



Management Services

Innovative Agribusiness Solutions

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Pigmeat Safeguards Inquiry, Productivity Commission

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SUBMISSION TO THE PRODUCTIVITY COMMISSION

EXECUTIVE SUMMARY

This submission by **John Riley** of IAS Management Services draws on the financial results of 10 family pork businesses, referred to in this submission as the FOCUS GROUP, to justify the commission advising government that safe guards must be introduced to allow the Australian pig industry to restructure. The imports of pig meat into Australia are at a record level of 109,000 tonnes per annum. The major suppliers are Canada, Denmark and the USA where in each instance the industry receives significant government support. The FOCUS GROUP of 10 family businesses averaging 470 sows per business and marketing 92 819 pigs, lost a total of \$1,112K in the financial year 2006-2007. In response, the members of the FOCUS GROUP have, to date, reduced sow numbers by 31%, made 46% of their employees redundant, terminated contract arrangements with 55% of their contract growers and nine of the businesses have increased their level of borrowing. As a result the members have increased their liabilities, reduced their assets and significantly reduced the percentage of owner equity in their businesses.

COMPANY BACKGROUND

IAS Management Services is a group of consultants providing veterinary and business advice to the pig industry nationally and internationally. IAS Management Services influence the production of about 48% of the Australian National herd. IAS Management Services provides consultancy and training programmes to pork producers, allied industries, government departments and industry bodies in mainly Queensland, NSW, Victoria and South Australia. The group is also currently providing support on projects in PNG and Fiji.

The seven directors of IAS Management Services have many years experience in the pig industry in Australia and internationally. The directors include four veterinarians, a former regional manager for a multi-national pharmaceutical company, and a former Chief Livestock Adviser in the UK's Ministry of Agriculture, Fisheries and Food. In addition two directors are partners in pork production units.

PURPOSE OF SUBMISSION

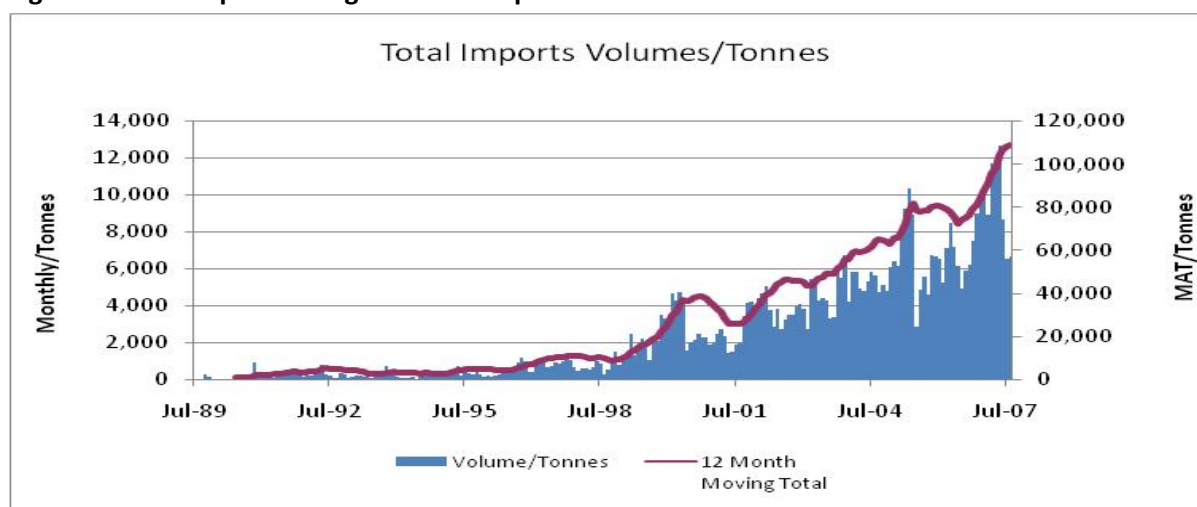
IAS Management Services wish to provide evidence to the Commission to substantiate the view that the imports of pig meat are injuring the Australian pork production industry. IAS Management Services strongly believes that safeguard mechanisms should be applied immediately to stabilise the industry.

