WINDRIDGE FARMS

Submission to Productivity Commission

Windridge Farms Background

Windridge Farms is owned by three local families. Windridge has 4,400 sows breeding and finishing for domestic and export markets (70 to 115kg carcase weights). We produce 140 tonnes of pigmeat each week.

Windridge also runs 1500 cattle and 7000 sheep and grows about 850 hectares of crop each year. We have our own feedmill, which processes approximately 30,000 tonnes of feed annually.

Windridge has 67 permanent employees, with an annual wage bill of $2.5 million. We are one of the top 3 private employers in the Young District.

Windridge's history is outlined by the following timeline.

1984	1986	1990	1991	1992	1994	1996	1997	2000	2001
Purchase Windridge	Purchase Golden Grove	Purchase Wonga	Purchase Koorani & Blantyre	Build New Feedmill	Build Templemore	Destock Wonga Change to PIC Genetics	Purchase/Lease 2 Victorian pig units	Purchase DHG	Build Koorani Close Vic Units Purchase Belowra Lease Torikina
200 sows	*500 sows*	*1900 sows 560 ha*	*620 &180 ha*	*Reduce costs*	*1000 sows*	*Improve health & performance*	*5000 growers offsite*	*890ha*	*10,000 growers Export weights 363 ha & 253ha*

2002	2003-4	Planned 2003-5 -now on hold
Build DHG I	Upgrade Feedmill Reids - contract growers	Finish DHG & GG Renovations Wonga
5,400 growers Export weights	*Increase capacity mill 2000 growers at Reids*	*add 1,000 sows 10,000 growers*

Notes:
- Little Windridge, Golden Grove, Wonga, Templemore, Koorani and DHG are piggeries. Koorani and DHG are grower only units. From 2005 Golden Grove will be a breeder only unit. The others are farrow to finish units.
- Wonga, Koorani, Blantyre, DHG, Belowra and Torikina are used for grazing and cropping.
- Blantyre and Belowra purchased partly for better utilisation of the fertiliser from Golden Grove - improved environmental performance.
- Destocking Wonga meant removing the entire pig population, cleaning the entire site thoroughly and repopulating. The herd now has equal to the highest health status of any pig herd in Australia.
- The Koorani, DHG and Reids expand the business and are also the first stages of a move to "Separate Site Production" to allow better management of health and productivity. Also involves new technologies to lower feed costs and improve environmental performance.
- Reids are our first contract grower. Allowing expansion of business whilst leveraging capital, and separate site production.

Improved productivity and reduced costs have constantly been sought through capital improvements, use of the best available technology and management practices, and achieving economies of scale. Not only each piggery built but every new shed that has been built has been different to the last as a result of incorporating new ideas. Industry technology is constantly changing. Some of the latest developments we are currently implementing or considering are automated weighing/drafting systems, automated flushing of sheds, acidification of young pig diets – as an alternative to antibiotics, and alternative sow housing.

Increasing the skill and motivation of staff has also been a focus. A productivity bonus was introduced in 1996. In 1998 Windridge began a traineeship scheme, training new staff internally to reach national competency standards. We currently have 15 staff on traineeships. In 2000 we implemented the next level of training, for those who successfully completed the traineeship using APL developed package Prohand. In the last 12 months Windridge assisted a smaller local piggery to implement a similar system with Windridge as the registered trainer. A new competency based training system linked to promotion for supervisory staff is currently being investigated.

As is clear from this brief history Windridge is a dynamic progressive business. Much of Windridge's growth has been funded with profit surplus. We have a strong relationship with our bank and with the buyer of our pigmeat – BE Campbell.

Strategic Plans

Windridge is currently part way through a strategic plan to expand and renovate. The aim of the plan is to consolidate Windridge's position as a low cost producer of large volumes of consistent high quality pigmeat. This position is critical to maintaining our attractiveness to the other members of the supply chain and our profitability.

The strategic plan involves:

- Renovation of existing facilities to maximise the use of existing equipment whilst also upgrading. These sites are currently farrow to finish and will be converted to breeder only sites.
- Building new facilities for grower pigs using new cheaper technologies to build housing.
- Separate site production allowing better management of health and reducing the potential impact of a disease outbreak.
- Batch production (rather than continuous flow) improving productivity.
- All sites will use new feed technologies to allow more efficient feeding and use of more diverse ingredients thus lowering cost of feed.
- By moving the bulk of the pigs to new grower sites better environmental management will be able to be achieved.
- Purchase of neighbouring land to increase security of existing sites without enough land.

The total cost of implementing the remainder of this plan, excluding working capital, is approximately $20 million. It is hoped some of this cost might be borne by contract growers, either with existing piggeries or broadacre farmers wishing to diversify. The end result will be a larger and more efficient operation with a 15c/kg lower cost of production.

