

14 November 2018

## RECENT FARMING SEMINAR

A QUESTION WAS ASKED AT THE END OF MY ADDRESS AND IN QUESTION TIME ABOUT MY MAKING A FEW COMMENTS LOOKING FORWARD - AS THE CHAIRMAN SAID, WE HAD RUN OUT OF TIME AND PERHAPS I WOULD LIKE TO PONDER OVER THE QUESTION AND WRITE BACK TO HIM AND HE WOULD CIRCULATE MY REPLY - THIS WAS MY REPLY - IT IS NOT JUST ABOUT AGRICULTURE

1. What does NZ have that the USA does not have or does not do as well as NZ does:

- Sheep and wool (they only have 5,000,000 sheep)
- White wine
- Isolation
- Stable politics
- Less religious issues
- Immigration
- Gun control

USA - 326 million people  
- GDP: US\$19,391 billion

NZ - 4.8 million people  
- GDP: US\$206 billion

USA has a population 68 x higher and a GDP  
94 x higher than NZ.

2. The War in Syria has now gone on longer than the Second World War - when it does come to a halt there will be enormous amounts of capital required to rebuild the economy with that money all to come directly or indirectly from western countries - much of North Africa will be caught up in this rebuild.
3. Over the years, immigration has worked in some countries like Australia, and earlier in Europe, but in others like the UK, Germany, Italy, Greece, it seems to have caused a lot more problems than it has solved.
4. It is going to take a long time to replace coal and oil in some countries, such as China, American India and Russia. Science is spending a lot of money trying to filter the pollution aspect and I struck people in America who were working full time with heavy dollars on this issue - they were convinced they could halve the problem. Solar power, wind power and energy batteries being developed are providing major energy progress but are some time away from replacing coal, oil and gas.
5. If climate change issues come to pan out as science is predicting, then air conditioning is going to become an even bigger business and an even bigger cost, both capital wise and running costs in many countries.
6. Australian banks now control around 94% of NZ banks. Any NZ based business that is heavily bank leveraged can expect probably annual bank stress tests - the writer has struck several of these - they are stressful, time consuming and often do nothing towards improving the business itself. Farming is very much going to have to get used to this - in Australia their drier conditions, vast distances, extensive rather than intensive farming set ups, and lower per farm debt tend to put a spotlight on many NZ farm debt situations. The Australian total term debt is approximately \$69 billion (NZD), with NZ being about \$60 billion (NZD) - it is consequently not surprising that they see some NZ farming situations being too indebted.

7. I think within several years NZ farming may need to work on a debt servicing position based on say 7 - 7.5% - that in practice may be 5.5% term loan interest and 2% loan principal repayments each year - 7.5% in total is not dissimilar to what we had some 10 years ago but a 2% - 2.5% overall increase would now have an enormous effect on NZ agriculture - despite this thought, I feel this issue will come to pass.
8. Education of farm children is more important than farm fertiliser - this has been the case for some years and it is not going to go away. The USA has a present student loan debt of \$2,146 billion (in NZ dollars) with 44 million student borrowers at around a debt per borrower of around \$45,000 (NZD) - our NZ student debt is around \$15 billion (NZD) with 732,000 borrowing each involved with an average debt of around \$21,000 (NZD) - the USA government is looking to sell/unload some of this \$2,146 billion onto private lenders. The USA student loan debt is now a lot higher than car debt and credit card debt and is second only to housing debt - big defaults are looming on some of these student loans - there is a message here for our NZ situation.
9. It is hard to make progress financially in a typical NZ farm business unless you are a crackerjack or one spouse is working full time off farm or the indebtedness is low, or all three of these - let's have a look at the benchmarks I am referring to, say, with a gross farm income of \$800,000.

Expenses as a percentage of gross farm income of, say:

Farm working expenses	60%	(\$480,000)
Interest and rent	17.5%	(\$140,000)
Depreciation on vehicles and plant	5%	(\$40,000)
Management	9%	(\$72,000)
Allowance for unforeseen	1%	(\$8,000)
Allowance for capital type costs	2%	(\$16,000)
Income Tax	3.5%	(\$28,000)
"Free cash"	2%	(\$16,000)
	<u>100%</u>	<u>(\$800,000)</u>
	=====	=====

No different probably to many wage and salary individuals. In practice, the farm working expenses to gross farm income ratio is hard in many cases to get below about 63% rather than the 60% I have used above - 63% would be closer to the 2017 and 2018 practice averages across all groups, that is dairy, sheep and beef, and cropping.

One really needs another line and figure above for business risks from climate, council, environmental, government and various ongoing regulations.

