The Treasury

Landcorp Farming Ltd: Independent Review Information Release

December 2021

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[23] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[25] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information

[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

[39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

[40] Not in scope

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TE TAI ŌHANGA
THE TREASURY

Treasury Report: Landcorp Farming Limited - Independent Review

Date:	14 April 2021	**Report No:**	T2021/682
		File Number:	SE-2-8-2

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson)	**Agree** to the recommendations in this paper, including the Minister for State Owned Enterprises sending a letter to the Chair of Landcorp on next steps	30 April 2021
Associate Minister of Finance (Hon David Parker)	**Note** the content of this briefing	30 April 2021
Minister for State Owned Enterprises (Hon Dr David Clark)	**Agree** to the recommendations in this paper, including **signing** a letter to the Chair of Landcorp on next steps	30 April 2021

Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Amanda Wilson	Analyst, Commercial Performance	[39]	✓
Maureena van der Lem	Manager, Commercial Performance		

Minister's Office actions (if required)

Return the signed report to Treasury

Send the signed letter to the Chair of Landcorp

Note any feedback on the quality of the report

Enclosure: Yes (attached)

Executive Summary

This report provides you with an overview of the Landcorp Farming Limited (Landcorp) Independent Review (the Review), implications and proposed next steps. A full summary of the Review report and individual operations can be found attached to this report as Annex 1.

A draft letter is attached to this report for shareholding Ministers to consider sending to the Chair of Landcorp outlining your views and expectations as a result of the Review.

On 19 March 2021, Dr James Morrison provided his final report on the performance of Landcorp. Landcorp provided its response to the Review to shareholding Ministers on 12 April 2021.

The key areas arising from the report are transparency and accountability, on-farm performance, off-farm performance and corporate overheads. Together, these matters raise questions about the current business model [34]

The Review finds:

- Strengths in Landcorp's environmental and health and safety practices, and its on-farm diversification strategies, including the shift to organic farming, which is proving profitable. On-farm operations have improved over recent years, but still perform at or below sector benchmarks (before the allocation of corporate overheads). A failure to demonstrate viable good practice on-farm operations could undermine Landcorp's ability to influence the sector to adopt improved practices.
- Continued risks to off-farm performance in the future, which has not delivered as intended to date. [37]
- Landcorp has high corporate overheads [37] , which are in part a product of its complex business model. More broadly, off-farm revenue and EBIT forecasts have been constantly over-optimistic and expenditure forecasts consistently underestimated. Although not inconsistent with new ventures generally, the Review notes that over-optimistic forecasting has become a pattern for Landcorp.

As a commercial business, Landcorp explores ways of developing its business. The Review finds that Landcorp is adding value through profitable on-farm activities and so does not necessarily need to go beyond the farm-gate into off-farm ventures to achieve value-add. The Review questions Landcorp's competitive advantage in 'off-farm' ventures, noting that other market players with better capability are undertaking similar ventures and that Landcorp's core roles and capabilities are in on-farm operations.

The Treasury proposes a phased response to the Review recommendations with actions framed in the short, medium and longer term. The short-term actions represent good practice that we would expect all companies to be doing. These can be implemented immediately, and the Treasury will work with Landcorp on this. The medium and longer-term actions are where the value lies in terms of lifting performance. Each action will inform the next.

Short-term – addressing transparency and accountability requirements. Landcorp has proposed actions to address the concerns set out in the Review and will work with the Treasury to implement them.

Medium-term – understanding core on-farm performance. We recommend that Landcorp be asked to provide a briefing on its current initiatives and proposed responses to lift on-farm performance. [34]

Longer-term – [25], [34], [37] The core rationale underpinning the current strategy was to diversify revenue streams to create more sustainable returns. This level of returns has not yet been achieved [25], [34] We recommend that consideration is given to the business model and strategy, including Landcorp's role in industry good and value-add opportunities. [34]

Recommended Action

We recommend that you:

a **note** that the Independent Review into Landcorp Farming Limited's (Landcorp's) performance outlines strengths in Landcorp's environmental, health and safety and genetics practices, but also notes concerns about Landcorp's on-farm and off-farm performance, high corporate overheads and consequently its business model and strategy

b **note** that Landcorp and the Treasury will work together to address the transparency and accountability issues outlined in the Review as a matter of urgency

c [34]

d [34]

e [34]

f **agree** to provide Landcorp with an extension for the delivery of its final Statement of Corporate Intent to 31 August 2021, as permitted under section 14(4) of the State-Owned Enterprises Act 1986

Agree/disagree.	*Agree/disagree.*
Minister of Finance	Minister for State Owned Enterprises

g **agree** for the Minister for State Owned Enterprises to sign the attached letter to the Chair of Landcorp.

