Processing and Farming - do they work together?

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Abstract: The EEC-USA trade wars of the late 80's were the catalyst for us as a farming family to look at the structure of our business in two key areas. The introduction of the EEP scheme in the US and the resulting crash in grain prices for producers in non-subsidised countries, made it imperative for farmers to become much more market and cost conscious, for us it meant focusing on two key areas:- (1) maximising income received per tonne of grain produced (better marketing), and (2) maximising productivity per hectare of land farmed. To try and achieve this goal we changed our rotation from grain legumes to a lucerne pasture phase in the rotation and have tried to constantly adopt new technology in better varieties, nutrition, plant establishment, weed control etc. This led to the advent of Australian Country Canola (ACC). ACC is a cold pressing plant that crushes canola and speciality canola's (modified fatty acid profiles) and markets the oil through a range of food and non-food areas. Meal is sold into the intensive livestock industry. The production has risen from 400 tonne in 1992 to 2500 tonne in 1998.

We are not a pasture dominant farming operation, but the combination of making our farming more profitable has lead us into a more pro-fessional approach to our pastures, and our attempts to make our business more profitable has lead us into processing.

Background

Management

"Little Boree" is run by a family partnership consisting of my parents (Lance and Marianne Mac Smith), my brother Bob MacSmith and myself. We have one full-time employee who is also contract hired to ACC as required. Contract labour is used at harvest and for tasks such as fencing and lamb marking.

ACC is a company which is owned by it's directors who are Bob, Rachel MacSmith (sister) and myself. It has 2 full-time employee's and part time labour as required.

Physical Description

"Little Boree" is located 30 km west of Orange on the Escort Way (Forbes Rd) on the eastern fringe of the Central West Slopes. It covers an area of 1400 ha of mainly red basalt soils (1-5 m deep) over mainly either a limestone base on the 660 ha west of the Escort Way and on a basalt base on the 740 ha east of Escort Way. The average annual rainfall is 600 mm and the altitude is from 440 - 600m a.s.l.

"Little Boree" is a mixed farming operation with generally 700-800 ha under crop and approximately 280 ha under lucerne pasture and 200-240 ha of native/subclover pasture of which 100 ha is currently in the first phase of an aerial improvement program.

The cropping rotation is based on wheat and canola with the introduction of lucerne based on the productivity and soil test results of individual paddocks. Average wheat yields have been 4.5 t/ha over the last 15 years and canola yields of 2.0 t/ha.

We currently run a self replacing Merino flock of approximately 1000 ewes with the wether portion being fattened for the meat trade at under 12 months. If conditions allow we also opportunity fatten up to 1200 lambs on lucerne pasture. We have tried to adopt a policy of not feeding livestock and have as result this year sold 250 cast for age ewes, 400 wether lambs, 100 cull ewes and 200 wethers carried over from last year earlier than anticipated. Although we now only have 900 merino ewes and 400 ewe lambs we will have to begin feeding this nucleus.

Approximately 160-180 ha of lucerne is cut for hay production each spring (although conditions did not allow this in 1997) with it generally being sold the following winter.

Prior to the 1982-83 drought, the property was mainly a livestock operation running up to 10,000 merino sheep and 100 cows with only 100-200 ha of cropping. At the end of the drought with reduced sheep numbers and a greater interest in cropping the emphasis of the property changed dramatically.

The place of pastures in a cropping dominant program

With the shift in direction and the purchase of 660 ha west of the Escort Way our initial aim was one of continuous cropping with the use of livestock only during the summer months on stubbles to help break them down and provide limited weed control.

Table 2: On-farm calculations (Source: AWB internet).

On farm prices calculated by taking AWB Closing Pool No. 1 prices and using 95/96 State Average Costs.	
	ASW 10
92/93	192.00
93/94	162.30
94/95	200.00
95/96	257.00
96/97	200.00
97/98	195.00
98/99 (at June 1 '98)	180.00
NSW State Average Direct Costs 95/96	
Freight	26.59
Graincorp	17.64
F.O.B	5.06
WIF (3.015%)	-
Freight to local depot	10.00

Table 3: AWB pool on-farm returns (Source: AWB internet).

