

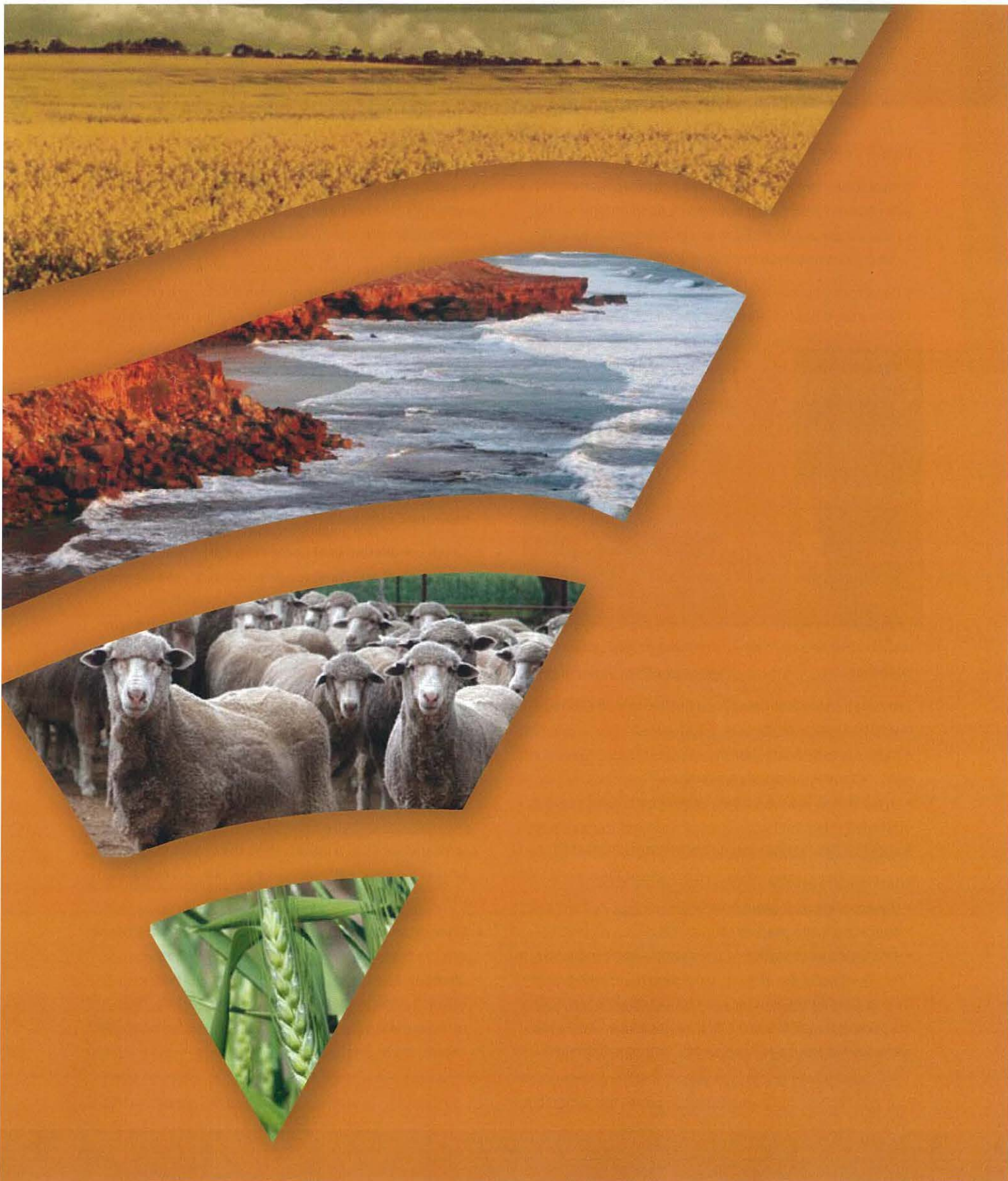
Meat Supply Chains

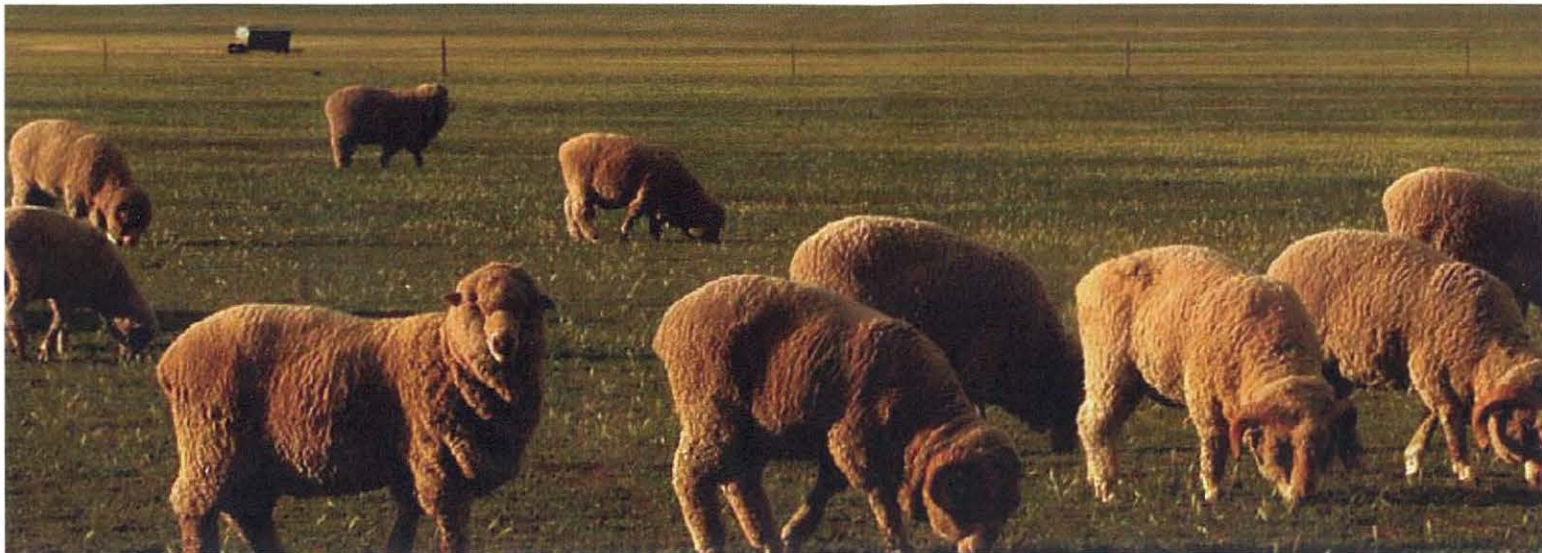
As strong as their weakest link



F·R·E·E·E Y R E

FRESH RARE ENTICING EYRE





The Project

With a shareholding of more than 375 farming enterprises FREE Eyre's aim has been to:

- Fully scope, explore and map the existing sheep and meat value chains in the Eyre Peninsula (EP),
- Determine, by way of international and Australian research, what the elements are which bring scale, success or failure in cluster groups of premium producers and in addition, what those learnings could bring other small groups around Australia in a rapidly changing and globally competitive environment.
- Evaluate opportunities and potential of developing an alternative lamb value chain for the Eyre Peninsula.

FREE Eyre, supported by MLA and PIRSA has gained a wealth of knowledge from their Red Meat Value Chain project. Understanding the role, responsibilities and investment made by stakeholders along the chain has been critical for evaluating the status quo and exploring opportunities. For the Eyre Peninsula there are many lessons learned from other producer driven value chain initiatives.

The project was instigated in response to shareholder questions concerning

- meat processing options,
- the red meat supply status quo,
- why there is such a big gap between producer price and retail value, and
- should FREE Eyre create branded lamb products?

Shareholders also wanted to know more about

- the economics of grain finishing,
- operating large scale feedlots, and
- strategies to add value to the region's lamb industry.

From the beginning of the project several meetings were held around the region for primary producer's input. At the completion of the project, three producer workshops were held at Minnipa, Rudall and Cummins on Eyre

Peninsula. These workshops provided answers, gave perspective on the status quo of the lamb industry, and outlined options for the future.

Explanation of feasibility of potential value chain models were given. These involved FREE Eyre retaining ownership of lamb along the chain and include supplying branded lamb products.