Agree/disagree.
Minister of Finance

Agree/disagree.
Minister for State Owned Enterprises

Maureena van der Lem
Manager, Commercial Performance

Hon Grant Robertson
Minister of Finance

Hon David Parker
Associate Minister of Finance

Hon Dr David Clark
Minister for State Owned Enterprises

Treasury Report: Landcorp Farming Limited - Independent Review

Purpose of Report

1. This report provides you with an overview of the Landcorp Farming Limited (Landcorp) Independent Review (the Review), implications and proposed next steps.

2. A draft letter is attached to this report for shareholding Ministers to consider sending to the Chair of Landcorp outlining your views and expectations as a result of the Review.

3. A full summary of the Review's final report can be found attached to this report as Annex 1.

Report overview

4. On 19 March 2021, Dr James Morrison provided his final report on the performance of Landcorp. Landcorp provided its response to the Review to shareholding Ministers on 12 April 2021.

5. The responsible Ministers for decisions on the Review are the shareholding Ministers (Minister of Finance and Minister for State Owned Enterprises) with the Review falling outside the delegation of day-to-day matters to the Associate Minister of Finance.

6. The key themes of the final report largely follow those of the draft document received on 27 February 2021 and reported to you by Treasury on 15 March 2021 (T2021/481). For the final report, Dr Morrison has reorganised the conclusions and key themes to provide useful insights into the underlying causes of performance and guidance for next steps.

7. There are four key issues arising from the report that we recommend require attention – (i) transparency and accountability, (ii) on-farm performance, (iii) off-farm performance and (iv) corporate overheads. [34]

Issue 1: Transparency and accountability

8. The Review concludes that Landcorp's performance has proved difficult to assess because of information shortcomings, lack of transparency and 'moving targets', making it difficult to hold Landcorp to account. In particular, strategy and targets have changed year-on-year and over-arching financial targets appear to be based on current year forecasts and change year-on-year rather than being set as a goal.

9. The Review advises that long-term strategic goals should be set and maintained as a reference point, to allow progress to be tracked over time. To complement this tracking, Landcorp should provide more transparent reporting, including segmented reporting and commentary on variances from budget on an ongoing basis and undertaking cost-benefit analyses of activities. Greater transparency about the trade-offs associated with activity choices will also assist to understand the underlying performance of the business.

10. We understand that financial systems weaknesses identified in the Review have largely been addressed by Landcorp and reliable regular year-on-year segmented and variance forecasts can be prepared.

Issue 2: On-farm performance

11. The Review noted significant improvements in health and safety and environmental practices, with Landcorp ahead of sector benchmarks in most areas.

12. In terms of on-farm performance, Landcorp's growth into organic farms has demonstrated that it can achieve profitability with lower intensive farming systems. More generally, on-farm diversification (forestry and lower carbon practices) is having a positive impact on profitability and outcomes.

13. However, Landcorp's on-farm operations still tend to perform around or below sector averages, before the allocation of corporate overheads. Allocating the relatively high overheads (discussed below) would further deteriorate on-farm performance. Landcorp's ability to take a leadership role in promoting the adoption of good farming practices is likely to be undermined by a failure to demonstrate viable on-farm operations.

Issue 3: Off-farm performance

14. To date, Landcorp's off-farm 'value-add'/beyond the farm-gate operations have not delivered as Landcorp anticipated. The Review identifies [25] [34] part of the gap between Landcorp's forecast and actual performance.

15. [37]

    Although not unusual with new ventures, the Review notes that over-optimistic forecasting has become a pattern for Landcorp.

16. The Review questions Landcorp's competitive advantage for making its 'off-farm' ventures successful. It notes that others in the market are undertaking similar ventures with skills more aligned to these operations than Landcorp's capabilities in on-farm operations. While large, Landcorp only represents only 5.9% of New Zealand's livestock farming by area and 1.1% of national dairy farming and has limited ability to leverage economies of scale. Its geographic spread means it cannot easily integrate systems between farms or processing to match competitors that are more efficient and/or have market power.

17. Put simply, the Review concludes that the core competencies required to deliver end-to-end distribution, sales and inventory management, marketing and branding are very different to those required of Landcorp's core pastoral farming role. [34]

18. We understand that Landcorp is exploring overseas deal options for Pāmu Foods, [37]

19. While Landcorp is only a part shareholder in Spring Sheep, FarmIQ and Melody, its Board is responsible for ensuring that Landcorp's investments are performing acceptably, including taking appropriate action where investments no longer stack up. [25], [37]

Issue 4: Corporate overheads

20. [37] , Landcorp's corporate overheads are high and are in part a product of:

    a the complex business model that Landcorp has adopted; and

    b tensions in the SOE model, namely that Landcorp sees that it has a higher cost of compliance due to public accountability requirements.

