Rural

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Overview

What goes up must come down!

While not always the case in markets it is fair to say that quick shifts in upward directions are often met with equally quick shifts in the opposite direction to bring a market back to a longer term average trend line. So what is the potential for the rural landscape to see a change of direction?

The 2015 and 2016 into early 2017 years have seen large value movements in most regions and commodity types nationally. In hindsight it is easy to see that falling interest rates, new free trade agreements (FTRAs), reducing energy costs and fuel prices, falling Australian dollar, increasing commodity prices and generally good seasonal conditions in most regions barring Western Queensland have contributed to this, the impact combining to move market sentiment and values paid for most assets. So what is the impact of these drivers reversing? Other than the FTRAs, we have started to see the shift and this may also coincide with one capital market in Chinese investment having also further restrictions placed on agricultural land investment if outside the new framework announced by the Chinese Government.

The dollar rising, energy costs rising, some commodity prices falling (cattle, grains of the past six months but some bounces around), cost of debt on the rise and drier overall conditions in most regions have in this punter's view seen a levelling of demand – not a crash by any means, but a shift none the less and lower sales activity would be expected. Does this mean values will correct as well? It is too early to tell this and given that supply has been very tight, we may not see any real change for a while yet, however most parties I speak with are not expecting a lot more upside in the short term and some are looking for a levelling out of values given that the economics of some markets are hard to justify the returns. There are and always will be exceptions and I expect we will see some record sales on a rate per HA/DSE/AE or other measure reflected in the near term. Agriculture is a long game investment and that is my focus in this note. Looking through the sharp upward cycle, what is on the other side and what else influences the current market sentiment? What is patient capital seeking and can it find value today with the current variables of market forces that influence the decision makers?

Next month in my absence, I will be asking the team to do up a local review of what they are seeing within the leasing market of rural property, comment on drivers for transactions and provide a general overview of potential returns that they have evidenced in the market. Finding the data is the hard part of this challenge I have set the team and the results will be interesting I think for many readers and investors.

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Southern Queensland

Seasonal conditions in the southern part of the state have been unfavourable which is now impacting on both graziers and farming operators. The abnormally hot winter season followed by dry westerly winds in late August has significantly reduced pastures and also brought evidence of crop stress. On the outer Downs and within the Toobeah area, losses to pulse and grain crops have been reported. Combined with the dry seasonal conditions over the past month, the cattle market has seen a significant drop in value. The EYCI is currently sitting at 543 for late

August, down from 725 this time last year (> 25%) and 570 for August 2015 (> 5%). No doubt the beef market has enjoyed two plus years of solid returns which has provided confidence to the sector and ultimately translated to strong property prices, but the question is now being asked on the back of weaker cattle market conditions whether the fundamentals are aligning for land values to now level off. Like any sound business model, with any weakening of business returns there must be some market shift to maintain the link between profitability and associated market risks. Another influence in the market that has the greater potential to weaken market confidence is seasonal conditions. There isn't any part of the southern area of the state that can boast to have had an exceptional season this year. If anything the market for Western Queensland and particularly the red Mulga Woodland hasn't seen the same levels of land value growth in comparison to their eastern neighbours which can been put down to prolonged dry seasonal conditions. The Bureau of Metrology has indicated that for southern Queensland there is a 45% to 50% chance of receiving average rainfall between September and November but a 60% to 70% chance of above median maximum temperatures for the same period. So with the weakening in cattle prices and poor seasonal outlook this may ultimately weaken confidence at the present level. Will this weaken property values? Maybe, but then if the market reacted to volatile commodity prices and poor seasonal outlook, the property market wouldn't be where it is today and hence must be viewed over a medium to long term economic outlook.

Transactions for this time of year are historically down and agents continue to report the lack of quality listings. Recent sales include that of Mayfield, a 19,431 hectare holding 45 kilometres west of Charleville and bisected by the Quilpie Road. The property is a typical red Mulga block with adequate building improvements and surface dams combined with reticulated bore water. The property transacted off-market for $74 per hectare and was encumbered by a carbon project. To the west of Morven, Glenba, a 6,057 hectare soft red and chocolate Buffel block has sold for $3,750,500 or $619 per hectare ($250 per acre) which continues to show the strengthening in the Morven/Augathella area after Mareto sold earlier in the year for $704 per hectare ($285 per acre).