Key Outcomes

- 1. The FREE Eyre board resolved that FREE Eyre Ltd. would not develop a new lamb supply chain, or invest in red meat processing, due to the inherent risk for FREE Eyre. However, it saw opportunities for individual farmers.**
- 2. Lamb production is at record high profitability.** The best, fastest and most reliable return on investment currently available to producers is to boost on-farm productivity. This should be complemented by targeting more lambs into premium priced specifications.
- 3. Producers should focus on margin as well as price/ kg to determine profitability.** Profit is the margin between income and costs, not just price. It follows that adding value is usually associated with increased costs. There is currently more profit to be made by lamb producers from producing more lamb, rather than from entering the processing and wholesaling sector to access a portion of a retail margin.
- 4. Understanding cost of production and good nutrition are the foundation of evaluating production changes.** Meeting nutrition requirements and utilising appropriate genetics, combined with good management will maximise livestock performance and enterprise profits.

In 2009 the best “supply chain” return on investment for Eyre Peninsula lamb producers exists within their own enterprise.

5. The meat supply chain is a tough economic and cultural environment. Our research revealed many failed attempts of producers to become wholesale / retail suppliers. The reasons for failure are many. Success requires years of dedication and commitment, access to the necessary skills and management and significant capital. Investment participants need to be prepared to do this in the absence of any “premium” that rewards the supplier above returns for producing a commodity product.

6. Profitability is the key to success in any value chain. Every link in a chain requires adequate profit to motivate their participation. Efficiency and effectiveness drive productivity. Investigating participants in the meat processing and wholesaling sectors revealed that these are very high volume/turnover and low margin sector. In contrast, lamb producers and meat retailers realise much higher margins from relatively small scale turnover.

7. “Suppliers” face a new set of responsibilities and risks over and above those of a “producer”. Failure of a supplier to deliver is not tolerated. Consistency is the most important feature of supply. In contrast, farmers are familiar with “doing their best” with the resources available which leads to huge seasonal variation in quality and quantity. Owning products through the supply chain present additional compliance, payment and “business” risks not impacting producers directly.

8. A lamb carcass is many products. Owning a lamb through to wholesale or retail level requires access to multiple markets. Maximising the value of all parts of the carcass, not just the highest value cuts is essential. Processing charges will reflect a processor’s ability to recover by-products such as offal, skins and trim. Export markets are an important option for value adding secondary cuts and by-products. Accessing these markets can require high volumes of product, and of course, other risks eg. currency.

9. Efficiency leading to effectiveness. Once maximum efficiency has been gained the opportunity exists, with education and training, for producers to begin to gain a greater understanding of consumer and customer demands, and align production activities to those demands.



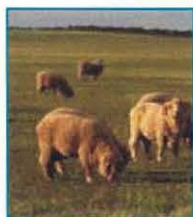
Background: **Inexperience at “Supplying”**

Successful transition into a supplier role would require bridging a large knowledge gap and fully understanding the level of commitment required to develop a business. Producers on Eyre Peninsula are not generally experienced at supplying lamb products to tight market specifications at a contracted volume and point in time. Failure to supply on any level (quality, quantity or on time) has a low or nil tolerance by supply chain partners.

The Eyre Peninsula is not traditionally a large volume, consistent supplier of Prime lamb compared with South Eastern Australia. Supplying lamb from EP should aim to compliment supply from other regions rather than competing. This improves the industry’s supply profile and minimises price reductions from seasonal oversupply. Developing the systems and processes to achieve consistent supply across the whole year underpins marketing opportunities.

A brand is not just a label. It defines the processes and systems used to supply the product.

Creating a "Brand"



A brand is not just a label. It defines the processes and systems used to supply the product. It also provides the consistent experience for those who consume it. The brand needs to build retail confidence in the product and attract repeat consumer demand.

- Suppliers need to clearly describe attributes of their lamb which will become the brand's "point of difference".
- Branded product needs to represent value to its target market. "Value" can mean many things to many people, from price through to ease of preparation and boasting rights.
- Creation of a brand does not guarantee market penetration or a premium price unless it is designed and managed well and the product backs up the "story".
- The consumer is the only part of the supply chain that brings money into the chain. All businesses involved are dividing up that consumer's money.
- Australian retail lamb price has doubled in the last 10 years from \$7/kg to \$14/ kg. (Sheep and lamb prices have more than tripled). If premium price is a key objective it must be understood that lamb is predominantly an "eat at home" product and has many meat substitutes.