PART 1 - INDUSTRY BACK GROUND

1.1 Imported Pig Meat

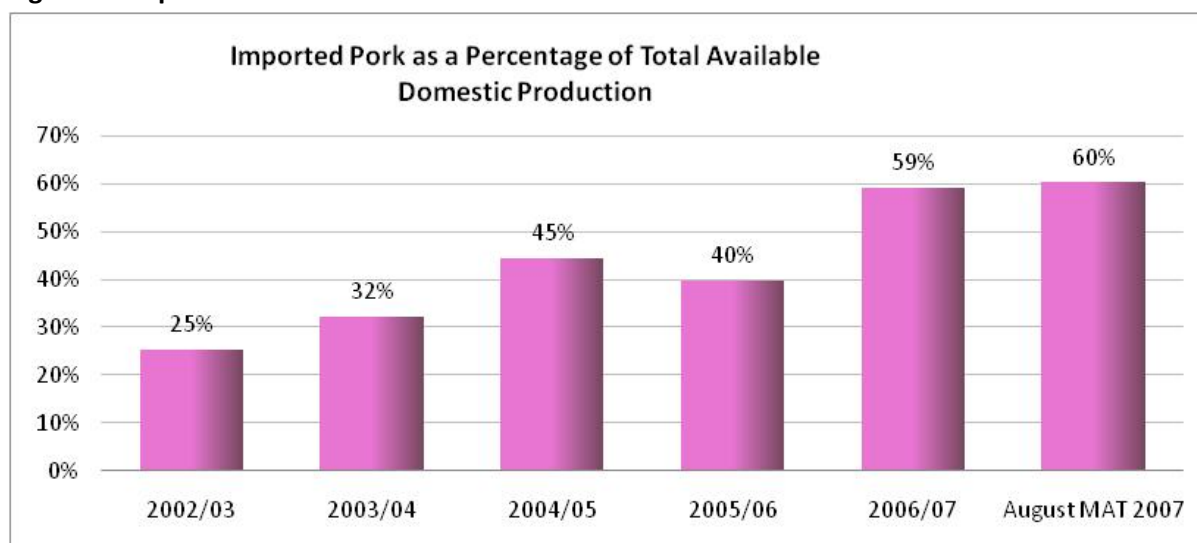
The level of imported pig meat has increased rapidly since 1990. Since 1999 the level of imports has increased from around 10,000 tonnes shipped weight to 109,000 tonnes of shipped weight in the year ending August 2007 (Fig 1).

Figure 1. Total imports of Pig Meat in the period 1989-2007



In the year ending August 2007 imported pork represented 60% of available domestic production (Fig 2).

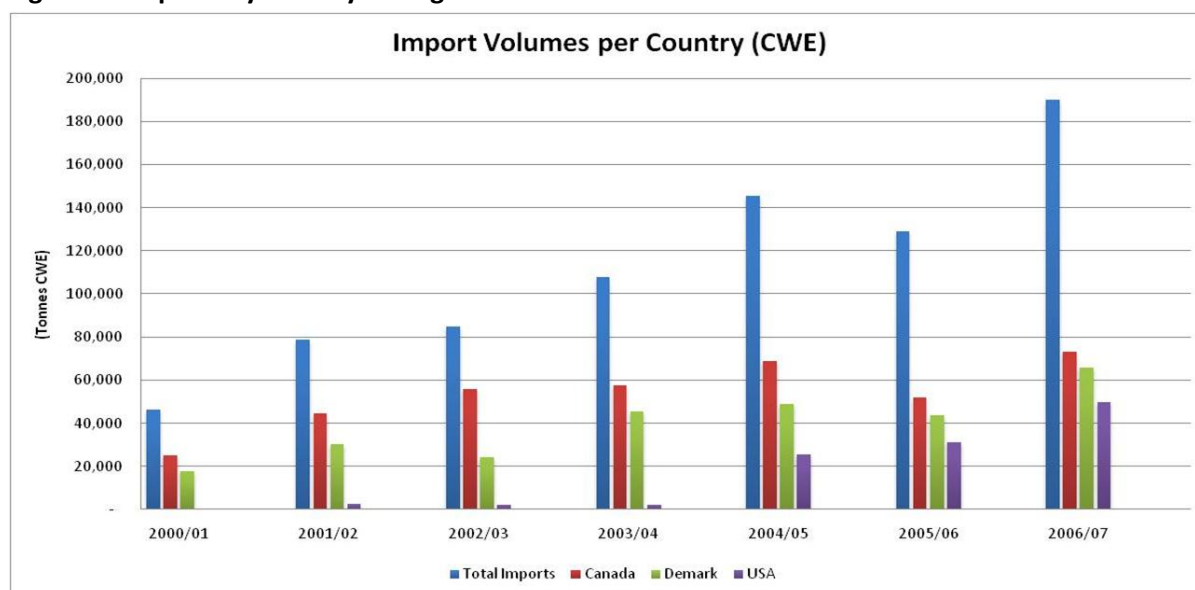
Figure 2. Imported Pork 2002-2007



1.2 Source of Imports

The three major sources of imports are Canada, Denmark and the USA. The industries in the three countries referred to receive significant direct and indirect government support that is used to their advantage and to the disadvantage of Australian producers. Figure 3 illustrates the volumes of imports expressed in tonnes of carcase weight equivalents from the three major suppliers to the Australian market.

