much greater value in substituting fertiliser-N spend for some of your traditional P K S fertiliser spend, particularly where there has been a good history of fertiliser P K S inputs.

Additionally, depending on the limitations of your property, tactical N use to increase growth rate or carry a greater number of store lambs may remain a cost effective option, depending on contract prices.

In terms of deciding on the most cost-effective fertiliser-N options, Ballance would advise to stick to the basics. SustaiN is a N-fertiliser product that has been developed by coating urea with a patented urease inhibitor named agrotain. This agrotain coating has been internationally proven to reduce ammonia volatilisation, and hence can improve N response efficiency. While ammonia volatilisation can cause a significant reduction in N response efficiency under some conditions of urea application, during late winter and early spring when soil moisture is high and rainfall frequent, ammonia volatilisation losses are likely to be very minimal, hence urea remains your most cost effective N fertiliser.

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