PGG Wrightson Real Estate

Rural Property Pulse

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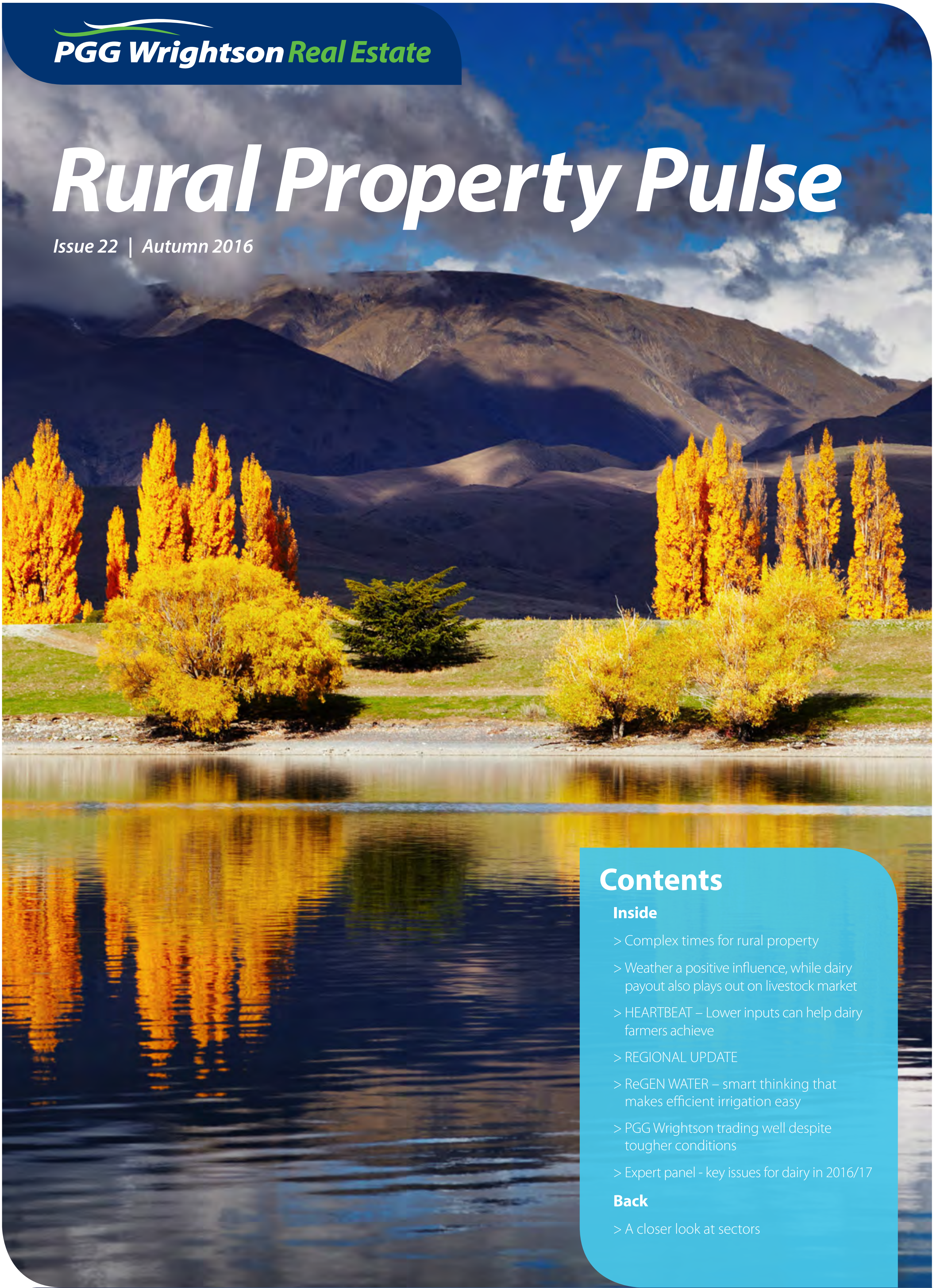

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Helping grow the country

Complex times for rural property

These are complex times in rural New Zealand. For a proportion of primary producers, a generally favourable summer, continuing low interest rates and encouraging projections for market returns make for an excellent outlook. As is explained elsewhere in this publication, for viticulture, horticulture and beef, prospects are as good as they have ever been. Where these land uses are concerned, the property market is surging ahead.