Figure 3. Imports by country of origin 2001-2007

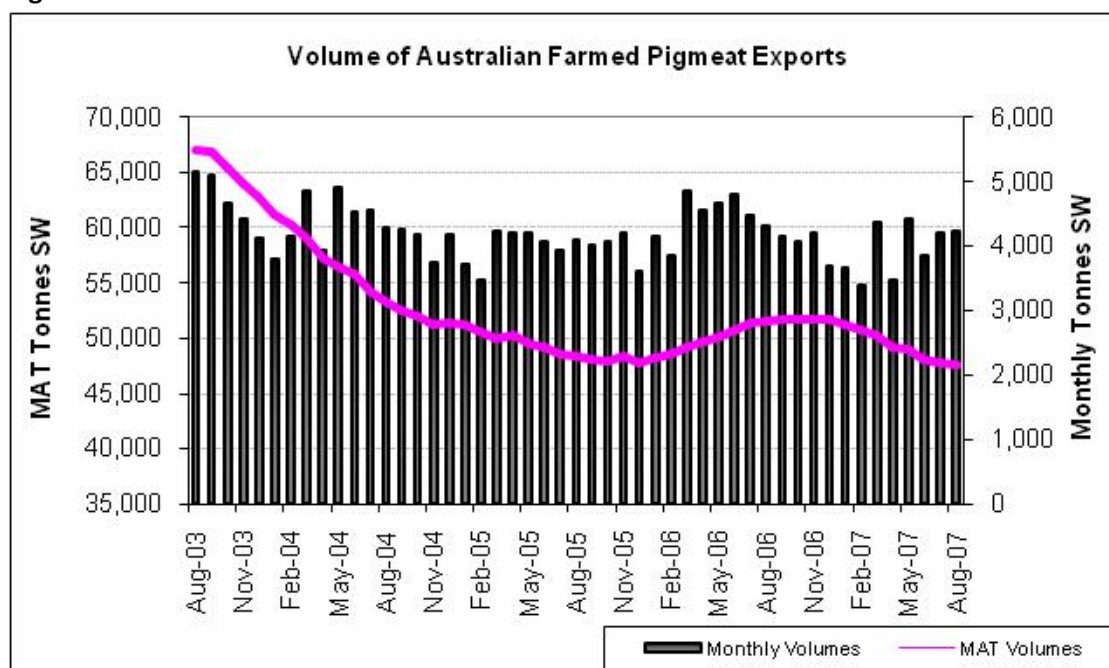


The support received by the industries in USA, Canada and Denmark was summarised recently in the document, "Competitiveness of the Australian Pig Industry" by Warwick Yates and Associated (February 2005) "Appendix G "Subsidisation and Market Distortions in Key Competitor Markets to which I refer you. In November 2007 support included US\$77 million over four years to Canadian producers to control disease and in Denmark Private Storage Aids and Export Refunds to support pig meat price..

1.3 Exports

The increase in imports coincides with a decrease in the level of exports from Australia in particular exports to Singapore and Japan. The oversupply of product has resulted in a reduced demand and lower prices for domestic pig meat. It should be noted that a number of producers and processors expanded their businesses, with state government encouragement to meet the export opportunities. One example was the Queensland Governments "Pig Industry Development Strategy published in 2001.