The development of a brand and achieving market penetration with differentiated lamb products may be an ideal situation for some producers to aspire to in the long

term. This is appropriate at a point where systems and processes exist that can profitably supply a consistent lamb product throughout the year.

Industry experience shows that 3-5 years is the time interval required by dedicated partners to begin supplying a branded lamb product. This period involves significant costs investment and adopting higher levels of management with added risk and without financial reward.

WA Q Lamb:

A proven model (www.waqlamb.com.au).

The "WA Q Lamb" value chain is Australia's most successful farmer driven lamb supply alliance. It involves 200 producers supplying to a processor, Hillside Meats located at Narrogin, WA. The evolution of this model, its systems, products and markets demonstrated a potential pathway to creating a new value chain for EP lamb producers.

The opportunity exists for FREE Eyre to implement "Q Lamb" protocols and supply lamb under licence to the "Q Lamb" brand through a South Australian processor. This has received a great deal of in principle support from potential supply chain partners. This is FREE Eyre's "preferred model" if establishing a new supply chain for EP Lamb.

To become a "supplier" equivalent to Q Lamb takes years, not months. The challenge includes developing the capabilities of EP producers to supply, and then securing that supply of lambs to the new value chain. This commitment is likely to damage relationships with current lamb industry players. There are risks of losing other marketing options and business links for producers who support an alternative supply chain.



Supply chain recommendation

The FREE Eyre board has resolved that FREE Eyre Ltd. will not develop a new lamb supply chain, or invest in red meat supply chain processing.

This decision has been made with consideration to the following issues:

- Preliminary financial analysis indicates a low return on investment from lamb processing and wholesaling activities combined with high risk.
- Testimonials from meat processors and wholesalers support project analysis that a "normal" return on investment would be in a range of 0-2% (assuming no system failures or payment defaults).
- The "Preferred model" business operating with permanent staff would break-even at a throughput of 40,000 lambs per year and turnover of \$5.6 million.
- Sensitivity analysis shows that small changes to the price received for product has significant impact on profitability. In the above scenario, if the price paid by a retailer falls by 1.5%, the margin to the business is zero.

Currently, the best "supply chain" return on investment for Eyre Peninsula lamb producers exists within their own enterprise.

Moving forward

Sheep and lamb producers who

- **Understand cost of production**
- **Identify profit drivers**
- **Are capable of implementing best practice**
are positioned to maximize livestock profitability.

1. Education and training is the best way for producers to fill knowledge gaps holding back livestock profitability.

2. The lamb industry can improve overall productivity by separating the functions of "breeding", "backgrounding" and "finishing". This allows producers to focus on areas which suit their skills and resources. This approach would allow many producers to carry higher stocking rates.

3. Lamb producers are receiving high prices for store lambs, trade and export lamb, and sheep meat. Currently and in the medium term, limited lamb supply and strong domestic and export demand should support lamb returns.

4. The 2009/10 season offers livestock producers access to low priced grains and fodder; ideal for boosting productivity of breeding ewes and growing lambs. The combination of high livestock prices and low grain prices present immediate opportunities to add value to grain through livestock.

5. Livestock producers can undertake training provided by existing industry bodies. Programmes such as "Sheep Connect", "Making More from Sheep" and others are funded programmes which are available to producer groups on Eyre Peninsula.

Knowledge and predictability give farmers confidence to invest in livestock enterprises. FREE Eyre facilitates training opportunities for producers to focus on profit drivers and adopting best practice. Through this a more progressive livestock culture can evolve in the EP region and accelerate the rate of uptake of profitable activities.

The margins achievable from lamb production compare very favourably with cropping in many Eyre Peninsula districts, especially averaged over the last 5 years (05/09). The number of farms with a livestock component has decreased over the past decade, but those remaining are being rewarded. Now is a great time to take livestock production profitability to a new level.



Feedlotting / Supplementary feeding

The most cost efficient and straight forward lamb production systems are those which align breeding ewe and lamb nutrition demands to local pasture availability and don't require supplementary finishing.