However, within the dairy sector, which is such an important part of our industry, more challenging conditions prevail, cashflow is tight, and many farmers are having a tough time.

That has not yet had a major impact on the rural property market. Buyers interested in taking on dairy properties are still evident throughout most of the country, albeit with a degree of caution. Although the number of sales has reduced slightly, particularly the sale of larger dairy farms, rural property transactions are still taking place and values have not altered appreciably. Although there may be an increase in the number of farms offered for sale in the autumn and through into the spring, any more profound change does not appear likely.

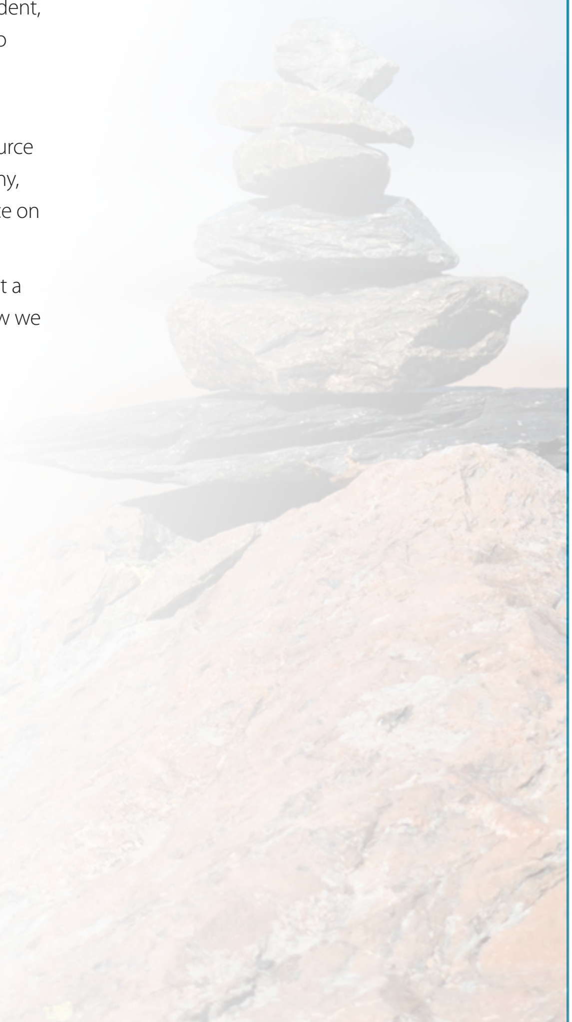
In the main, dairy farmers, with backing from their bankers, will find ways to cover the cost of production and sustain their businesses. Farmers have always been resilient, and, while dairy payouts recover, those in a position to re-focus budgets or diversify should prevail. As in the rest of dairying's history, a few will not make it and will exit the industry. However, these are likely to be orderly and relatively limited instances that do not significantly affect values.

If you are contemplating buying or selling rural property in the short or medium term, independent, objective advice will give you the best chance to achieve your goals.

PGG Wrightson Real Estate Limited is the logical source of such advice, particularly with the resource of our colleagues throughout the wider company, providing detailed and wide-ranging intelligence on all other aspects of farming.

If you need assistance, in complex times, contact a PGG Wrightson Real Estate office to find out how we can help.

Peter Newbold
General Manager
PGG Wrightson Real Estate Limited



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Weather a positive influence, while dairy payout also plays out on livestock market

During January the weather turned sharply and positively.