21. While Landcorp undertook a Corporate Services Review in 2019, this review assumed no change to the current strategy or business model and identified no immediate material cost savings. [34] [25], [34], [37] [34]

Strategy and business model

22. Shareholding Ministers have, to varying degrees in the past, had a keen interest in Landcorp participating in value-add activities, innovation, lowering environmental footprints, undertaking an industry good role and in being an exemplar to others in the market. Shareholding Ministers have set expectations to this effect, while being clear that Landcorp's core role is to excel as a pastoral farmer.

23. The Review finds that there has been some tension in these expectations, in particular that some of the activities could come at a higher cost and/or expose Landcorp to higher risk. It notes that under the State-Owned Enterprises Act 1986 (SOE Act), Landcorp must carefully balance its activities so as to be as profitable and efficient as a company not owned by the Crown. If Landcorp does not deem an activity commercially beneficial, it should be transparent about the trade-offs made.

24. As does any commercial business, Landcorp explores ways of developing its business. The Review finds that Landcorp is adding value through profitable on-farm developments and so does not need to go beyond the farm-gate into off-farm ventures to achieve value-add. For example, the shift to:

    - alternate land uses, in particular forestry, has become a profitable and self-funding part of Landcorp's portfolio; and
    - organic farms and practices leading to lower GHG emissions, coupled with a shift to other milk suppliers such as Synlait, has been profitable.

25. These successes present opportunities for Landcorp to further share its knowledge with others in the sector to promote good practice farming. The Treasury recommends further promotion of this work and more weight on achieving shareholder expectations on-farm to demonstrate the viability of these practices.

26. The Review highlights that the [25] 'off-farm' ventures are not without risk, [37]

    In its response, Landcorp notes that "Pāmu Foods will take on a greater degree of risk than in its core operations, it will evolve quickly, fail fast and move on with the aim that the prize is worth the risk.".

27. [34], [37]

Implications

28. The Review highlights some serious concerns with the current model and performance, which could be addressed through a phased set of actions to be carried out in the short, medium and longer terms. Note that the stages relate to implementation rather than commencement:

    - Short-term – addressing transparency and accountability requirements;
    - Medium-term – understanding on-farm performance; and
    - Longer-term – [25], [34], [37]

29. The short-term actions represent good practice that one would expect all companies to be doing. These can be implemented immediately, and the Treasury will work alongside Landcorp on this. The medium and longer-term actions are where the value lies in terms of lifting performance. Each action will inform the next.

30. Landcorp has provided a response to shareholding Ministers on the Review, predominately focusing on the Review's 13 recommendations and proposing ways to address the short-term, transparency and accountability concerns. The Treasury has also met twice with the Chair, Dr Warren Parker, to discuss the report.

31. The Treasury's view is that the wider strategic questions raised by the Review should also be addressed. These are discussed in the medium and long-term sections below.

Short-term – transparency and accountability

32. The Review identifies a number of basic transparency and accountability practices that it says can and should be readily implemented. At a minimum these include:

    - Setting and retaining long-term strategic goals to transparently track progress on performance of the strategy over time.
    - Providing more transparent accounting, including segmented reporting and commentary on variances from budget on an ongoing basis.
    - Undertaking cost benefit analyses of activities and being transparent about any trade-offs between commercial performance and broader sector benefits.

33. Landcorp proposes to work with the Treasury to assess the information requirements, strengthen its accountability documents to include linkages and clarity over strategic goals over time and prepare regular segmented reporting and variance analysis. This work has already begun, with Landcorp developing a 2030 strategy incorporating targets to reach over time. The Treasury is yet to assess this proposed strategy and will continue to work with Landcorp to address other information requirements. We recommend that you note in your letter to the Chair, your support for this increased transparency.

Medium-term – on-farm performance

34. In addition to the on-farm business being Landcorp's performance priority, any underperformance in core farming undermines Landcorp's ability to influence change. The broader sector is unlikely to see Landcorp as an exemplar if it sees it as operating in a way that is not viable. Therefore, it is critical for Landcorp's on-farm performance to continue improving, if it wishes to have influence over the broader sector.