92/93	93/94	94/95	95/96	96/97	97/98	98/99
ASW 10 at close of No. 1 pool						
128.70	99.90	136.46	191.74	136.46	131.61	117.07
LJM & MJ Smith on farm returns						
134.00	128.00	237.00[1]	190.00[2]	155.00	152.00	135.00[3]

[1]On advice negotiated from $145 (400 tonne) rolled into 95/96 and renewed at $240.00/t base price; [2]Includes 400 tonne at $159.00 (from 94/95 base at $145.0/t); [3]Sold 300 tonne at $150.00 on-farm.

- *Quality* - having the best possible article to sell will probably get you a premium.
- *Keep the buyer informed*, even if you think he knows or should know tell him you will have more/less, better/worse than anticipated.
- *Sell a little bit all the time*, we try to sell grain forward as we feel comfortable with our anticipated production and the price. You'll probably never do much better than the average but we are all trying to avoid having to sell it all at harvest/shearing when the market is at the bottom because we need the cash flow.
- A very valuable *type of forward sale* is a GMP (guaranteed minimum price) contract where you have the sale to protect against falls in the market (put option) and also the chance to benefit from any price rises against a given benchmark (call option). This is an ideal situation with the only risk being if the contract does not have an 'Act of God' clause which protects you from non performance due to drought, fire, flood or frost.
- *Pick one or two information sources* and stick with them otherwise you will be snowed under with 'marketing' newsletters.
- *Do not try to pick the top or the bottom of the market.* Have a sell price you are comfortable with.
- You must *know your cost of production per unit* for your main enterprise otherwise you will never know what price represents a good profit.
- If you plan to store wheat/wool, hold cattle *etc.* because you are not happy with the price on offer, you must know what price you will accept and what your real holding costs are, interest, storage, double handling, shrinkage, pest control *etc.*
- *Always do your own research.* We have all heard of someone getting $400/tonne for canola, but was that delivered port or farm gate with or without bonification?

If you wish to use an option/futures program, start with a small trade and use it as a learning exercise, as you will probably understand the mechanism of the market better this way than any amount of seminars/reading can teach you.

Another strategy, one which we have not employed, but one I feel would be worth pursuing is to sell the physical (commodity) on any given day, and at the same time take an out of the money call. While this incurs the cost of the call it gives the ability to take advantage of any potential upside, while the sale covers your downside. By taking an out of the money position you reduce your expenditure, therefore giving a higher minimum net return, but you need a bigger shift in the market before your call comes into the money.

Our own experience has shown us that often if you are caught with excess production or didn't sell forward because you were uncertain about the season *etc.*, you are often better selling if you do not have a FIRM opinion on what the market is going to do. Our attitude is to take the price on offer and use it to either reduce debt (the easiest way to increase profit = returns), or move on to the next project (buying a mob/herd of replacements). Let me add that if we had the discipline to follow our own guidelines all the time we would probably be in a stronger position but we do not follow our own guidelines entirely!

Processing

If you choose to have your own beef killed and undertake the marketing, I call that processing. If you are serious about value adding you need to look at it as a separate enterprise as much as you can, otherwise you will end up with so much cross subsidisation you won't know if it's worthwhile or not. If your phone bill jumps 50% and you have to have a contractor do jobs you normally do but are still charging the farm for these items, are you really making a profit out of your value adding or just making the farm look worse than it really is? This is the reason I believe it is critical to separate 'value adding' from processing, as one involves trying to

increase the price you receive for a particular commodity while the other (as we have found the hard way) involves acquiring a whole new range of skills. These include working with machinery that is new and cannot be serviced by many typical farm suppliers, through to negotiating with major supermarket chains and food processing companies. What we have found to be the most critical ingredients are time or labour (something that is already in short supply on many farms). It is the equivalent of at least another full-time job to run a small processing plant, the second most important thing is to continually ask questions or look for better ways to run your plant, find/promote markets *etc*.