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Central Queensland

A substantial cane farm in the Proserpine district has been purchased by non local buyers. Six Mile was sold in June with crop plant and equipment. Of a total area of 234.96 hectares, it has an irrigated cane land area of 219.9 hectares held over five adjoining and adjacent freehold titles. The reported average annual production of the farm is 17,000 tonnes. It is located approximately 22 kilometres north-west of Proserpine at the end of the Up River Road and has a combined supplemented allocation of 983 megalitres from the Proserpine River. The sale price is confidential, however upon analysis we conclude that the rate per hectare is consistent to slightly stronger than previous benchmarks set by sales of smaller, dress circle farms which have been thinly traded over the past two to three years. To our knowledge this is the largest sale in the Proserpine Mill area since the change of ownership from the growers co-operative to Singapore -based Wilmar International in 2012.

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Echuca

Demand for cropping holdings appears to have finally tapered, albeit slightly, on the back of a very dry spell from the early break to early August. Nevertheless agents would be happy to list as much cropping and grazing country as they can find. Dairy holdings are still more challenging though there appears to have been a spate of sales for smaller holdings which can be utilised for non dairying pursuits.

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Mildura

WATER: The new water season has opened positively and has been further boosted by good rainfall (and snowfall) across the northern Victorian and southern NSW catchments over recent weeks, which has increased inflows to all Murray Valley storages.

As at 18 August 2017, the New South Wales Murray High Security allocation is at 97% and General Security at 13%. Victorian Murray River High Reliability Water Share allocations are sitting at 70% and South Australian Murray River irrigators have a 100% allocation.

The total active Murray Darling Basin Authority storage is at 69%.

Current permanent water values are as follows, noting that these levels include the benefit of the 2017/18 allocation:

- NSW Murray High Security - $3,400 to $3,500 per megalitre;
- Victorian High Reliability (Zone 7) - $3,000 to $3,100 per megalitre.
- South Australian Irrigation Entitlement - $2,950 to $3,050 per megalitre.

The temporary water allocation leasing market is presently trading at around $135 to $145 per megalitre across the Murray Darling region.

WINE INDUSTRY: Recently released data from the Murray Valley Wine Growers shows that the overall total crush in the Murray Valley region was down 2% to 360,000 tonnes in 2017 compared to 368,000 tonnes in 2016. The good news is that the value of total crush sold was up by $12 million with the overall average price increasing from $320 per tonne to $357 per tonne.

On a national basis the total crush was up by 5% to 1.93 million tonnes, whilst a 13% rise in value terms to $1.22 billion was recorded. The average purchase price nationally rose by 7% to $565 per tonne.

Wine exports reportedly rose by almost 10% year on year in value terms and 7% in volume. China exports rose a staggering 44% year on year in value terms and the USA showed 3% growth in value terms. The US rise is positive news as this growth was in the higher end of that market. The value of exports to the UK fell which is due to a number of issues including the falling value of the pound sterling, exiting the EU and the hung parliament following the election.

SALES: Property sales activity has continued in the past month with several properties across all agricultural sectors transacting. Some notable pastoral sales include:

- Eaglehawk Station, NSW, a 28,240 hectare holding which sold at auction on 28 July 2017 for a reported $3.45 million bare. The property comprises open, undulating red grazing country and is located 80 kilometres south of Broken Hill and 295 kilometres north of Mildura. The property was well improved with a 5-bedroom homestead, large wool shed and has equipped bores supplying water. The sale shows $122.50 per hectare or well over $500 per DSE which is an unprecedented level for the Broken Hill region.
- Gundalundie Station, NSW, an 11,685 hectare holding which sold privately earlier in 2017 and recently settled for $2,887,400 bare. The property comprises open blue bush grazing country and is located approximately 80 kilometres south of Ivanhoe and 175 kilometres north-west of Hay in the Mossgiel area. The property was improved with a traditional homestead, large wool shed and good yards and has equipped bores supplying water. The sale shows $247.10 per hectare which is well in excess of any sale level in this region.
- Martins Well Station, SA, a major holding in the Flinders Ranges region recently sold on a walk in walk out basis for $5,975,000. The property comprises 100,500 hectares and is located 90 kilometres north-east of Hawker and 450 kilometres north-east of Adelaide. It generally comprises open grass plains with blue and salt bush along with rocky outcrop sections. It has excellent water improvements and extensive