Ample rain fell throughout most of the country, drought prospects ended and the predicted El Niño receded. This was the strongest influence on livestock markets through the summer. Where at the beginning of 2016 farmers were de-stocking in preparation for an arid and challenging season, by February they were looking at surplus feed through the autumn and insufficient stock to fully capitalise.

Meanwhile, the outlook for dairy farmers has not changed appreciably, with pressure on cash flow resulting in many cutting stock numbers.

Positive trends for beef mean demand for adult cattle and weaners is strong throughout the country, and these could hit record price levels during the autumn. Demand for dairy run-off grazing is likely to be weak over the coming months, with farmers inclined to make do on their milking platforms through the winter. This provides additional scope and incentive for those able to finish beef cattle. As a consequence, farmers are seeking to re-stock and paying premium prices for quality beef genetics.

North Canterbury and Marlborough have particularly benefited from the January rain. Both previously on track for drought, both entered the autumn unseasonably green and with prospects for ample feed stocks through winter.

While the outlook for sheep is less positive, at least until China comes back to the market, which does not look likely in the short term, the need to re-stock farms is driving the market in annual draft ewes and two-tooths. As demand is likely to outweigh supply for some time to come, the ewe market should remain reasonably positive in the short term. Those farmers with insufficient cash flow are able to take advantage of supply chain initiatives offering assistance to buy livestock. These should be on offer at autumn calf sales, where finance should be available to make the purchase of calves more easily manageable.

For dairy farmers, although feed conditions are favourable, predictions about confidence returning to the market and a rising payout are still some distance in the future. Although this has impacted buyer behaviour, demand for quality has not been compromised. In this category are buyers who hold a long term view and maintain that good genetics have compounding benefits. These discerning buyers have been active in the market since early January maintaining top end prices for dairy cows of $1700 to $1850, with rising two-year old in calf heifers making $1400 to $1500.

This report was prepared in consultation with PGG Wrightson's livestock team.

HEARTBEAT – Lower inputs can help dairy farmers achieve

While various of New Zealand's primary production sectors are going from strength to strength, accompanied by their respective property markets, for dairy farmers, prospects are more subdued.

Those farmers who are able to reduce inputs while the lower payout prevails will be better placed to thrive again once global markets start to move in a more positive direction.

In various parts of the country PGG Wrightson Real Estate salespeople are reporting how dairy farmers are adapting to shrunken cash flows. Measures some have taken include reducing herd sizes, dropping between ten and 15 per cent of cow numbers. Because it is poorer performing cows that have been removed, and because there is more feed to go around the better producing animals, those who have reduced inputs in this way have found it has not substantially altered their output.

Another saving that farmers are making is reducing costs associated with winter run off, wintering more of their cows on the milking platform. For many, reducing supplementary feed, or changing the balance of supplements given is also an option.

Also possible for some is to sell a few Fonterra shares, aligning with reduced output.

For those farmers able to make such savings, which might amount to reducing inputs by 50 to 60 cents per kilogram of milk solids, while also cutting labour costs, their budgets can become more manageable.

A small handful of dairy farms, meanwhile, has sold to farmers intending to change their land use, for example to bull beef production, which is on an upward trajectory at present. However, wholesale retirement of dairy farms is not practical in most instances, and is not likely to become a trend.

Regional Update

Northland

Excellent growing conditions provided encouragement for Northland's rural property market, which was active through the summer, particularly prior to Christmas. A number of dairy farms sold, priced from $9,000 to more than $18,000 per hectare. Sales values and volumes were on par with last year. Even with the latest payout forecasts, locals and outsiders remain interested in dairy property, particularly in the $1 million to $4 million range, which should continue while the supply-demand equation remains balanced. Beef grazing blocks also sold well in the region, between $5,500 and upwards of $15,000 per hectare. Although listings are short entering autumn, buyers are tending to bide their time, waiting to see where the market will go, and in particular what action financiers will take, if any, in response to the the continued dip in dairy returns.