The agricultural trade wars of the late 80's, high debt levels and the need to support three households made us look closely at our operation. The big 10-15% yield gains in our cropping system were behind us. We were only looking at small increases in yield (our current 10 year average wheat 4.5 t/ha canola 2.0 t/ha). We were certainly not finished with trying to improve our system, and its efficiency and profitability was not and remains not at its maximum.

The catalyst was that in a period of excessively low grain returns, combined with small increases in yield, and a 2-3% reduction in costs were not going to be enough to give us real profitability when we also faced a period of high interest rates.

Why canola? Why cold pressing?

We had grown rapeseed (Canola was developed in Canada by reducing the levels of erucic acid in the oil and glucosinolates in the meal, and was called Canadian oil, hence the name canola) since 1985 and in 1988 received our first canola varieties which lifted our yield potential from 1.5 t/ha up to 2.5 t/ha along with a 50% increase in price. The real thrust was provided by Meadow Lea who began marketing canola aggressively due to the health benefits associated with it, and it seemed it would be an ideal opportunity to take advantage of this effort.

To succeed we realised we would have to have a unique product or we would get swamped in the market. Olive oil sales where beginning to grow especially in the cold pressed end of the market, and canola was equal or slightly superior nutritionally to olive oil. Cold pressing would allow us to differentiate our product in the market and limit competition to processors of a similar scale and cost structure. It also had the highly attractive feature of much lower capital start-up costs than conventional solvent extraction plants.

As the emphasis here is on marketing I will not go into detail about the processing. Previously I said what I believe the differences between value adding and processing are, but now to some extent I will have to contradict myself. Although what we are doing is processing, but because we also run a farm as well it is impossible to keep the businesses separate, but we try, where possible, and use the synergies to advantage were possible.

- Grain is sold on commercial rates to ACC.
- The premises/ silos and augers etc. that are used are rented for an annual fee.
- Labour is paid for separately.
- Separate accounts are kept for both businesses.
- The ownership structure of both businesses is different.
- Labour employed by the farm is contracted to ACC as required.

Benefits

- Allows better utilisation of labour.
- Infrastructure such as commercial weighbridges are more easily justified.
- Silos can be used for grain and meal storage.
- Farm trucks and tractors are better used.
- Makes you more commercially focused, in that you look more critically at your farming operation in terms of net return on capital *etc*.

Drawbacks

There is no 'quiet' time to do normal farm maintenance on machinery, fencing etc. You must either use more contract labour, or leave jobs undone otherwise your family/personal life will suffer.

Arrange for the processing business to have it's own finance package so that the farm can be paid for produce that is being stored so as not to have a detrimental effect on the farm cashflow.

It is very difficult to juggle labour around a processing plant that needs to run 45-50 weeks of the year and peak farm times such as sowing and shearing. During the start up phase it can be very draining on the farms resources as so much 'unpaid' time and energy is being devoted to establishing the business.

The one thing that has remained constant throughout the 6 years we have been in business is the need to continually be looking to develop new markets and keep abreast of research to see if there is an opening for your company. You may think things are going well but a change in personnel at one of your major customers can have a dramatic effect on your business, like most things personal relationships and rapport are important and can be your greatest asset in gaining markets. We have experienced 150% growth annually in some markets and an equal reduction in sales when our contact left the company and they floundered under new

management.

The development of both GMO (genetically modified oilseeds) oilseeds and advances in traditional plant breeding have created opportunities for both specialist producers and processors. Those who can link the fatty acid profiles required by the market for uses as diverse as deep frying to rock drilling compounds will benefit. Clearly there are rewards for those processors and producers who can grow/crush these crops, while maintaining the purity and quality needed for specialist applications. If in co-operation these markets can be developed there is the possibility of increasing farm gate returns of 'traditional' crops. There is a range of new canola's being bred that offer exciting possibilities for all sectors of the market. Some of these are lauric, stearic and low linolenic (Monola) canola's. They offer the chance for the producer to grow a crop which has a value which is not directly linked to world commodity markets, but allows for forward selling at a premium for growers who can produce the crop to the higher quality and hygiene standards required. ACC has for the last three years been involved with the growing and crushing of Monola, which with its reduced linolenic acid (C18:2) levels makes it more suitable for deep frying, increased shelf life and margarine. This product is aimed at replacing some of the 120,000 metric tonnes of palm oil and its fraction that Australia imports annually. It also opens up opportunities in export markets for a deep frying oil with a better nutritional balance than palm oil (highly saturated fat). The development of these lines is still in the early stages but they will allow for the development of very high value crops as the carrier for pharmaceutical genes as one example. Already in Canada (the worlds biggest canola exporter) over 50% of 1998 plantings are GMO canola's, at this stage large commercial plantings are limited to varieties with agronomic advantages such as Roundup Ready, High Oleic, Low Linolenic, improved yield and better disease resistance.

