

Investment News

Opportunity knocks

Is now the time to capture the dairy market?

High dairy commodity prices and the outlook for increasing milk payouts to farmers have the team at MyFarm feeling optimistic about dairy returns. But it's not just us; investors are also recognising that the industry is at another turning point in the cycle.

The 'kicker' for investors is that positive market sentiment could mean values for quality dairy land start to move upwards from current levels. We wouldn't be surprised if good quality farms are offered to the market at higher prices next season.

So why do we think that "now" is a golden opportunity?

- Demand for dairy has recovered strongly and that demand growth is many times the rate that local industries can supply additional milk - at least in Asia. The most recent evidence of this was the global Dairy Trade result on April 6 when milk powder prices increased 20-25%.

The prices achieved at this event may not be sustainable but the outlook seems positive never-the-less.

- The additional supply will probably need to come from existing dairy exporters, who largely have a higher cost structure than NZ. Good commodity prices will be needed to encourage a supply response.
- Some dairy assets are distressed and are available at attractive values.
- Cash buyers such as MyFarm syndicates are in a very strong position because lenders to NZ farmers are requiring greater levels of equity and less debt than has recently been the case.

Of course there are also risks associated with entering what appears to be a rising market. They include:

- Dairy returns fluctuate, with the past few seasons perhaps a forerunner of the future. Businesses need to be prepared for returns to vary by at least \$1.00/kgMS.
- When returns increase, costs will tend to increase in tandem. For example, if the "world is short of food", then the price of inputs such as fertiliser are likely to rise. Because of

this the NZ industry's future success will be determined by how well we can maintain a low cost structure.

MyFarm and our sister company, AGInvest, has been in operation since 1990. And the owners of the business have had farming careers prior to that time. We've experienced downturns in the mid to late 1980's, the mid and late 1990's and in 2002/03. Our experience is that a successful farm investment is ultimately influenced by its potential (to deliver returns); its inherent risks (that physical and financial performance won't meet expectations) and by its liquidity (the ability to exit the investment).

Our basic investment tenets have withstood the test of time:

- Buy good quality land. Good farms perform through a wide range of climatic circumstances and can also operate with the lowest cost structure and therefore profit margin. In tough economic times good farms hold their value.
- Have a productivity improvement plan. Being able to identify 20 - 25% increase in production potential will underpin the value of the investment. Occasionally we will accept smaller potential gains, but only if it's a very good quality farm bought at the right price.
- Avoid borrowing too much. MyFarm has always promoted investments with less than 40% debt, but the last 12 months

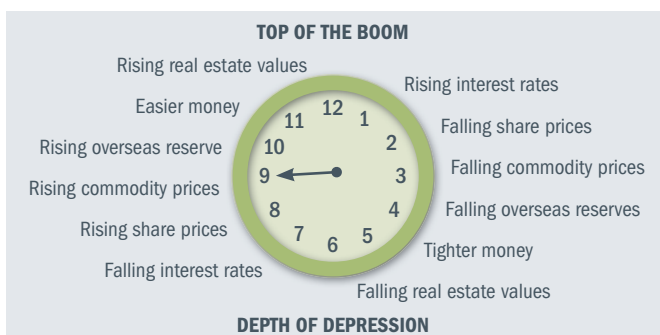


Figure 1: The economic clock. In August 2009 we were in the midst of the Depression phase. In autumn 2010 rising commodity prices indicate gradual recovery.

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Dairy Globe gives unique insight into industry

MyFarm has joined forces with Australian agrifoods analyst, Steve Spencer to provide the weekly email newsletter covering major events in the domestic and world dairy markets and how they affect the New Zealand dairy industry.



Steve Spencer



Steve Spencer brings rare insight to dairy industry analysis. He is an agrifoods analyst and adviser, and a director of Freshlogic based in Melbourne. Steve is recognised as one of Australia's leading dairy analysts, involved with clients engaged along the dairy value chain in the industry over the past 15 years. He co-produces the industry's annual Situation & Outlook package which is released in May each year. Freshlogic also provides consulting and market intelligence products across food retail, meat, fresh produce and seafood sectors, as well as insights into consumer spending on food,

based on their own surveys of households. Steve writes an opinion column on broad issues for the food sector for a leading Australian agribusiness newspaper and has produced the Dairy Globe for the past 10 years.