Waikato

Despite the challenges facing the sector, 18 Waikato dairy farms changed hands in December, well above average for that month in recent years. At $46,700 per hectare the average price was almost identical to the region's average dairy property value during 2014, with most sales tending to be neighbour to neighbour as many corporate farmers become less active. For sheep and beef properties the market has continued in a positive vein. One large coastal drystock property, 867 hectare Waipapa Station, north of Raglan Harbour and carrying between 8000 and 9000 stock units, sold for $10 million. Sales of a 137 hectare Orini dairy farm and a 104 hectare Tirau property suited to dairy, cropping and dairy support should attract close attention, though autumn listings are limited as vendors and purchasers are wary on how the banks will react to reduced cashflows for their dairying clients.

Bay of Plenty, Central Plateau and South Waikato

Sales of kiwifruit orchards continue to set the pace for the Bay of Plenty rural property market. A five hectare Whakamarama property established in gold kiwifruit vines sold for $3 million in January, the first such property to reach the $600,000 per canopy hectare benchmark. While a handful of South Waikato dairy farms have sold recently to farmers intending to change their land use, for example to bull beef production, retirement of dairy farms is not likely to become a trend. However, the number of farms in the region listed for autumn sale may be limited. One significant recent listing, a 289 hectare self-contained Mangakino dairy farm, will be closely watched. Properties of this calibre, with scale and above-average farm infrastructure, are not regularly offered for sale. Buyers interested in such farms only rarely have the chance to purchase.

Hawke's Bay, Wairarapa and Manawatu

Hawke's Bay's rural property market was slow during summer, as usual for the season. Talk of a late 'El Nino' and the schedules currently paid for lamb have dampened enthusiasm, as have dairy fluctuations and the Ruataniwha Dam project's continuing uncertainty. Activity should pick up in autumn, despite a lack of listings in the range from 4500 to 10,000 stock units. Elsewhere in the southern North Island sheep and beef farms are attracting keen interest, including a 195 hectare finishing property just outside Marton. A 315 hectare Kimbolton farm sold in January, selling some time after it was put up for auction as a larger unit, when the bidding stopped at $8.6 million. Also in Manawatu, a 225 hectare intensive dairying unit near Fielding changed hands prior to Christmas for $9.1 million.

Nelson/Marlborough

Marlborough's viticulture sector remains vibrant, with new plantings in Tua Marina, new grape infill in Fairhall and many companies assessing where to go next. Improved frost protection and planned new water schemes suggest areas south of Seddon could come into focus. A move from a major player in the coming months is likely to precipitate the next run of sales. Values for established Sauvignon Blanc vineyards remain above $180,000 per hectare and industry confidence continues to attract outside investors. Meanwhile in Nelson, caution surrounds dairy farm listings as buyers wait to see what stance the banks will take, and therefore what prices will do.

A number of large bare land blocks around Lake Grassmere are among listings that will attract market interest during the autumn. With listings relatively short, appealing properties offered for sale should find ready buyers.

Canterbury/West Coast

Prior to Christmas Canterbury's rural property market was under the influence of drought and the reduced dairy payout. While rain fell in the new year, the global dairy situation has not improved and purchaser confidence weakened. Dairy property sales are subdued, although listings are forthcoming. A number of North Canterbury sheep and beef farms sold in the summer, valued between $850 and $1000 per stock unit.

As elsewhere in the country, Canterbury farmers are waiting to see whether the banks will influence the property market. That is difficult to predict, though some larger dairy properties may come up for sale. On the West Coast a range of dairy farms are available, and some outside interest has been registered by purchasers from Southland.

At present listings appear sufficient to meet demand during the autumn, although buyers are cautious and wary of the economic environment.