I do not profess to having special marketing skills, and our approach revolves around a few main points which are similar to marketing farm produce.

- Try to keep abreast of the market. For us, Chicago bean seed/oil/meal futures are critical along with Winnipeg Canola price, as they are the main determinant in the local canola oil/meal price.
- Use your local knowledge to advantage. You are in the field and can get a feel for how the season is shaping up before it has been factored in. In 1997 we felt that canola was well priced as a buyer at $340 tonne. It was not the bottom but it was a price we accepted.This allowed us to purchase seed before the seaboard realised how poor the spring was. For this one 'win' we have also had our fair share of 'losses'.
- We have found it very difficult to establish reliable, cost effective distribution channels. If your agent is not actively promoting, distributing your product it doesn't matter how good it is it will fail. This is especially important if you are actively involved at the retail level as it is very difficult to monitor when you are 300 kms from your main market. In hindsight we would like all good marketing strategies start at the market and work back, by that I mean ask the retailers who of the broker/distributors they feel best promotes a particular sort of product (remember it's in there interest as well to have your product moving off there shelves) and then approach several of these to make a choice. Another important factor in distributing your product is to keep the chain as flat as possible, by that I mean the less links between producer and consumer the better. This makes your choice of distributor even more critical as every link you can cut out means your product will still be competitively priced but you will receive more for it. Ideally if you can send your product to one distributor who can go direct to the food services market and at the same time service the consumer (supermarket, delicatessen, independent) market you will have a much lower cost structure. Another way of achieving this is to join up with a bigger manufacturer who supplies other ingredients to food services, and by adding yours allows them to offer a bigger range of products and gives you very cost effective distribution. •
- You must always be looking for new uses and markets as the lead time in developing markets when you are dealing with multinationals can run into years.
- Try to maintain a constant dialogue with your customers to get a feel of how your product is working for them. It may help you squeeze a few extra dollars next time you have to negotiate with them.
- Try and maintain a reasonable sized customer base so as not to be to reliant on one customer.
- You will soon discover that some customers take up a lot of your time for very little reward, so be careful not to take your 'good' customers for granted. Try to maintain contact as they are the ones who are the cornerstone of your business.•
- Remember that as a small business you often get a lot of customers who do not want to deal with big companies because they feel like they are treated poorly. These people represent an excellent chance to improve your margin by offering product in the quantities and packaging they require with the personal service they want.
- Most marketing in our experience is mainly just

hard work on the phone/road telling the market what you have to offer. I don't believe that there is any magic formula that guarantees success. You just have to follow every lead and probably end up with a strike rate of less than 10%.

Conclusion

I have probably not painted a very bright picture but I believe it to be a realistic one. Returns in agriculture have not been keeping pace with other industries, and those of us who are operating on land that has high DSE (dry sheep equivalents) values are feeling these squeezes probably more rapidly and acutely than operators with a lower cost structure in terms of fixed and variable costs. One day we are told that the world will be short of agricultural produce and the next that increases in productivity and land coming into production will maintain the status quo. Whatever the result, to remain competitive in processing or farming, we must produce as much as possible per unit of production available to us at the best possible quality and then try to maximise the price we receive for it.

There are lots of opportunities for agriculture 'out there' but perhaps some of us will have to change the way we farm. In the processing area the emphasis is similar. We must continually look to make our process more efficient, find uses for products we haven't dreamt of, and continue to try and get the best price possible on offer.