Figure 4

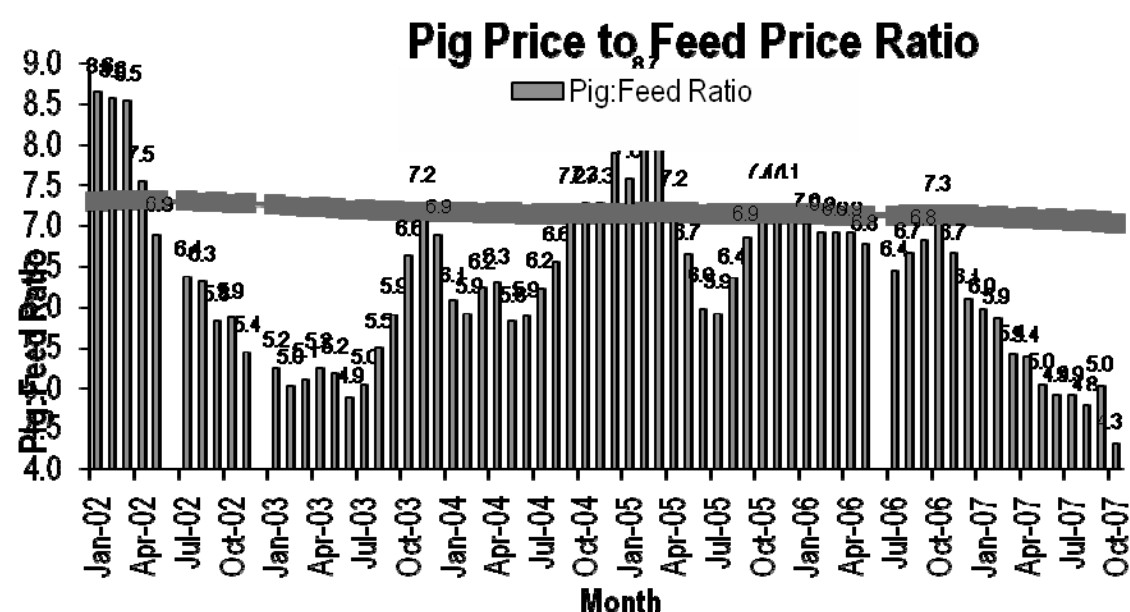


1.4 Pig Meat: Feed Price Ratio

The general health of the production industry can be assessed by reference to the Pig Meat: Feed Price indicator published by the Queensland DPI &F (fig 5).

The Pig Meat: Feed Price ratio indicates the number of kilograms of feed that can be purchased by the sale of one kilogram of pig meat. The graph shows the ratio in October 2007 to be 4.3:1, the lowest in the last 20 years. The graph also illustrates the volatility of the industry.

Figure 5. Pigmeat: Feed Price ratio 2002-2007



1.5 Benchmarking the Australian industry against major competitors

Benchmarking the Australian industry with other pig producing countries is fraught with difficulties. The management systems, marketing weights, nutritional strategies, labour skills and buildings vary considerably from country to country.

In 2004 the Danish Pig Industry commissioned a report (No 29 2006) on the performance of pigs in a number of countries including Canada and the USA. Table 1 summarises key performance indicators published in that report compared with Australia. The figures for the growing herd are corrected to the growing period from 30 to 100 kg live weight. The Australian results for the grower herd are extrapolated from the APL Australian Pig Annual 2005 book and the analysis of records of a large scale producer recording performance on a number of contract grow out units. The source of the Australian breeding herd data is the APL Australian Pig Annual 2005.

Table 1. Performance of the Australian growing herd compared to the major pig producing countries.

Grower herd	Australia	Denmark*	Canada*	USA*
Feed Conversion efficiency (kg feed/ kg wt gain)	2.65**	2.69	2.96	3.18
Growth rate	820**	835	826	700
Breeding herd				
Litters per sow per year	2.27	2.25	2.2	2.2
Pigs born alive per litter	10.32	12.7	10.8	10.34
Pigs weaned per sow per annum	21.05	24.7	21.4	19.9
Pigs sold per sow per year	20.3	23.7	20.9	19.1

• Extracted from Danish Pig Production Report No 29 20006 Jacob Rasmussen

** Source:- John Riley, IAS Management Services (Unpublished)

The data presented in Table 1 shows that the performance of the growing pig in Australia is comparable with the world's major industries when assessed over a standard weight range. .

The performance of the breeding herd compares with that in Canada and the United States. It is recognised that the reproductive performance of the Australian sow might be increased by improvements in heterosis resulting importation of new genes. However, the bio-security risk associated with importing genes is also recognised. Australia is free of a number of diseases which have a devastating effect on the economy in Canada, Denmark and USA.

PART 2: IAS INDUSTRY SAMPLE

IAS Business Monitor

IAS Management Services provide a number of business control programmes to their clients including a full financial analysis programme "Business Monitor". The financial performance of ten herds totalling 4700 breeding sows and their progeny for the period July 1st 2006-June 30th 2007 is summarised in Table 2.

The data represents the performance of a group of well established family farms specialising in pork production in South East Queensland and Northern NSW. The group hereafter referred to as the Focus Group range in size from 65 to 1200 sows. The businesses produce bacon pigs for slaughter at around 105 kilograms live weight. Five of the herds purchase prepared diets from reputable stock feed manufactures and the remainder mix feed on farm from purchased grains, proteins and micro-nutrients. Four of the businesses have arrangements with contract growers to feed the growing pigs for part of the growing period prior to slaughter. In addition to employing family members eight of the businesses in the group employ staff as skilled animal attendants.