10. The EU has an issue at the moment with Brexit, but it also has potential issues with Italy - one of the major problem areas in the background is that under the EU currency arrangements, if a country goes through a bad patch it cannot devalue its own currency - Italy looks a bit too big to bail out - it is the ninth biggest country in the world measured by Gross Domestic Product (GDP) - it is bigger in this sense than any of Russia, Sweden, Canada, South Korea, Australia and Mexico.
11. The USA is still the cutting edge with many worldwide issues, but it certainly has its problems re:
- The country is really divided politically which takes focus away from other more important issues.
  - Twenty USA military veterans commit suicide every day (over 7,000/year).
  - Gun control or lack of is killing a lot of people and it's ongoing - we would be horrified with gun deaths in our schools and universities.
  - USA does not want to be the policeman for the world, but does not want China to be either.
  - They need the 11 - 13 million Mexicans working in their economy for much of the heavy lifting, but Mr Trump is not so sure.

- (f) Up or down movements in the USA currency has a big effect on many countries, including NZ.
- (g) We need the USA more than they need us - approximately 20% - 25% of our longer term fixed loan money still comes from the US - NZ people are not saving enough to cover the long term borrowings of NZ people.

12. It is always worthwhile having an understanding of the GDP of the worlds, say, top ten countries (GDP is a measurement of a countries financial horsepower and performance re goods and services, it is not the only measure but it is comparable country to country).

The 2017 year data in billions (US\$):

USA	\$19,391	} ( The USA economy is more than equal to the combined economies of Germany, UK, India, France, Brazil, Italy and Canada - the USA has been dominant like this from 1961 - no major war rebuild cost helped - it currently represents around 31% - 32% of the total world GDP. )
China	\$12,238	
Japan	\$4,872	
Germany	\$3,678	
UK	\$2,622	
India	\$2,597	
France	\$2,583	
Brazil	\$2,056	
Italy	\$1,935	
Canada	\$1,653	

- 13. Rising temperature with climate change as predicted will mean higher rainfall and more flooding. There are 136 coastal cities around the world that will be vulnerable with this and higher sea levels from snow and ice melt. The politicians won't take the front foot here, that will be taken by insurance companies and banks - the insurance company will refuse to insure and the banks then will not lend - the other alternative is that the insurance premium will be too high to proceed to purchase. Parts of Florida are going through some of this right now - along the Gulf of Mexico there are miles and miles of houses that have been built after Hurricane Katrina in 2005 that are built with 10 - 15 feet of piles - without this the insurance company will not insure and banks will not lend. We are going to see more of this issue around the world and in time in NZ. Higher salt water levels and flooding will also have adverse effects upon our present fresh water aquifers.
- 14. In a survey I did three weeks ago, I found that many of our larger scale farming clients are now paying close to \$1,000/week in rates and insurances - rates and insurances are a good example of an upwards creeping mortgage that is not repayable in full or in part at any point.
- 15. The 'rule of 72' has applied throughout history and will apply going forward - that is if you have a cost that on average is increasing at 3% a year, then that hold cost will double every 24 years - at 4% the doubling will be every 18 years - at 5% the cost will double every 14.4 years - at 6% it will double every 12 years. If you have any control at all of your charge out/invoicing, never lose sight of this rule.
- 16. We all need to have a financial reserve or buffer of a minimum of 10% of our gross income - sustainable substantial debt reduction is just as good as long as your bank will relend the money back to you when requested - over the last 10 years I have struck about half a dozen times when the bank would not relend when requested, but these were a minority and in most cases were the clients' fault. Put this rule in place - over the next 5 - 10 years you will come to realise that this business rule is a key part of running your business the way you want to - not the way your bank or government wants you to run your business.
- 17. Our children come out of school without a good enough understanding about basic life financial skills - you and I need to fill this gap across the farm kitchen table - if we don't then our children start behind the eight ball - fill this gap as they will have enough other gaps to fill without this - our schools seem to think that they cover this gap but you ask any employer, solicitor, accountant, banker and business person and you will get the real answer.
- 18. Am I concerned about synthetic milk and synthetic meat as a result of my seven farm study tours in the USA - I think they will both become important and will replace some existing NZ milk and meat product - the USA is spending enormous dollars in this area and some of it will stick - NZ though can only feed probably 30 - 40 million people from milk and meat - we need to think quality, quality and quality, timelines, timelines and timelines, and clean green, clean green, and clean green, and marketing, marketing and marketing on this potential issue.

19. Is there somewhere I would prefer to live? No. NZ people in the main are:

- Honest
- Have integrity
- Are hard working
- Don't make promises they cannot keep
- Pay their debts
- Help their neighbour if required
- Very few are corrupt
- Pay their taxes, even if reluctantly
- There are a lot of small businesses that employ a lot of people
- We are clean and green and are trying to maintain this
- Good country to bring up children
- Good country to retire into
- Our National Superannuation and National Health Schemes are better than most countries
- A little bit of isolation is, I feel, good for us.

A handwritten signature in black ink, appearing to read 'Pita Alexander', with a long, sweeping horizontal stroke extending to the right.

**Pita Alexander**