The widespread drought and government imposed monopoly of the wheat industry caused a 100% increase in grain costs in 2002-3. This was followed by low pig prices, and now the uncertainty brought about by the changes to quarantine. The result is that our strategic plan is on hold indefinitely.

In addition we feel it has become necessary for us to increase our "emergency reserves" or liquidity in case of downturns. Building additional reserves further slows our progress.

Not being able to progress our strategic plan means we are not able to utilise some capital already expended, we cannot reduce our cost of production further and have been left vulnerable due to our inability to complete this development.

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Note on capital value: The value of Windridge Farms' business is highly dependent on the viability of the pig industry in Australia. All of the buildings that Windridge Farms owns have been specifically designed to house pigs and are not suitable for housing other animals or for any other use. Thus when the pig industry is not viable, the buildings are worth nothing and the value of the business is reduced to the value of the land we own. The land value is approximately half the building value, thus two thirds of the value of our assets will be wiped out if the industry is not viable.

Competitive Advantages
Windridge has some key competitive advantages that have allowed us to remain in business to date despite some difficult periods for the industry. These are as follows:

1. High carcase weight
Our carcase weight is approximately 10kg over national average. This reduces our cost of production per kg by an estimated 15c/kg. Achieving this higher carcase weight has involved significant capital expenditure – approximately $3 million invested in new housing for pigs and another $1 million in additional working capital. Additional land was also needed with a value of $2.5 million.

However, our carcase weight is still much lower than our international competitors. We cannot increase our weight further without changes to market specifications from domestic retailers (or a drop in the AUD so we can export a larger proportion of our weekly kill viably). We strongly support APL's restructure plan as it will help overcome this hurdle which our supply chain has not been able to overcome on our own.

2. Low feed costs - byproducts
We use byproducts from food processing in our feed reducing our costs. Our "normal" feed includes wheat, lupins, triticale, peas, oats, canola meal (byproduct of processing for canola oil), millmix (byproduct of flour processing), sunflower meal (byproduct), soya bean meal, and a variety of other products depending on prices and availability. The above products are commonly used by intensive livestock businesses. Diets for pigs are formulated by combining different products to achieve the nutritional requirements at the lowest overall cost. A well-established market for these byproducts is a significant advantage to the original farmers who produced them as it helps maintain higher returns for their crops.

We also use some less common byproducts. For example, wet, liquid or dry human food products in retail packaging, which are unsaleable for humans for various reasons, such as use by date. We have built special purpose machines to remove retail packaging and hired extra labour. A computer controlled liquid feed system is used to mix the feed and deliver it to the pigs. We recycle almost all of the packaging we are receiving (after installing more special purpose equipment).

This enterprise allows us to beneficially reuse products, and recycle packaging that would have all gone to landfill and sewerage otherwise. In one of these projects 2,500 tonnes of product each year is diverted from Sydney landfill and beneficially reused. In another 8,600 tonnes of product is diverted from use as an inappropriate fertiliser and landfill in regional NSW. This is a cost saving to us and to the suppliers but also a significant benefit to society.

3. Low feed costs – own feedmill

We have our own feedmill, which we have spent $1.1million upgrading in the last 12 months. This will provide improvements in feed quality, efficiency and capacity but was also necessitated by old equipment wearing out. Due to low cashflow this project had to be financed by additional debt. These sort of capital costs are necessary to compete (we hope it will lower our cost of production by 3c/kg) but also need to be able to be recouped eventually for the business to stay afloat.

Feed is by far our greatest input cost. We use approximately 4 kg of feed to create every kg of meat. Any improvements in feed efficiency and costs will have a significant impact on our ability to compete. We are confident that there are gains to be made in this area. More focussed research and development as proposed for the Pork CRC is the first step.

4. High health status

This means we do not have many of the diseases, which are common in pigs in Australia, or those common in the rest of the world. Particular common Australian diseases that Windridge Farms' pig herd does not have include mycoplasma hyopneumoniae, serpulina hyodysenteriae, serpulina pilisicoli, mange and most strains of actinobacillus pleuropneumonia. Windridge Farms' health status is very important as it minimises our production cost, minimises the use of antibiotics and allows us to market our pork as "clean and green".

We have invested a significant amount of money in developing the high herd health status. 3 of our piggeries have been fully destocked and restocked in the last 10 years. We run a special quarantine site to allow introduction of breeding stock without jeopardising our health status. We have many other practices, which we implement at some cost to protect our health status.

APL's plan to eradicate some of these diseases will further help us as it will reduce the likelihood of the diseases re-entering our herds.

5. Strong supply chain relationship

All Windridge's pigs are killed at the Burrangong Abattoir for BE Campbell. The pork is then sold domestically to Chinese restaurants and butchers, wholesalers, supermarkets, processors, and exported to Japan and other countries.