Mid and South Canterbury

Rural property market activity in Mid and South Canterbury during the summer included the sale of a 221 hectare St Andrews beef finishing farm for $3.1 million, and a Mid Canterbury foothills property with access to water from Barrhill Chertsey Irrigation for between $46,500 and $47,500 per hectare. As autumn progresses vendors and purchasers seem content to wait for market indications and will react with caution. However, a 190 hectare Waimate dairy farm, and a 446 hectare arable property, with multiple options, at Wakanui in Mid Canterbury, should both generate strong market interest. Purchasers are willing to pay between $52,000 and $54,500 per hectare for well-located, spray-irrigated Mid Canterbury dairy properties, while run-off farms with irrigation will command between $38,000 and $43,000 per hectare, depending on the nitrate baseline.

Otago and Central Otago

In Otago the positive beef market has kept the rural scene relatively optimistic, although lamb and dairy product prices provide less encouragement. Rural property listings through the summer were moderate, though a number of East and South Otago sheep and beef farms have changed hands recently, which is likely to generate more activity. Further South Otago listings include Cairn Flats Farm, an 852 hectare Kuriwao Gorge sheep and beef property offering scope and relatively drought free farming. A number of other farms in the region have also come to the market lately with carrying capacity ranging from 1500 to 3000 stock units. During the autumn sale period rural property listings in the province look to be relatively short, suggesting those farms that are offered for sale should find willing buyers.

Southland

Southland sales of both sheep and beef and dairy properties were at similar levels to the preceding summer. Five inter-linked farms north east of Winton, comprising 1206 hectares and milking 3600 cows, sold for $47.1 million. With United States involvement, these required Overseas Investment Office approval, which was granted in January. This transaction boosted the region's high value sales, which have otherwise diminished since last year. Sales to neighbours are still progressing. One such, a 1317 hectare breeding block at Dunrobin Valley south of Mossburn sold recently three weeks after being passed in at auction for $3.225 million, making around $850 per stock unit. Meanwhile a 230 hectare Gore district sheep farm sold to neighbours between $22,000 and $23,000 per hectare. While listings of Southland dairy farms are sufficient to meet autumn demand, sheep and beef properties are sought after.

> ReGEN WATER – smart thinking that makes efficient irrigation easy

Ensuring the right amount of water goes on at the right time is the key to efficient irrigation, and has implications for cost, productivity and environmental impact.

ReGen Water is an innovative water management system that, based on soil conditions and weather forecast data, delivers irrigation recommendations via an app, which farmers can access immediately, on and off farm.

Developed to enable farmers to apply enough water to keep pasture in the optimal soil moisture zone, therefore maximising production when rainfall is insufficient, ReGen Water makes it as easy as possible for farmers to take decisions based on their farm's data.

Farmers can access the app via a smart phone, as well as accessing the information via a web login.

PGG Wrightson Water distributes ReGen Water. For more information, contact a PGG Wrightson Water representative on 0800 864 774.

> PGG Wrightson trading well despite tougher conditions

PGG Wrightson Ltd recently announced its second-strongest interim performance for eight years.

For the six-months ended 31 December 2015 the company achieved Operating EBITDA of $30.9 million, down $2.9 million from the record result in the corresponding period last year.

Mark Dewdney, Chief Executive, called it a strong result in challenging trading conditions.

"The positive momentum we've built as a group has been sustained and we have confidence that we've outperformed the market as conditions in the agricultural sector have tightened over the past 12 months.

"Our trading performance through the first half is a testament to the broad base and resilience of our business. We have a clear strategy that we continue to execute well. Clarity of strategy and engaged staff have positioned our business well to trade through the very volatile conditions that currently exist," he said.

Other details from the result included:

- Low dairy prices, and the perceived risk of drought led to more conservative spending from farming customers.
- Retail increased Operating EBITDA by $500,000.
- Horticulture and the performance of the Fruitfed business was particularly strong.
- In the livestock business, domestically, cattle and sheep tallies were higher, though sheep prices were lower. Dairy volumes were also lower.
- In the company's New Zealand seed business, farmer preferences towards higher-performing forage and crop seeds are continuing. Many of the spring-sown forage options, such as brassicas and fodder beet, are increasingly seen as a key part of animal winter plans. Demand for dairy summer feed options, such as chicory, are also growing as farmers look to reduce reliance on imported supplementary feed.

