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FINANCIAL ANALYSIS OF MAFTECH BULL BEEF INVESTMENT OPPORTUNITY

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ABSTRACT

MAFTech has established an investment opportunity whereby a non-farming investor can provide the capital required to farm bull beef. The farmer and the investor share the returns from the investment, with the investor having a first charge over the proceeds received from the sale of the beef up to the amount of the initial capital injection.

This type of investment scheme differs from more conventional form of investment. However, in order to compare this scheme with the more common forms of investment it is necessary to evaluate it to enable an optimal investment decision to be made. Hence the market for the production of bull beef is appraised. The risk involved in this investment is outlined and a sensitivity analysis to changes in price and weight conducted. Using this risk and return information a comparison with other investments is then made.

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INTRODUCTION

A farm is a business unit and like other businesses in New Zealand, this industry has undergone dramatic changes in recent years. To cope with the changing environment, businesses must be adaptable. Recently many farmers have faced financing difficulties. To assist farmers in these difficulties alternative methods of financing have been devised.

Traditionally the farm unit has been financed through mortgaging and as such has carried high debt levels. As interest rates have risen, many farmers have had difficulty bearing the large debt burdens they have been forced to incur. The solution lies in a reduction in Debt and an increase in Equity.

Various schemes to increase the Debt-Equity ratio in the farming sector have been developed by those associated with the agricultural industry. Lincoln College has devised a joint farming scheme. The objective is to share not only equity but also, by extension, risk and returns. Under this scheme, the owner retains ownership of the land and buildings and the sharefarmer buys the stock and plant with the owner having an option to repurchase at the termination of the contract. Farming decisions are made jointly[1]. However under this scheme there is still a high level of exposure to interest rates,

1 Johnson, [9], p75.

although the exposure is shifted marginally from the owner to the sharefarmer.

The agricultural industry has traditionally been exposed to large debt burdens as financing has not been undertaken in the same manner as other industries. The nature of farming has traditionally precluded raising capital through the flotation of equity issues as is done for other industries since the transaction costs involved in floating a company for each individual farm and listing it on the Stock exchange would be prohibitively high. The value and uses of properties in different districts are broad, requiring expert valuation. The remoteness of many properties would make this a costly and difficult exercise[2].

As the company form of business is impractical and costly for the farming business unit, MAFTech has devised an alternative scheme to enable equity investment in farming. At present the MAFTech scheme is confined to Bull Beef investment and it is this particular scheme that will be analysed. However, there is a proposal to expand the scheme to other types of farming such as Merino sheep and dairy cattle[3]. In this paper the terms and operation of the investment will be detailed. The economic situation in New Zealand that has given rise to the development of this scheme will be investigated as will the implications for the beef industry. The present and potential markets for beef raised under the scheme will

2 Johnson, [9], p70.

3 The Dominion, [3].

be examined before undertaking a financial analysis of the investment itself.