Windridge has a long-term contract for the supply of pigs to BE Campbell. This has been beneficial for both parties in reducing extreme price fluctuations and maintaining consistency. Both businesses try to work closely together to maximise value in the supply chain. However, at this stage changes are required from other members of the supply chain to allow additional improvements to be made. The particular changes we desire are 1. higher carcase weights – changed specifications from retailers are needed; 2. improved measurement of meat yield and quality with corresponding feedback so that we can improve yield and quality. Unfortunately the latter investment is required largely from Abattoirs who probably have least incentive to make this investment. Particularly in situations like ours where the abattoir largely performs a service kill. As a result additional outside impetus is needed to effect this change.

A long term contract makes the best of a bad situation, in that producers are forced sellers (not able to choose the time of sale) and price takers for both output and input costs. A pig price contract provides some certainty in a situation where the producer bears a large risk. Unfortunately we have found it has not been possible to obtain similar contracts from grain producers. Grain growers will sign contracts a few months before harvest but not more than 6 months prior. This stems from their significant production risk – unpredictable weather determining if they will have any product to sell at all.

Australia's advantages
- High health status
- Clean green image
- Geograhpical location
- Relatively low population density.

Australian pig industry and Windridge's disadvantages
- Other countries (and our own) government assistance to other countries industries.
- Destabilised local market due to imports. Several factors are important including, subsidies in other countries, which also change from time to time and supply changes in other countries – the changes from one year to the next are often larger than Australia's entire annual pig production. Imports may only be of one part of pig but as the pig is an unchangeable unit (at this stage we can't add or subtract a leg as one processor suggested to us once), returns for the processor from the whole pig is impacted and hence price of the whole carcase to the producer is effected.
- Apparent ability of countries importing to Australia to absorb exchange rate and other price changes. Particularly in comparison to an Australian pig producer who has very little control over input prices.
- Increased uncertainty caused by changes to quarantine, impacting both
  - price through increased import levels, potential price wars between importers and
  - costs through 95% chance of devastating disease (PMWS) introduction in next ten years.
- Corruption of markets in countries we export too, eg gate price system in Japan.
- Recent adverse movement of exchange rate.
- High cost business operating environment – particularly high levels of regulation of our key input costs, feed and labour.

International Competition
It is difficult to find accurate figures, measuring like with like, to allow sound international comparisons. However, the figures we have reinforce the impression gained in our visits to pig producers in other countries: <u>with a level playing field</u> we should be able to compete to farm gate level with the bulk of producers in the countries importing to Australia. Productivity in North American piggeries we have visited is very low by comparison to ours. On the other hand in European piggeries we have visited although productivity was high decisions had been made to incur extraordinarily high capital and operating costs, which could not possibly be afforded in Australia.

The key point is that the playing field is not level. Our government needs to act, as other countries governments do, to help level the playing field, not tilt it further against us. A safeguard inquiry would be an appropriate next step in this process.

Local Economy
Piggeries are capital intensive, labour intensive and input intensive. These characteristics are all good news for regional communities. In 2001 we analysed some of our costs by location of the vendor. We found that we spent:

> **79%** of our operating costs within 100km of Young.
> **97%** of our operating costs within NSW.

Windridge shutting down would have a significant impact on the local economy.

Windridge pigs are killed at Burrangong Abattoir. This abattoir has been multi species in the past, but has just had to shut down its mutton floor. Burrangong is the largest employer in Young, its viability is highly dependent on Windridge’s viability. If Burrangong were to shut down the impact on the local economy would be devastating.

Vertical Integration
Vertical integration has benefits, however pig production and pigmeat processing are both capital intensive, labour intensive and require highly specialised skills and management. In our case we feel it is a far better strategy to build a strong relationship with other parts of the supply chain and each “do what we do best” rather than try to duplicate their knowledge and capital.

Exports versus Domestic production
Export markets mostly require much larger pigs than the domestic market. It is neither easy nor quick for a producer to switch from production of one to the other. Additional housing is required to produce export pigs, from any given number of sows, as the growing pigs need to be kept for a month longer. To provide this additional housing requires development applications, environmental impact statements, building, possibly additional land, and a period of no sales and income whilst pigs are grown to the heavier weights. Alternatively the number of sows could be reduced and a smaller number of heavier pigs sold each week. This would mean expensive sow housing would be underutilised and existing feed systems and housing would be the wrong size for the new weekly batches. These things can be changed but only at considerable cost and compromise.

Impact and Effectiveness of Government Programs
Many programs such as Farmbiz have been partly available to pig producers. For example, some training used in the industry has fitted within Farmbiz guidelines, other training does not. As the pig industry is highly specialised, specialised training is required. However as the industry is small, limited resources are available for rewriting training to fit new guidelines/formats, etc. Thus small specialised industries are somewhat disadvantaged by such programs.

