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Review of Non-Forestry Managed Investment Schemes
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Submission by Agribusiness Research and Management

Agribusiness Research and Management (ARM) and its preceding entity have been involved in the wine industry since 1989. In that time it has established around 1000 ha of wine grapes and 221 hectare of Avocados. Currently it manages on behalf of clients over 1,080 ha of wine grapes, located across the South West of WA and Victoria, and 221 hectares of Avocados. The vineyards range in size from 26 ha through to 358 ha.

Currently the vineyards managed include 4 MIS operations with a total area of 543 hectares and 9 non-MIS operations with an area of 537 hectares. The 221 hectares of avocados are an MIS operation.

Of the MIS related operations managed 3 were conceived and developed by parties associated with ARM, with the last MIS being released in 1999. Thus we have experience in both the development of projects, the ongoing management of MIS projects and also non-MIS agribusiness.

Topic 1: Is there a tax advantage?

The short answer is that we believe that broadly there is no tax advantage *but* that tax has become a driver for some MIS (and non-MIS agribusiness). A broad statement is that some MIS projects would appear to be less focused on the fundamentals of the agribusiness investment and more on selling the project to the investor and thus generating a profit for the MIS promoter.

To date further regulation has seen prospectuses no longer having any form of forward forecast. This would seem to decrease the investor's available information to make their investment decision and provides less ability to try and hold the promoters to account. In short "it has opened the door" for the less scrupulous promoters.

Agribusiness projects often involve periods of several years where the projects generate losses and existing industry participants are often able to access those losses and offset them against other income streams. To

completely remove the ability to do this for MIS investors both seems inequitable to those investors and would most likely see the large scale and often very professional agribusiness investment from these sources decline.

As a source of capital for new and innovative agribusiness the MIS structure provides an excellent medium. Unfortunately new agribusiness is often where the investor has the least information available to make an informed decision.

Our experience has been that both MIS and non-MIS schemes access the same tax deductions available to all primary producers. The particular circumstances and structure of each project may impact the tax deductions and timing of those tax deductions but over the life of the projects there is little if any difference between the structures.

Topic 2 – How well do non-forestry MIS perform?

ARM's experience in MIS performance is predominantly in the wine industry. The structure of the MIS projects results in the majority of the agricultural and market risk being borne by the MIS investor. However in the projects ARM manages the MIS managers have focused on operational efficiencies and wherever possible passed resultant cost savings through to the MIS investors through reduced management fees.

The revenue for MIS projects ARM manages in the wine industry have performed poorly against the MIS projections despite generally good performance in the early years. The performance of the MIS schemes is reflective of the industry situation of oversupply and falling prices. With MIS vineyards accounting for only 10% of the industry¹ the oversupply and price pressures are more linked with global market conditions. The Rabobank Global Focus, Winter 2007, states that "...many wine-producing countries also faced structural oversupply at the same time. As a result world market prices have fallen." It goes on to state "...other global suppliers are also sitting on large inventories of excess wine, so the outlook for demand in global markets remains subdued."

From our experience ARM has not perceived any difference in the performance of MIS versus non MIS vineyards. The MIS structure has made it more challenging to make structural changes to vineyards e.g. vine removal and/or reworking of varieties in vineyards. However this is somewhat offset by the fact that the MIS vineyards are larger and internally can accommodate a level of this work each year. In our opinion, as any MIS prospectus is required by regulation to be very prescriptive in the way a project is set up (particular varieties in precise areas, etc), this does limit the ability to make significant changes (of a capital nature) to the project in future years, whereas in agriculture change is continually occurring as consumer preferences change, new technology becomes available, etc, which can require major changes (in varieties or equipment) to the underlying project

¹ Wine Grape Growers Australia - 17 July 2008

Topic 3 – Inputs, the environment and regional impacts.

Labour

ARM provides in depth services covering labour recruitment, remuneration, management and reporting for 863 hectares of vineyards with the operations split into 4 different management companies that manage a total of 9 vineyards.

