Section Editor:
Naomi Scholz
SARDI, Minnipa Agricultural Centre

Should sheep come into my farming business?

RESEARCH

Mike Krause
Applied Economic Solutions P/L, Adelaide

Introduction

The popularity of continuous cropping through the challenging years of the 2000s is coming to an end, due to both the financial rewards from sheep significantly improving, and as a result of the experience of the higher financial risks involved in continuous cropping. However, the decision to add more sheep in the farming system is a complex one, with the final decision being driven by many factors. What will be the correct decision for one farming business, may not necessarily be correct for the next. This paper looks at some of these issues.

Farmers are now considering expanding their flocks and perhaps replacing some break crops with pasture. This could be driven by the issue of resistant ryegrass management in the cropping program, or just wanting to make more money in the drought-affected years. The decision to return to more sheep is a challenging one, in that it's not just about comparing gross margins, but also considering the impact on the 'whole farming business'. The following issues need to be considered:

- The passion of the farmer
- The financial numbers for break crops vs pasture and sheep
- The capital cost of buying in expensive stock, or breeding up
- The skills of sheep husbandry in the business
- The efficiency of the farm cropping plant if less cropping is undertaken
- The property's sheep infrastructure
- The risks to the farming system
- The current financial position of the farming business.
- The market trend of the increasing capital costs of cropping machinery.

These issues all need to be considered when making a decision about expanding the sheep enterprise in the business.

The passion of the farmer

The risks of drought and commodity price variations that farmers have experienced over the last decade means that 'passion for farming' is an essential ingredient for long-term farming success. This is also the case for having sheep in the system. With the profits from sheep being in the doldrums through the 1990s and most of the 2000s, a lot of farmers adopted continuous cropping. Consequently, many younger farmers have not known sheep. Sheep take a different management skills set than cropping and definitely require a different passion. If a farmer who is looking at taking on more sheep doesn't have the passion for sheep, then don't start and remain in cropping. There is a saying that 'Do what you do, do best', which means you generally succeed if you follow your passions.

The financial numbers for break crop vs pasture and sheep

A common quote used in business management says that, 'If it doesn't work on paper then it's unlikely to work in practice'. So, before you start down the track of adopting more sheep, do the budget estimates. A good position is to start looking at the gross margins of break crops against the gross margins from sheep. This is a challenging analysis, but necessary if the decision is to be correct from a profit perspective.

With prime lamb prices hitting \$160/hd and wool prices in excess of \$1,000/bale, the gross margins for self-replacing sheep have gone from \$25/DSE to above \$40/DSE. However, it is important to do these numbers for each particular farming situation. If the farm's management doesn't have the skills to do this, then either get training or used a qualified adviser in this area of farm management.

When doing this analysis, it is important that you also consider the expected outcomes given poor, average and good seasons. Also, assess whether it's better to manage self-relacing merinos, prime lambs, or both.

The capital cost of buying in expensive stock, or breeding up

If you have decided that you have a passion for expanding the sheep enterprise, then you can pursue two main strategies: (1) to purchase the additional stock that you require or (2) expand the breeding animals from natural increases using the current sheep numbers in the business. This too can be a challenging analysis, but tools like Plan to Profit (P2P) (www.PlantoProfit.biz) are excellent for doing this calculation.

A lot of farmers elect to grow their sheep numbers by retaining more ewe lambs each year. This is easier on the cash flow, but may take 3 to 4 years to achieve the desired sheep numbers. The potential income lost needs to be also considered in this analysis. Even under current high prices for sheep, in a lot of cases it would be better to purchase the additional sheep and get higher production earlier. However, let the farm specific analysis guide this decision.

The skills of sheep husbandry in the business

Sheep take a special skill set and with cropping dominating the farming business in the last 10 – 15 years, a lot of farmers may have lost or perhaps never gained this livestock management skill set. So, look to improve the necessary skill set through training or using a professional livestock adviser.

In the past, improvements in cropping technology have driven crop yield improvement and hence cropping profits. The technology improvement in sheep management has tended to be slower. However, there are significant improvements in management practices that can improve the financial performance of sheep. These include: improved genetics, time of lambing, pregnancy testing, nutrition management and the type of sheep enterprise selection (self replacing, prime lambs and South African sheep breeds). If sheep are to be managed well, then time needs to be put into learning these improved management methods.

The efficiency of the farming cropping plant if less cropping is undertaken

One of the economic dilemmas of taking on more stock means the cropping area may decrease. If this is the case, then from a business efficiency perspective, the business will have surplus cropping capacity, which will lead to some cropping inefficiencies. Although this may only be a minor cash flow issue, as some farmers say the cropping machinery should now last more seasons as it is being used less, it should still be considered.

The property's sheep infrastructure

The condition of the infrastructure (fencing, water points, shearing shed and yards) for sheep is also an important issue. This infrastructure needs to be at a certain standard to achieve livestock management efficiencies. Any upgrading of necessary infrastructure will require capital investment, which will need to be funded from either cash reserves or borrowings. A financial analysis of taking on more sheep will also need to include this capital expense.

The risks of the farming system

There are two fundamental elements to risk management:

- First, to identify the financial risks of a particular strategy. There is a saying in investment practice that 'high risks bring high rewards', and this is very true when it comes to comparing cropping and sheep returns. Crops provide the higher profits, but also come with the higher risk of seasonal and commodity price performance. Sheep, on the other hand, offer a more steady return regardless of season, and so offer a lower reward for lower risk.
- Secondly, to identify if the decision makers are 'risk takers' or 'risk adverse'. Generally, risk takers will be more attracted to the risk profile of cropping, while risk adverse decision makers will be attracted to the lower risk profit offered by sheep.

The current financial position of the farming business

The decision of taking on more sheep should be taken from a 'whole farm' perspective, which is what P2P can help analyse. A 'whole farm' analysis measures the impact of strategic changes, such as changes to expected business profits, cash flow and balance sheet.

As a general rule, the higher the business equity, the greater the business borrowing capacity. So, if a business currently has a high equity (i.e. 85%), then it can afford to borrow money to increase the sheep enterprise quickly. If the business equity is low, for example at 60% and the sheep enterprise is to be expanded, this may have to be done at a slower pace.

The markets trend of increasing capital costs of cropping machinery

In recent times, the capital cost of machinery has increased significantly, which is a major concern to cropping farmers when it comes to changing over the header, boomspray and main tractor. This is another reason to look at increasing the sheep enterprise, as it tends to be a cheaper enterprise to manage.

Conclusion

Yes, the economic pendulum has swung back toward sheep being a good financial match to break crops in the lower rainfall area of SA. The gross margins of sheep enterprises are now competing very well when compared to the financial performance of crops such as canola, peas and beans. This indicates that it is a good time now to reconsider the role of the sheep enterprise in the low rainfall farming systems. However, the broader issues outlined in this paper need to be considered during the decision making process. The most important consideration is whether the management have a passion for sheep! If the answer is yes, then look further into the capital, profit and cash flow considerations of taking on more sheep.