2.1 Summary of Financial Performance

Table 2. Average performance of FOCUS GROUP June 2006-July 2007

Key Performance Indicator (KPI)	
Average return (\$/ kg dressed carcass weight)	\$2.51
Cost of production (\$/kg dressed carcass weight)	\$2.66
Feed cost (\$/kg dressed carcass weight)	\$1.48
Non Feed Cost (\$/kg dressed carcass weight)	\$1.17
Average dressed carcass weight (kg)	79.21
Average herd dead weight Feed conversion (kilograms of feed used per kilogram dressed carcass weight)	3.97:1
Average feed cost (\$/tonne)	\$374.23
Pig meat feed price ratio (kilograms of feed that can be purchased by the sale of one kilogram of dressed carcass)	6.7:1
Average operating margin per slaughter pig (\$)	-\$12.08

2.2 Benchmarking FOCUS GROUP in the Queensland industry

The key performance indicators of feed cost, market returns and pig meat: feed price ratio indicate that the Focus Group herds are achieving above average performance, when their performance is benchmarked against Queensland DPI & F published data (table 3).

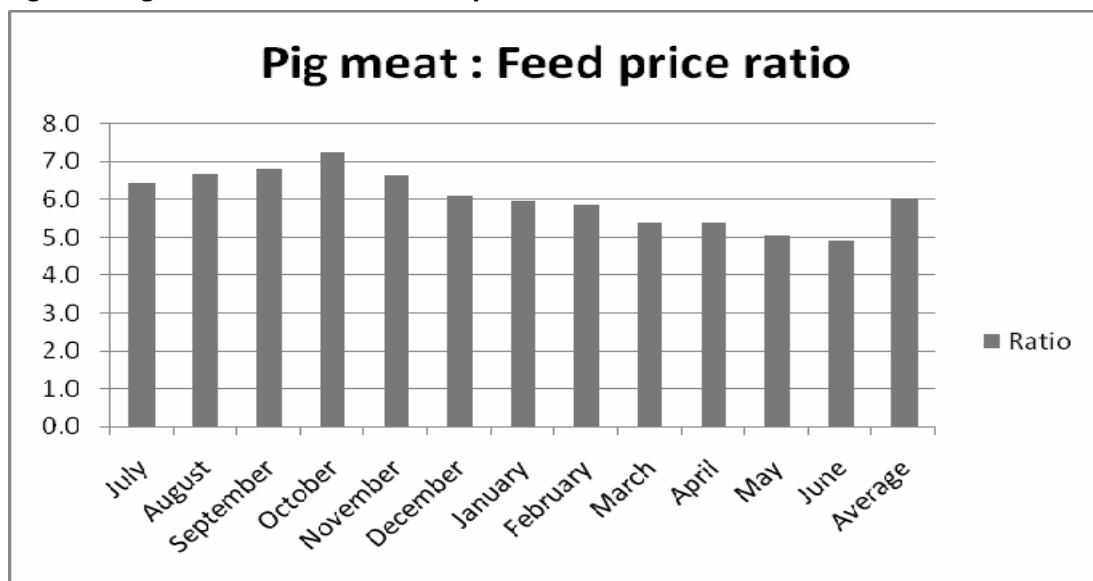
Table 3. FOCUS Group compared with Queensland DPI& F data.

KPI	FOCUS GROUP	Queensland DPI & F
Average Feed Cost (\$/tonne)	\$374.23	\$382
Average Market Returns (\$/kg dressed carcass)	\$2.51	\$2.28
Pig Meat : Feed Price Ratio	6.7:1	6.0:1

2.3 Benchmarking Pig Meat: Feed Price Ratio

The average Pig Meat: Feed price ratio for herds in the FOCUS GROUP in the financial year July 2006-June 2007 was 6.7:1 compared to the Queensland industry average for the same period of 6.0:1 quoted by the Queensland DPI&F. The higher ratio achieved by the FOCUS Group reflects their competitive advantage in both the sale of their product and their purchasing of feed and/or feed ingredients compared with the rest of the Queensland industry.