For the full 2016 year PGG Wrightson is forecasting Operating EBITDA in the range of $61 to $67 million.

Note – Operating EBITDA: earnings before net interest and finance costs, income tax, depreciation, amortisation, the results from discontinued operations, fair value adjustments and non-operating items.

Expert panel – key issues for dairy in 2016/17

Three dairy experts give their opinions on key issues facing the sector during the coming season.

Jacqueline Rowarth is Professor of Economics at the Business School of Waikato University.

Susan Kilsby is a senior dairy analyst and researcher for AgriHQ.

*Alison Dewes is a fourth generation dairy farmer, a second generation veterinarian and, via her company Tipu Whenua, is about "**One World, One Health,**" consulting to business, professionals and farmers on sustainable food production systems.*

What do you expect will be the most significant development for the dairy industry in 2016/17?

Jacqueline: Fonterra has some very difficult challenges to meet around its expansion plans and the cost of financing these. Dairy farmers should be wary of how this will impact on them as Fonterra shareholders. Present finance costs within the co-operative appear to be approximately $49,000, on average, per shareholder. The current review of the Dairy Industry Restructuring Act is progressing and could put Fonterra in a more competitive position. The hope is that Fonterra will use any advantage gained to obtain better returns for farmers.

Susan: I expect to see a contraction in New Zealand's dairy industry in terms of stocking rates. The number of dairy cows at the start of the 2016/17 season could be as much as ten per cent less than the previous season. The flow-on effect of this is less demand for off-farm grazing – for wintering dairy cows and young stock. So we expect to see an increase in the number of real estate listings of dairy support blocks. By the later part of the 2016/17 season, we do expect the dairy markets to have rebalanced and prices will then move back to more sustainable levels.

Alison: Farmers are facing their third consecutive year of a sub -$5 payout, which will require a paradigm shift on production systems. Wherever possible our farmers will need to ensure that the cost of production, including the cost of finance, is pegged back below that level. Farmers may look at scaling back to more optimal stocking rates, with fewer, better-fed cows, and less reliance on brought-in feed. Finding efficiencies in the system, producing more from less with reduced wastage, not carrying under-performing cows, will be critically important, though obviously not easy.

What do individual dairy farmers need to focus on this autumn to set themselves up for the next few years?

Jacqueline: In the face of warnings about cost savings, dairy farmers know that they need to protect the value of their assets. That includes the value of their stock, soil, fencing and plant, putting them between the proverbial rock and hard place.

Susan: We expect the milk price will remain below the average cost of production through the 2016/17 season, so farmers need to prepare for this. They need to do the cashflow budgets, and share these with financiers. While the numbers may not look pretty, it is better to know this in advance rather than try to do these numbers in the middle of calving. Farmers should also look for alternative sources of income. There is a shortage of stock on many sheep and beef farms as a result of the previous drought, and also a reduction in the number of dairy grazers. This should be seen as an opportunity. A dairy farmer could approach a sheep and beef farmer and agree on a contract to raise stock for these farmers. Understand what each other's needs are and come to an arrangement that works for both parties, for example you may agree that 50 per cent of the agreed price is paid up front, when the contract is signed, and the remainder is paid when the stock are delivered.

Alison: Resilience and diversification are important. This is likely to be an incredibly stressful time for our farmers. Time spent away from the business can be as valuable as time in the business. Ask yourself where are the opportunities to diversify and reduce risk? Are there alternatives to dairying that can work in part of the farm, such as red meat or specialist crops? Our markets are looking for ethical, safe, green produce. Do you have an opportunity, within the farm gate, to add value? Even tourism could be an answer for some: maybe your farm has high value ecosystems that can be shared with tourists to generate additional income?