building improvements including a 5-bedroom stone homestead, seven stand wool shed and several sheep and cattle yards. The sale included almost 6,000 merino sheep, 500 Hereford cattle and some nominal plant. The pastoral board maximum stocking rate is 12,900 dry sheep equivalents. After allowances for the live stock and plant, the sale shows an overall $49.50 per hectare and $385/DSE based on the pastoral board maximum stock rating.

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Northern Territory
Although the general perception for the NT pastoral market is that things may have peaked, there are still sales taking place that suggest strong confidence in the northern beef industry's foreseeable future. Conways Station (1,392 square kilometres) located on the Central Arnhem Road 180 kilometres east-north-east of Katherine has contracted for close to the $9 million (walk in walk out) asking price. The property, which borders Arnhem Land to the north, had been on the market since around January 2016 initially asking around $9.3 million walk in walk out with approximately 4,500 head and a small amount of plant. The property is reportedly under contract for sale to an Australian based company. We understand that the purchaser is investing in the property primarily for its pastoral use and did not place significant value on the property's tourism/hunting business opportunity. The existence of the carbon credit contract in place (reportedly capable of generating between $70,000 and $100,000 profit per annum) reportedly positively influenced the purchase price. This is a strong sale and by our estimations of current carrying capacity would push the $/AE above $1,700.

Meanwhile we are aware of another three large scale northern cattle stations (ie. 20,000 AE + carrying capacity) that are at advanced stages of negotiations for sale. While there appears to be a wider range of value levels ($/AE) being paid for smaller scale cattle stations in the north of the NT (mainly due to the amplifying effect that every additional dollar spent has on the $/AE over a smaller carrying capacity - refer Table 1 beside) these larger scale sales, if they occur, should give us a better indication on where values currently sit, particularly now that cattle prices have come off the boil (refer Table 2).

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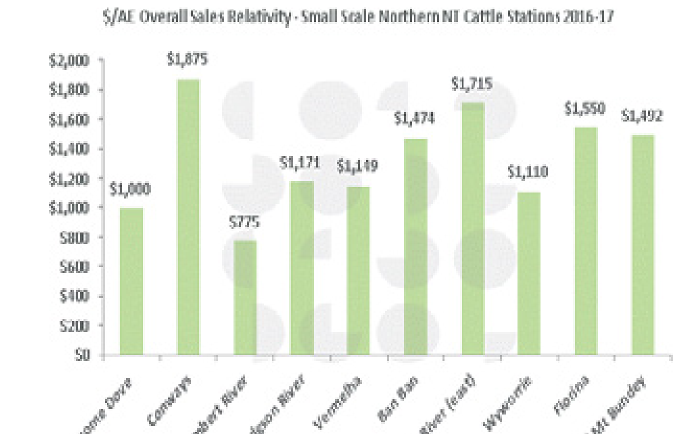

Table 1

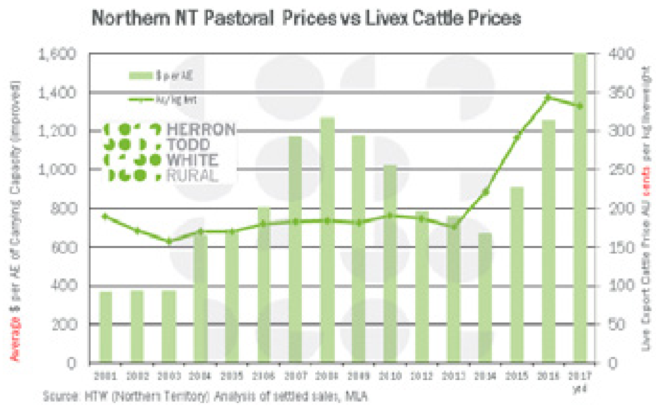

Table 2

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