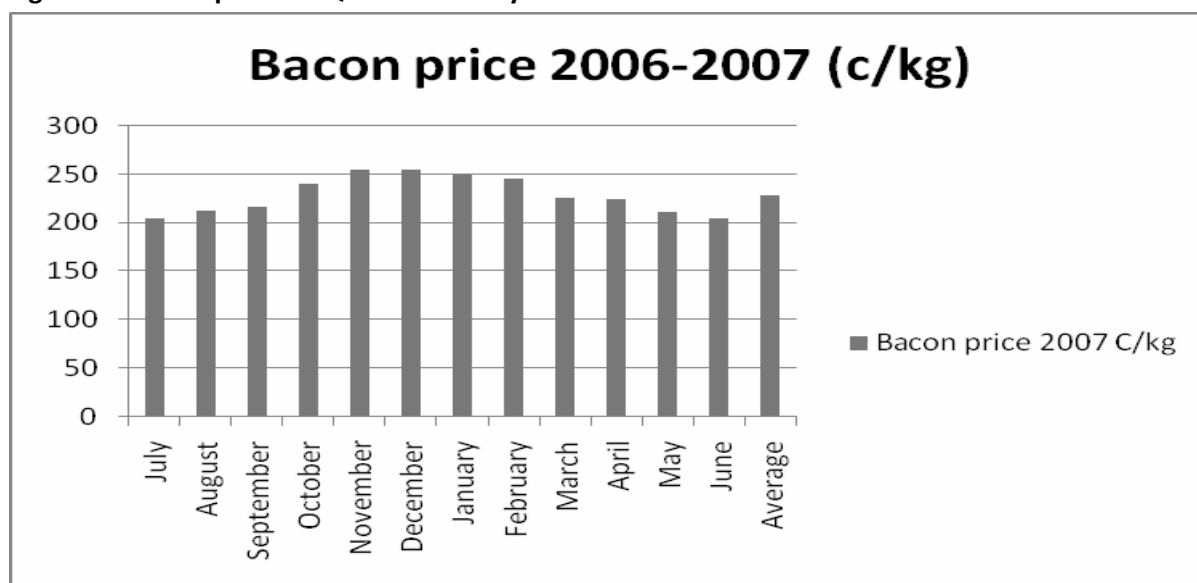
Figure 5. Pig Meat: Feed Price ratio July 2006-June 2007



2.4 Benchmarking Market Returns

The average market returns realised by the FOCUS Group for every kilogram of pig meat sold in the period July 1st 2006 to June 30th 2007 was \$2.51 per kilogram. The high price compared with the Queensland industry average quoted of \$2.28 in Table 3 (source Queensland DPI&F) is an indication of the effort made by the FOCUS Group members to market their product effectively. For example some of the sample herds sell part of their production directly to butchers and the majority of businesses signed long term contracts with processors at the start of the financial year.

Figure 6. Bacon prices in Queensland July 2006-June 2007

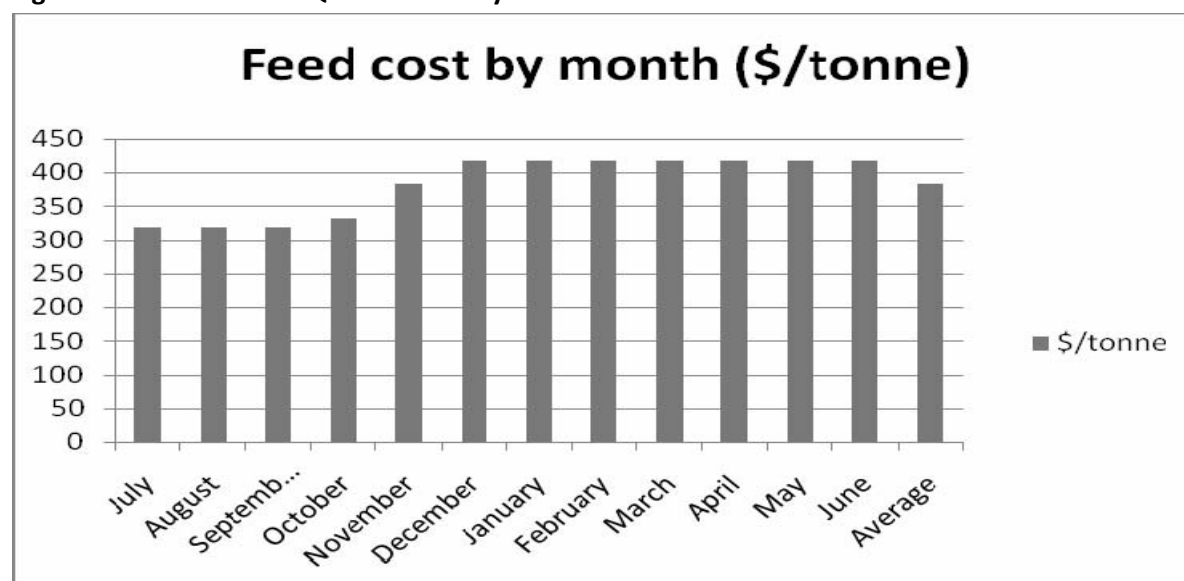


2.5 Benchmarking Feed Cost

The FOCUS Group includes five businesses which purchased their feed requirements as complete diets, whilst five businesses mixed their diets on farm from a combination of purchased and home grown ingredients. The home grown ingredients included wheat, barley and sorghum. Where home grown grains are used their inclusion in diets is charged at the current market value. The average feed cost incurred by the FOCUS Group in the 2006-2007 financial year, was \$374.23 per tonne.