What single action should the New Zealand dairy industry as a whole take to protect and enhance its long term sustainability?

Jacqueline: Market on the basis of what only New Zealand can do – grass-fed (mostly); free-range (mostly); third lowest user of antibiotics; no hormones; high minimum wage; 'A' rating for animal welfare, which only three other countries have; best practice for greenhouse gas and Nitrogen loss, amounting to high environmental compliance; no subsidies; no trade barriers.

Susan: New Zealand's dairy industry as a whole needs to get closer to its customers, the end users of dairy products, and understand their needs in terms of both products and services. We need to do this better than our competitors as the global dairy industry will become increasingly competitive in the coming years.

Alison: The structural shift in the milk price has given the dairy industry a hard landing, faster than most thought likely. We can no longer be focused on limitless growth and the industry needs to prove its claims of legitimacy. Important in that is quality assurance, from paddock to plate, tuning in to the real opportunities of what consumers want: guaranteed safe food. Not just safe as a protein source that will enhance our health and our children's health, also ethically safe with regard to climate and water. Working back from the market, how do we communicate the strength we have inside our farm gate back to the consumer? This is tricky, I acknowledge, and it may take clusters of farmers to lead this sort of initiative. Look at Lewis Road Milk.

Aside from what has happened to the payout, what has altered, if anything, in the past 15 months to make the long term outlook for the New Zealand dairy industry more or less positive?

Jacqueline: Greater legislation is creating expensive compliance costs, but the underpinning benefits are not always clear. Debt is associated with these compliance costs and attempts to increase 'business resilience' in the face of climate changes. Federated Farmers estimates that farmers have spent over a billion dollars on environmental compliance. Fencing of rivers for Fonterra farmers alone is a $360 million cost. These are sizeable investments. Fencing certainly assists with keeping animals out of waterways, but questions remain around the value of huge effluent ponds. Of particular concern to farmers is that these regulations change – no regional council is giving assurance that infrastructure to achieve compliance now will still be OK in five years' time. In addition, Fonterra's increased debt means increased interest charges, which come off the co-operative's capacity to make returns to farmers in payouts or dividends.

Susan: The long term outlook for New Zealand's dairy industry remains, and is virtually just as positive as it was 15 months ago. Most of the issues the industry is currently facing are short-term rather than long-term issues. The slowing of global economies, as reflected in the oil price, is a concern for the medium term as this will have some impact on demand for dairy products over the next few years. Assuming the world's economy recovers, then the outlook for New Zealand's dairy industry remains very positive.

Alison: So long as we do the right thing, the future is positive. However, we have some gaps to fill. We have to bring New Zealand's bio-physical and resource strength to the fore. We have paradise here, with a wealth of natural asset: it is time to promote that legitimately and strengthen our story so that we reach the top five per cent of consumers. That is not as easy as it sounds. It means front footing risk and being at the front of dynamically changing consumer perceptions as a priority. The outlook is mixed. Success can be achieved, though it will not come without hard work. The only place success comes before work is in the dictionary.

A closer look...

Sheep and Beef

With beef schedules holding up well, interest in pastoral property remains positive, although those who might otherwise sell are electing to make the most of the current season's strong outlook, which leaves listings short and demand unsatisfied. While wool and lamb prices are less buoyant, dedicated purchasers of drystock farms remain motivated. Subject to financial support, they will buy. Dairy farmers seeking a shift in land use and lifestyle are less evident than previously. One significant Waikato summer sale of a coastal drystock farm exceeded $10,000 per hectare. Meanwhile, a 1500 hectare King Country property should help gauge the market's strength, if it sells as expected during the autumn. With the trajectory of product prices apparently set for the next few months, little is likely to change in the sheep and beef sector through the autumn.