Analysis of the number of hectares per Full Time Equivalent (FTE) shows a range of 12 to 17 hectares per FTE with the operations ranging from 90 hectares to 360 hectares respectively. There is a clear correlation between the scale of the operation and the labour efficiency achieved. Over time the larger MIS operation has increased in efficiency with the number of hectares managed per FTE increasing from approximately 10 to 15 over the past 10 years due to productivity gain. Most of these gains have been through innovations developed in the larger scale vineyards.

Safety

The scale afforded by the MIS schemes has enabled the investment in developing and maintaining comprehensive integrated OH&S systems. Agribusiness operations tend to be complex and involve a diverse range of labour tasks and machinery such that the development and maintenance of OH&S systems such as Standard Operating Procedures is both time consuming to develop and maintain.

To date we have not seen any other agribusiness operation with as extensive systems other than operations managed by large publicly listed companies (e.g. Fosters). Although our experience is mainly in the South West of Western Australia. The scale of operations have enabled the development of these systems and other smaller operations have then benefited as a result.

Economies of Scale

The level of capital raised in MIS projects allows for the development of operations that benefit from the economies of scale of larger operations.

Experience shows that,

- Per hectare operating costs decline as operations increase in size. A review of budgeted expenditure across vineyards (all cool climate) shows that budgeted per hectare costs for 2008/09 range from \$13,388 for a 36 hectare operation to \$8,106 for 358 hectares.
- Large operations benefit from the ability to undertake ongoing R&D and continuous improvement programs.
- Retention and training of staff is generally improved where operations are of a scale where such benefits as employee housing can be built on site and sufficient numbers of staff are employed such that leave and training are easily accommodated.

- Systems and processes are more easily developed and implemented where vineyards have scale of operation. The scale and number of operations managed by ARM has allowed for the development of sophisticated systems that are designed to increase efficiencies, reduce risk and integrate with the OH&S systems.

Topic 4: Non-forestry MIS and commodity markets

The Rabobank Global Focus, Winter 2007, states “The fact that there are many competitors seemingly able to supply the world market at lower prices than Australia suggests a clear cost problem for the Australian industry.”. The report goes on to discuss that the per tonne production costs are best lowered by better vineyard management enabling increased yields.

The experience of ARM is that some of the vineyards best able to compete are those that were planted through MIS projects.

Frequently MIS projects are blamed for contributing to over-supply of markets. From our experience of horticulture in general (where most non forestry MIS has occurred), Australia operates in a global market and supply-demand imbalances are primarily due to plantings in other countries and/or reduced consumer demand rather than the effect of MIS. For instance Australia produces less than 5% of the world’s wine and if 10% of that is coming from MIS, then the impact on supply is (at most) 0.5%. This does not take into account the large number of small grape growers in Australia who have left the industry due to their inability to compete. Overall Australia is a very small producer on a world scale and its best chance of competing against low cost producers in other parts of the world is to get better economies of scale and a greater use of technology.

Conclusion

ARM is of the view that *some* promoters of MIS schemes have not focused on the fundamentals of the product being promoted and some are structurally unsound. This is arguably evidenced by a recent scheme being wound up due to insolvency in WA. However its worth noting that parties associated with ARM wrote to both the ATO & ASIC when this particular scheme was initially released and advised that even a superficial analysis of the project against existing industry benchmarks showed that it was unsound. No action was taken by either the ATO or ASIC. The scheme has recently gone into receivership owing investors in the region of \$127,000,000.

However the better MIS schemes have provided an excellent source of capital to assist in the growth of long term agribusiness investments that have economies of scale and professional management.

ARM would support changes that result in increased vetting of schemes and possibly one that requires the promoters/manager of the scheme to take a greater proportion of the agricultural risk (as some schemes do through remuneration that is in part linked to the schemes EBIT).

Responsible MIS schemes that show to the potential investors all the underlying budgets and assumptions definitely have a place. They have been important in moving many regional areas in Australia ahead with dynamic large scale innovative and often vertically integrated businesses. In addition they have also attracted capital into “new” industries (e.g. sandalwood) that are high risk but given time some will develop into good business that add diversity to Australian agribusiness.