Readers tell us they like MyFarm DairyGlobe because it provides a quality snapshot of global dairy industry news, with the added insight of an experienced analyst. If you are not yet receiving MyFarm DairyGlobe and would like to, please email info@myfarm.co.nz.

MyFarm DairyGlobe provides a weekly snapshot of the global dairy industry.

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has emphasised the importance of a strong balance sheet. You'll see proposals from us now with less than 35% debt. Low debt means the business can survive and prosper at lower milk payouts. Lower debt provides expansion options and underpins shareholder returns.

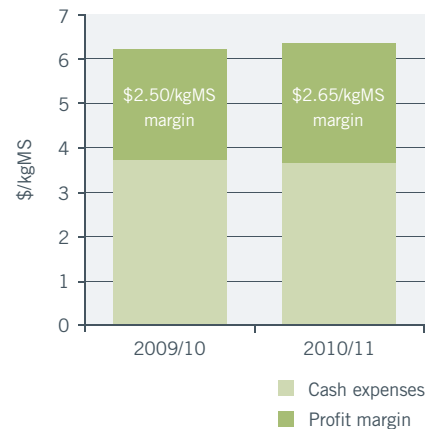
- Partner with great young people. We've had great success with our MyFarm START programme aimed at giving young talented farmers a 'leg up' into equity managing and ultimately farm ownership.

By focusing on these fundamentals MyFarm syndicates this year are set to have income of approximately \$6.15/kgMS from advance

and deferred milk income plus stock revenue. Costs are on average \$3.65/kgMS, though varying from \$3.20 to \$4.20/kgMS. This leaves, on average, an EBIT (operating profit) of \$2.50/kgMS. Interest costs are around \$1.20, with a range from \$0.80 to more than \$2/kgMS, leaving a profit before tax and capital investment of \$1.30/kgMS.

It's always hard to pick the bottom of an investment cycle - and the shape of the recovery is hard to pick. But right now as the 2009/10 season comes to a close, there are most definitely some good opportunities. Our advice is if you are interested to invest, don't wait too long.

Figure 2: MyFarm syndicate actual and expected performance



Is this the last chance?

With this season's dairy payout set to be the second highest ever, we don't expect values for prime Southland dairy land to stay at their current levels for much longer.



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Mabel Bush. Outstanding dairy investment, Southland:



- Sharp price: \$32/kg MS plus Fonterra shares
- Excellent forecast returns - 11% p.a. made up of 7% p.a. cash yield plus 4% p.a. capital growth
- Low cost operation - very reliable pasture production
- Adjacent to two other high performing MyFarm syndicated dairy farms.

INVESTMENT IS OPEN TO INVESTORS WHO ARE INVESTING NO LESS THAN \$250,000 AND WHO ARE EXCEPTED AS BEING MEMBERS OF THE PUBLIC UNDER S 3(2) (A) OR S 5(2CC) SECURITIES ACT 1978.



Water security focus in Canterbury

Secure supply and efficient management of water is the development priority for MyFarm syndicates in the Canterbury region this year.



Philip and Adrienne Wall and Gareth Evans alongside the new 7 hectare/100,000 m³ water storage pond at Poplar Dairy, mid Canterbury

Over the past six months AGInvest Farms general manager, Gareth Evans has overseen conversion of three syndicates from border dyke to spray irrigation via centre pivot and rotorainer.

“With irrigation our overriding goal is to stabilise the milk production curve through optimal pasture growth. Border dyke or flood irrigation is inefficient because you apply a lot of water in a short period of time. Spray irrigation is more water and labour efficient delivering increased pasture production per unit of water applied.”

In two of the conversions water use is being further optimised with the construction of large water storage dams. These are fed by the local water schemes, but give the farms up to 14 days

storage, meaning that irrigation can continue at times of low water flows.

“These projects are a major capital investment at \$2/m³ of water storage. But when we did the cost benefit analysis with shareholders we looked at historical information about water flow and assessed the risk of water deficits and potential impact on milk production.”

The largest pond about to be built at Sakura Pastoral is 8.6 hectares and will provide up to 19 days storage.

German Investors enthusiastic about MyFarm model

MyFarm hosted some German investors down-under recently and found them overwhelmingly enthusiastic about not only New Zealand’s landscape but even more so about the attitude and approach to business of our farmers.