North Island Dairy

Sales activity in the North Island dairy sector was low through the summer. Premium dairy farms in preferred locations, with strong infrastructure and proven productivity, are still attracting positive attention. However, farms that lack those characteristics have generated diminishing interest, particularly since Fonterra's most recent payout forecast downgrade. Those purchasers who are active are generally local buyers who already know the property concerned. Cashflow is becoming an issue for some North Island dairy farmers and some are active pursuing options for diversification. For some farmers, conversations are occurring about possibly listing property for sale. While some of these potential vendors may make a decision over the next few months, they are mainly holding off selling while they wait to see whether banks will come out more definitely and how market sentiment will develop.

South Island Dairy

Aside from the Zeestraten farms at Otapiri north east of Winton, which sold in January after Overseas Investment Office approval, this summer's South Island dairy property activity was generally restricted to local buyers. Reduced Canterbury listings are persuading vendors to hold out for top prices. Premium spray irrigated farms command $52,000 to $54,500 per hectare, while irrigated dairy run-off properties range from $38,000 to $43,000 per hectare on the plains and $25,000 to $30,000 per hectare in the foothills. With very limited numbers of sales transacting in the Southland market, values have tended to be approximately ten per cent back on 2015 levels.

Nitrate leaching will play an increasing role in the marketing and purchase agreements of Canterbury dairy farms, and where a farm's nitrate baseline sits will become ever more closely related to its desirability.

Viticulture

Optimism prevails in the present market for viticulture property. Established growers and corporates are expanding, while new investors are eager to participate. To anyone driving through Marlborough, new plantings and grape infill spreading through the district is evident. This is set to reach yet further south in the near future as new areas are opened up for grapes. Above average rainfall during the height of summer provided a further psychological boost for the sector. Confidence in the industry continues to attract outside investors, and as the autumn progresses, benchmark values for established vineyards should be tested by an active buyer pool. Many vendors are holding off for the post-harvest market. Offshore sentiment indicates continued demand, which should strengthen the viticulture property market even more once the current season's harvest is gathered in.

Horticulture

Kiwifruit property transactions broke new barriers during the summer as a handful of top producing G3 gold orchards achieved $600,000 per canopy hectare for the first time. Meanwhile, green kiwifruit sales of $400,000 per canopy hectare have been recorded. These, however, are rare and only justified when a property's returns exceed the industry average by at least 20 per cent. Values of $380,000 per canopy hectare for green kiwifruit are more realistic. Due to the uncertainty around how far values might rise, most orchards offered for sale change hands through the tender process. Like last season, this year's harvest is shaping as exceptional, further sharpening the desire of investors to participate in the industry. Through the autumn, the market is therefore likely to grow even stronger, particularly for gold orchards with proven productivity.

Cropping

A select number of Mid Canterbury farms in a tight band east of Ashburton, taking in the districts of Wakanui, Pendarves and Chertsey, comprise New Zealand's best cropping country. Good farmers can comfortably raise two crops per annum from this land. While irrigation consents and nitrate baseline readings confirm the multiple options obtainable on these soils, which at present include growing potatoes, seed multiplication, malting barley contracts and rearing bull calves, with dairy-related activity also an easily viable alternative, these properties are only rarely listed for sale. One such property has been offered recently, to an eager market. Recent benchmark sales of these arable properties have been between $47,000 and $49,000 per hectare. With listings forever scarce, all indications are that demand will remain firm at this level through the autumn.

High Country

Enquiry for high country property is sporadic. However, if the right opportunity presents, a handful of potential purchasers will be motivated. Most of these parties are New Zealanders, and their interest is mainly in the economic farming dimension of a high country holding, rather than from an aesthetic perspective. Current returns for beef increase the credibility of the business case for such properties. A small selection of high country stations, in Canterbury and Central Otago, have been on the market for some time. In most instances these are progressing slowly towards sales, though this can be a complex process that will generally take longer for high country stations than for more orthodox rural properties.