

# Changing times ahead

by John Francis

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*Now could be the time to consolidate and look for the high yielding investments within the existing fence line.*

**R**ecent expansion analyses for clients have demonstrated the extent to which commodity prices, inflation and interest rates have changed the game.

Finance cover (operating profit divided by annual interest) with what was previously considered to be a reasonably solid equity position (say 80%) has moved from greater than 7 times to less than 2 times.

Following are some rough numbers for 2022 (columns 1&2) for a beef and prime lamb enterprise compared with 2023 where commodity prices have declined by 40% and 30% respectively (columns 3&4).

Operating returns on the basis of dollar per DSE land asset values of \$1,200 and livestock/plant values of \$150 per DSE have gone from 5% to 2% in beef enterprises and from 3% to 1.1% in prime lamb enterprises.

While recent land value reports from financial institutions suggest solid growth to continue its hard to see how that will hold true, at least for broadacre grazing enterprises in the short term, given the rapid changes in commodity prices, interest rates and inflationary pressures.





For those interested in expansion through land purchasing cast an eye to the partial budget (columns 5 & 6 which are the last two columns in the table below).

This shows that 100% debt funded expansions with solid economies of scale related to lower marginal cost structures (\$5 overheads v \$25 in existing businesses) are bleeding heavily (i.e. losing cash).

Such losses may have been tolerable (and smaller due to lower interest rates) when there was confidence that the gains in capital growth significantly exceeded the marginal cash losses from fully debt funded expansions. If the view is that there will be a return to nil to low rates of capital gain on land, then a business case in further expansion will be hard to justify.

Now could be the time to consolidate and look for the high yielding investments within the existing fenceline.

Land value (\$/DSE)	\$1,200					
Livestock & plant (\$/DSE)	\$150					
	Beef	Lamb	Beef	Lamb	100% debt funded expansion - partial	
	2022	2022	2023	2023	Beef	Lamb
					2023	2023
<b>Change in income</b>						
Gross profit (\$/DSE)	\$100	\$85	\$60	\$60	\$60	\$42
Enterprise expenses (\$/DSE)	\$8	\$20	\$8	\$20	\$8	\$20
Overhead expenses (\$/DSE)	\$25	\$25	\$25	\$25	\$5	\$5
<b>Operating profit (\$/DSE)</b>	<b>\$67</b>	<b>\$40</b>	<b>\$27</b>	<b>\$15</b>	<b>\$47</b>	<b>\$17</b>
Return on assets managed	5.0%	3.0%	2.0%	1.1%	3.5%	1.3%
Interest rate	3%	3%	7%	7%	7%	7%
<b>Equity</b>	<b>80%</b>	<b>80%</b>	<b>80%</b>	<b>80%</b>	<b>0%</b>	<b>0%</b>
Interest costs (\$/DSE)	\$8	\$8	\$19	\$19	\$95	\$95
<b>Profit after interest (\$/DSE)</b>	<b>\$59</b>	<b>\$32</b>	<b>\$8</b>	<b>-\$4</b>	<b>-\$48</b>	<b>-\$78</b>
Finance cover ratio	8.3	4.9	1.4	0.8	0.5	0.2