All supplementary finishing systems add feeding and management costs compared with pasture based finishing.

The key factors influencing cost efficiency of a finishing system are the:

- margin between the price of the lambs entering the system and the sale price of finished lambs,
- ration cost and the length of time on feed, and
- feed conversion ratio of lambs.

Supplementing nutrition is most efficient in increasing carcass value when the additional weight gain adds a price premium to every kg of the carcass.

For example in November '09; taking a 16 kg XB lamb carcass @ \$3.00/kg = \$48 to an 18.5kg carcass @ \$3.70/kg = \$68.45.

The carcass value increases by \$20, or 42% from adding 2.5 kg, or about 15% more weight.

November '09 ration cost using Feed Barley @ \$120/tonne. Requires approximately 35 kg to gain 2.5 kg carcass weight. Cost of grain = \$4.20

Assumptions:

- Lambs supplemented in paddock with grain feeder, water, stubble (or hay) and shade.
- Lambs introduced to grain via stubble or lick feeder prior to adlib access.
- 13 kg of barley converts to 1 kg carcass.
- Weight gain of 0.14 kg carcass/ day requires 18 days.
- Skin value not included (November '09 = \$8-\$10)

High volume, commercial feedlotting



The economics of feedlot finishing depends on many factors. While feed cost and the price of lambs (both store and finished) has the greatest affect on profitability, specific lamb and management issues also have a direct influence profit margin. Genetic potential, live weight, sex, feed intake and feed conversion ratios all affect daily weight gain. Health issues and disease status are a major threat to production.

In 2009, feedlotting is a profitable finishing option, but for the previous 2 years it has not been. When feedlotting is unprofitable these businesses either shut down or operate at a loss to protect markets they supply. Both of these scenarios are unacceptable for a FREE Eyre investment. A large FREE Eyre owned feedlot would need to be a profitable stand alone enterprise. It would require full time management including a supply manager to source a continuous supply of suitable store lambs and grain. Profits are generated from buying and selling grain and lambs or receiving commissions to contract finish producers' lambs.

FREE Eyre does not consider owning and operating a large scale, commercial feedlot a good investment for shareholders.

The economics of feedlot finishing depends on many factors. While feed cost and the price of lambs (both store and finished) has the greatest affect on profitability, specific lamb and management issues also have a direct influence profit margin.

Reasons to supplement/ lot feed on-farm:

- Increase profit (income minus costs)
- Extend supply period (outside of natural pasture season)
- Deliver a consistent product (critical for a brand)
- Meet market specifications of carcass weight and fat
- Achieve MSA eating quality
- Retain breeding stock in periods of low paddock feed to protect soil cover

Farm feed lots can be constructed simply and are as expensive as the fencing and feeding systems used. There are a number of important considerations which need to be incorporated into the design, and producers should access advice before proceeding.

Supplementary feeding systems can be created without a large capital outlay. On-farm finishing systems can be operated as need and economics dictate. There are no additional stock movements or external management costs required. The equipment can be used for feeding pregnant and lactating ewes and lambs, dry sheep or finishing lambs. Lick feeders and hay cradles offer a labour saving method and significantly reduce wastage of feed.

For further information please contact:

FREE Eyre Limited

Tel: (08) 8363 5010

Ben Ranford (Project Officer)

Susi Tegen (Project Manager)

Meat & Livestock Australia

Rebecca Austin (Project Leader)

Tel: (02) 9463 9333

Primary Industries and Resources SA

Jack Langberg (Project Partner)

Tel: (08) 8226 0222

Eyre Regional Development Board (ERDB)

For further Meat Supply Chain development programs contact

Stacey Fallon (Food Officer)

Tel: (08) 8682 6588

FREE Eyre thanks its shareholders and growers for their input and spirit in looking for local opportunities to add value to the region.



F·R·E·E·EYRE

FRESH RARE ENTICING EYRE

FREE Eyre Limited

T. 08 8363 5010

F. 08 8363 5020

E. info@free-eyre.com.au

W. www.free-eyre.com.au

The following organisations have partnered this project with financial and in-kind support.



Government of South Australia
Primary Industries and Resources SA



EYRE REGIONAL DEVELOPMENT BOARD INC



F·R·E·E·EYRE

FRESH RARE ENTICING EYRE