Windridge is a registered training organisation and runs its own traineeship. Some funding is available from the government for some of the trainees. Administration and registration of the traineehsip is a lot of work, making the funding of questionable value.

Programs such as AFFA scholarships for the Australian Institute of Company Directors course have been inflexible with timing and criteria, so that due to work and family commitments they have been completely inaccessible to our business to date.

Most aspects of drought assistance have not been available to us for a variety of reasons. These include: assistance being related to time your local area has been in drought despite feed prices being impacted by Australia wide drought; assistance not being available to businesses with particular structures (eg companies), and assistance being tailored to those who are least well prepared for drought.

The impact of the above mentioned programs is however, trivial by comparison to the impact quarantine, trade policy and the business operating environment have on our viability. Quarantine is critical for protection or otherwise of our competitive and marketing advantages. Trade policy impacts through fighting or otherwise to help us gain access to new export markets and in granting access to our domestic market to those whose governments are artificially supporting them. (Please see producer subsidy equivalents for pig industries in Denmark, Canada, USA and Australia.) A few aspects of the business operating environment are particularly important; exchange rates are critical for competing with imports and for exporting. Regulation of our major costs of feed and labour is also highly significant to our viability.

Other aspects of the operating environment, which are particular problems are workers compensation, payroll tax and superannuation. In spite of proactive OHS and exceptional management of workers compensation claims, we still pay 4.7 times our total claims cost in premiums. In other words we would spend 4.7 times less if we directly paid all the claim expenses, including legal and lump sum payouts. Payroll tax and Superannuation in their current forms are a direct tax on jobs and businesses for which there is no equivalent in many other countries. “Other labour costs, eg, Work Cover, Superannuation” were quoted as the key impediment to exporting by over 80% of exporting businesses in the ACT and South Eastern NSW in a survey conducted by the Department of Business, the Arts, Sport and Tourism in the ACT.

Environmental requlation is an ongoing issue. The pig industry is highly regulated forcing us to perform to a higher standard than other industries, which are not regulated but have similar activities. The industry will accept regulation based on science and risk. APL has undertaken several programs in recent years, which have been designed to help solve this problem. If all governments adopt the National Environmental Guidelines for Piggeries this will be close to being achieved.

Impact and Effectiveness of Industry Programs

Windridge frequently uses extension materials developed by APL. Most of our internal training materials have been developed by APL (or PRDC). Our staff have attended external training also developed and provided by APL, for example, environmental training. The National Environmental Guidelines for Piggeries will be very useful to us.

APL’s research and development is often useful to us. We would like more research and development carried out, however, this is difficult in a small industry with limited funds. The focus for research and development and the new CRC outlined in APLs draft restructure plan are appropriate and should return value for money to the industry.

What have we done to help ourselves?

The previous points show Windridge is committed to doing everything possible to help put our business in the best position to compete.

Likewise the industry as a whole, and APL, have continued to take whatever actions are possible to put the Australian industry in the best position to compete. The industry has been in a continuous and intensive restructure program since 1970 when there were 40,000 producers all with very small herds. Now the industry looks very different with less than 6% of producers left, and an average herd size ten fold higher than in 1970.

From 1996 to 2003 total exports per annum grew from 5 million kg to 66 million kg. This growth only just outpaced the growth of imports. Significant restructuring occurred during this period to support this growth. Imports have continued to increase whilst exporting has been much more difficult leading to another period of restructuring0. Despite the difficulties many in the industry, including Windridge, have worked hard and suffered significant costs to maintain the newly developed export markets for diversification and in the hope of better times.

Recently domestic consumption of pork has shown significant increases due in part to industry promotion. This will help the industry but further gains are needed.

The industry and APL now have a restructure plan which will set in train the next round of changes needed to keep this dynamic industry afloat. The Australian pig industry is not resting on its laurels waiting for someone else to solve our problems. However this is no guarantee of success. Threats to the industry have multiplied in recent times and outside help will both speed the implementation of the plans and give individual businesses time to put in place the necessary changes before they are decimated.

Conclusion

Windridge has a strategic plan, which when implemented will improve our competitiveness. APL has a restructure plan, which we support and which, when implemented will create further opportunities to increase our competitiveness.

For Windridge to implement our strategic plan we need enough confidence in the short term future of the industry to commit additional capital and reasonable pigmeat prices to generate the cashflow to implement the plan. This is unlikely with the threat of ever increasing levels of imports and price wars between the source countries in the Australian market.

For APL’s plan to be implemented the industry needs support from the government for the restructure plan, deregulation, or at least accountability of the wheat industry, and a safeguard action to stabilise prices allowing producers and processors to stay in business long enough for the restructuring to proceed.