Figure 7 illustrates the average monthly feed cost recorded by the Queensland DPI&F for the same financial year.

Figure 7. Feed costs in Queensland July 2006-June 2007



2.6 Non Feed Costs

Normally the non-feed costs are defined as all costs incurred by the business except purchased feed or feed ingredients. In the case of the figures submitted for the FOCUS Group (Table 2) the non-feed costs do not include interest on borrowing, depreciation or a figure for the required return on investment.

Where feed ingredients are grown, they are transferred to the pork enterprise at their market value at time of inclusion into a diet.

In the FOCUS Group the non-feed costs are added to the feed costs to arrive at the cost of production (excluding interest, depreciation and return on investment) of a kilogram of pig meat. In the FOCUS Group non-feed costs incurred averaged \$1.18 per kilogram of pig meat sold. Non-feed costs are contained by maximising the total weight of pig meat produced per sow and or per area of housing. The higher the slaughter weight per pig the lower the non-feed costs. The herds included in the FOCUS Group have incurred increasing non-feed costs due to the drop in exports, particularly to Japan and Singapore, and the demand from the wholesalers and retailers for smaller carcasses to meet the domestic market for fresh pork. The change in market demand has been accelerated by the increase in imports, which are used in processed products.

2.7 Profit Margin of the Focus Group

Whilst the Focus Group is achieving above average performance for the KPI's listed in Table 3 the Group experiences an average loss of **\$12.08 per pig** sold. The loss experienced by the focus group in the period July 2006 to June 2007 totals **\$1,112,681**.

The author submits that the level of imports has

- Undermined the FOCUS Group's ability to absorb the increased costs of production incurred due to drought and the strength of the Australian dollar
- Undermined the FOCUS Group's confidence to invest in new technology and improve it's international competitiveness.
- Undermined the FOCUS Groups ability to expand and to exploit the increased demand for pig meat and pig meat products.
- Capped the wholesale price of pig meat thereby reducing the income of the FOCUS Group.

2.8 Performance Period July 2007 – September 2007

The financial performance of a sub sample eight herds in the FOCUS Group for the period July –September 2007 is summarised in Table 4.

Table 4. Average performance of FOCUS GROUP July 2007-September 2007

Key Performance Indicator (KPI)	
Average return (\$/ kg dressed carcass weight)	\$2.27
Cost of production (\$/kg dressed carcass weight)	\$2.24
Feed cost (\$/kg dressed carcass weight)	\$1.40
Non Feed Cost (\$/kg dressed carcass weight)	\$0.84
Average dressed carcass weight (kg)	87.06
Average herd dead weight Feed conversion (kilograms of feed used per kilogram dressed carcass weight)	3.4:1
Average feed cost (\$/tonne)	\$413.04
Pig meat feed price ratio (kilograms of feed that can be purchased by the sale of one kilogram of dressed carcass)	5.5:1
Average operating margin per slaughter pig (\$)	\$2.63

At first glance the results for the quarter from July 2007 to September 2007 might suggest that the FOCUS Group is now in a positive financial position. In fact the positive operating margin of \$2.63 per pig is due to:

- The culling of healthy productive sows,
- The reduction in the number of employees
- The termination of alliances with contract growers.
- Reduction in the investment in genetic improvement
- A reduction in non-feed costs

2.8.1 Reduce sow numbers

The businesses in the FOCUS group have reduced sow numbers by a total of 31% to date. The reduction in sow numbers will reduce feed usage in the short term and enable the businesses to operate within financial constraints imposed by their finance sources. However, in the long term the viability of the business is put at risk. The increase in average slaughter price plus the decrease in average pig meat price in the quarter compared with the previous financial year confirms that the perceived improvement in performance as measured by Herd Feed Conversion Ratio is due in fact to an increase in the number of sows slaughtered.

The reduction in herd size within the FOCUS Group is mirrored by the increase in the number of sows slaughtered in Queensland and nationally.

2.8.2 Reduce staff numbers

The reduction in sow numbers and the pressure on financial resources has resulted in a reduction in the number of employed skilled piggery attendants on the participating units. Whilst all herds in the sample are family businesses they did employ in mid 2007 a total of 36 non family members of staff. Since that time the number of non family staff has been reduced by 46%. With limited opportunity for employment locally their skills will almost certainly be lost to the rural economy.