They commented that New Zealand is an attractive and secure place to invest because we have a stable economy and government plus the infrastructure, water supply, soils, climate and thus grass-growing capacity needed to produce quality food cost effectively on a sustainable basis.

European investors are increasingly attracted to agricultural investment because of the global supply/demand situation. The strong trend is for increasing demand for protein and there are few countries with New Zealand’s highly efficient, unsubsidised low-cost grass-based production systems.

The German investors who visited Kaiangaroa and MyFarm dairy syndicates in Canterbury and Southland are attracted to the MyFarm ownership model. As “hands-off” financial investors, they want to partner with young New Zealand equity managers and New

Zealand investors driven to improve high quality, productive assets. They also like the idea that they are helping to provide an alternative avenue to farm ownership for young farming couples, which is valuable for the industry.

Most indicated a preference for medium term investments and they prefer a minority investment position with New Zealanders who understand the local farming conditions and processing opportunities.

Their investment in New Zealand farming can deliver direct benefits to New Zealand farmers and the wider economy because they are cash buyers. This is positive in the current New Zealand farm market because it allows some farmers to sell property and free up considerable debt. They have a valuable role at a time when NZ agriculture needs investment capital.



The tour by German investors included the grazing property, Kaiangaroa near Taihape.



Syndicates tackle effluent management

Effluent management is a hot topic in farming circles. Regional authorities are tightening their regulations with many now requiring effluent storage and low application effluent irrigators.

MyFarm syndicates are taking a proactive approach and investing heavily to mitigate problems and lessen their environmental footprint. In Southland seven of the syndicates managed by AGInvest have upgraded their effluent storage capacity and application systems in the past two years at an average capital investment of around \$100,000 per farm.

AGInvest supervisor Grant Payton says new larger effluent storage ponds give a minimum of 60 days storage, allowing more flexible management over wet periods. On many farms the effluent discharge area has also been extended - up to 100ha on the larger properties, which in turn has a positive impact on farm fertiliser budgets. AgResearch figures indicate K-line irrigation improves retention of nutrients by 20-40kg/N/ha/yr; 30-60kg potassium/ha/yr and 2-4kg phosphate/ha/yr delivering an average saving of \$4250 per year for a 700 cow farm.



The effluent storage pond under construction at Hedgehope Pastoral (Southland) in March. The pond is 70m long, 45m wide and 4m deep with 2 liners to prevent leakage. The new design separates solid and liquid waste and has a 60 day holding capacity.

“The greater the area the less total capital fertiliser that is required due to the levels of nutrients such as potash and nitrogen being applied via effluent application. Systems with solid separation will also allow for the solids to be applied to poorer performing areas of the farm and/or new crop ground in spring again reducing fertiliser expenditure.”

Grant says equity managers and sharemilkers are adapting well to the new technology and report on the positive benefits additional storage provides in busy periods such as spring.

“The extra storage is allowing farm management to place greater focus on animal welfare and pasture management until conditions allow for the application of effluent in mid to late spring.”

To achieve this also requires a conscious effort at the end of the season to ensure all pond levels are at their lowest heading into winter which is the focus at this time of year for on farm management.

Construction of a 60-day storage pond and extended discharge area was completed at Edendale Pastoral just before the start of this season. Sharemilker, Eli Gibbs says he was thankful for the additional capacity early season, which meant not having to irrigate at all until conditions dried up in October.

Adjusting to the management of K-line pod irrigators is taking time, but he says it’s worthwhile when you consider the effluent irrigation now covers approximately 75 of Edendale’s 220hectares.

“Those paddocks haven’t had any fertiliser on them this season and they’ve been keeping up with the rest of the farm so far and sometimes going ahead.”

Meanwhile Grant Payton says the effluent management developments have strengthened AGInvest’s relationships with Environment Southland; Fonterra, consultants and contractors.

AGInvest continues to closely monitor development of effluent technology and regulations. Recent council and Fonterra feedback indicates it may soon be possible to introduce systems that reduce overall dairy shed water use by up to 20% through recirculation of waste water washing down yards. This is currently being reviewed by Fonterra and the NZ Food Safety Authority and if agreed will be a considerable benefit to all dairy farms in reducing their environmental footprint.

Grant says all the new effluent systems built in the past two years could easily be adapted to capture this potential benefit, making these farm even more sustainable.



AGInvest supervisor, Grant Payton.