2.8.3 Contract growers

Contract growers are the forgotten section of the Australian industry. They have very limited political voice, but many have invested substantially in pig housing and other facilities. The contract grower rears pigs from about 3 to 12 weeks to slaughter and are paid a fee for their facilities, labour and services such as power and electricity. The contractee provides the pigs, the pig feed and veterinary inputs.

The businesses in the FOCUS Group engaged a total of eleven contract growers. The average fee paid by the contractees in 2006-2007 was \$1 per pig per week. Due to financial pressure the standard fee has been reduced to 80 cents per pig per week and in addition contracting agreements have been terminated with six contractors as a result of the contractees reducing sow numbers.

The contract growers in an alliance with businesses in the sample are also therefore under extreme financial pressure due to imports and many will be forced to realise assets to avoid foreclosure.

2.8.4 Investment in genetics

In an attempt to reduce non feed costs three of the herds in the sample have stopped purchasing breeding stock thereby compromising the genetic merit of their herds and in the longer term herd performance and profitability should they stay in the industry. A 0.1 movement in FCR equates to an increase of \$272k for the FOCUS Group based on 2006-2007 feed prices.

2.8.5 Non Feed Costs

The positive margin of \$2.63 per pig sold in the quarter July-September is due to a significant decrease in non-feed costs and not an improvement in market conditions. By culling sows, reducing staff numbers and reducing payment to contractors, non-feed costs have fallen to \$0.83 per kilogram of pig meat sold compared with \$1.17 for the previous financial year.

2.9 Owner Equity

The level of owner equity in each of the businesses in the FOCUS Group has fallen significantly in the last 15-18 months. As indicated the number of stock on hand has fallen and due to the level of imports the value of pig units has fallen.

To survive, of the ten businesses in the FOCUS Group nine have had to re negotiate their loan arrangements and in five instances have had to apply to the Queensland Rural Adjustment Authority (QRAA) for carry over finance, because their banks were unable to support them beyond their current levels of debt.

In brief, liabilities have increased and assets have fallen significantly.

3.0 IMPACT ON THE SERVICING INDUSTRY

The demise of the production sector will impact on a number of servicing industries including slaughter houses, hauliers, feed manufacturers and companies such as IAS Management Services.

3.1 IAS Management Services

IAS is a company with an income from activities in the pork production industry of around \$3 million. IAS has been forced to re-assess its business activities. To date one full time representative and one part time office assistant have been made redundant and plans are in place to down size our office facilities.

3.2 DHA Rural Supplies

DHA Rural Supplies is a principal supplier of animal health products, housing and raw materials for diets to producers who 'home mix' their feed requirements versus those who purchase finished feed.

Over the past 39 months the company has experienced a 22% decline in its pig producer customer base as farmers have exited the industry due to the absence of any economic benefit / profit margin from their pig enterprises. As a direct result of this change DHA Rural Sales has had to reduce its staff numbers by 20%.

3.3 Better Blend Stock Feeds

Better Blend Stockfeeds are one of the major stock feed manufacturers on the Darling Downs. In the last twelve months they have lost 59% of the bagged feed clients and experienced a 10% reduction in the volume of bagged feed sales. During the same period they lost 47% of the bulk feed clients and sales of bulk feeds have fallen by 17%. The staff levels in the retail outlet have been reduced by 16% with further cut backs predicted.

4.0 CONCLUSION

The purpose of this submission is to illustrate the plight of the pork industry using the results of the FOCUS GROUP. It is critical that the commission recommends a temporary tariff to allow a restructure of the Australian pork industry to be formulated which minimizes the impacts on all sectors.

Biographical Notes

The author is a director of and a partner in IAS Management Services whose head office is in Kingaroy. IAS Management Services is a group of consultants with expertise in veterinary science, business management, livestock husbandry and quality assurance. IAS Management Services own Techvet Animal Health, which supplies veterinary products to the livestock industry and are part owner of the Toowoomba based company Farmgate logistics.

Prior to settling in Australia in 1992, the author of the submission was employed in the U.K Government extension service and rose to the position of Chief Livestock Adviser. He sat on and contributed to a number of policy making committees in both the U.K and in the E.U. He has experience in the pig industry in USA, Canada, South Africa as well as Europe. He is a regular contributor to the industry press both nationally and internationally and he has a number of referred papers published. In Australia, he has been employed by primary producers, commercial companies, Government Departments and Industry bodies. He is a director of Pork Queensland and retired in September 2007 as a delegate to APL.

John Riley NDA; CDFM; MIMC