35. Regardless of its longer-term strategy [25], [34], [37] , being a good pastoral farmer is likely to remain Landcorp's primary objective. Landcorp is focused on implementing benchmarking practices and upskilling staff across its farms with performance improving in recent years. We recommend that Landcorp provides a briefing about its improvement initiatives [34]

36. [34]

Longer-term – [25], [34], [37]

37. The core rationale underpinning Landcorp's current strategy is diversifying revenue streams to create more sustainable returns. This intention has not been achieved. [34]

38. Given the absence of any clear competitive advantage, the high risks to strategy delivery and continued financial constraints, [34]

39. [34]

40.

41. Shareholding Ministers can set expectations at any time. We recommend that you sign the letter attached to this report, which sets out expectations about areas of focus and for action by Landcorp as a result of the Report. The draft letter also asks Landcorp to take the expectations it sets out into account in its upcoming Statement of Corporate Intent.

42. As per the SOE Act, Landcorp is required to deliver its draft SCI to shareholding Ministers by 31 May 2021 with a final normally due by 1 July 2021. The matters noted above will take time for the Board to consider. There is no legislative mechanism to delay the delivery of the draft SCI, however, under section 14(4) of the SOE Act, shareholding Minister can agree to an extension of the final SCI's delivery. We recommend that shareholding Ministers agree for an extension to 31 August 2021 to allow time for proper discussion and consideration of the implications to occur.

Risks

43. There is likely to be a high level of public interest in the outcomes of this Review and Landcorp's performance. We will keep your office informed of any information requests.

Next Steps

44. The Treasury recommends that you consider sending the attached letter to the Chair of Landcorp outlining your views and concerns as a result of the Review.

45. This includes asking that:

    a as it proposes, Landcorp work with the Treasury to address the information, transparency and accountability concerns arising from the review as an immediate action;

    b Landcorp provides an overview of its current on-farm initiatives to lift performance, [34]

    c [34]

46. These actions are proposed to be carried out as a phased approach with information being developed at each phase that supports the assessments proposed in the succeeding phase.

47. Successful performance of Landcorp's core role is critical in it being able to influence the adoption of good practice farming. This work should continue and should not be interrupted by the proposed phased work programme set out above.

48. [34]

49. [34]

Hon Dr David Clark

MP for Dunedin

Minister of Commerce and Consumer Affairs
Minister for the Digital Economy and Communications
Minister for State Owned Enterprises
Minister of Statistics
Minister Responsible for the Earthquake Commission

Dr Warren Parker
Chair
Landcorp Farming Limited
[23]

Dear Dr Parker

LANDCORP FARMING LIMITED INDEPENDENT REVIEW

I am writing on behalf of shareholding Ministers to outline our reflections on the Independent Review and next steps.

Thank you for participating in the Review process and in sharing your response. We appreciate that you are planning changes to address the transparency and accountability concerns raised by the Review and ask that you work with the Treasury to implement these as soon as possible.

We understand that differences in your views to those of the reviewer are inevitable and will give careful consideration to the challenges you have set out to some of the Review's findings.

However, in our view there are some substantial questions arising from the Review and the overall themes that emerge need to be considered further. These include concerns around performance and the current cost structure which ultimately lead to fundamental questions around the company's strategy and business model. We believe these matters should be considered further and we look for your support and co-operation to do so.

We note and commend improvements in Landcorp's on-farm performance in recent years, in particular, the growth in organic farms and in demonstrating on-farm diversification to have positive impacts on profits and outcomes. However, we note that Landcorp's on-farm operations still tend to perform around or below sector averages, before the allocation of corporate overheads.

Shareholding Ministers continue to see that Landcorp's core objective is to excel as a pastoral farmer. It is critical that Landcorp is able to demonstrate strong farming performance for it to be a leader in good farming practice. We understand that you are undertaking a number of activities to strengthen your on-farm performance [34]

The Review highlights that off-farm ventures continue to under-perform [25] A number of the original business cases appear to have been based on overly optimistic forecasts. The Review noted that there are risks around Landcorp's ability to execute its strategy cost-effectively given that the core competencies for successfully delivering 'off-farm' ventures are quite different to those required to deliver pastoral farming excellence.

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[37] We expect the Board to take a realistic view on the business's prospects. [37]

The level of corporate overhead has been a concern of shareholding Ministers for a number of years. We note that this Review concludes these high costs are in part due to the current complex business model. We expect that further work is undertaken to optimise corporate activity and make it fit-for-purpose, relative to Landcorp's operational model.

Next steps

We expect, as you have proposed, for the transparency and accountability changes to be implemented as soon as practicable and for you to work with the Treasury to make this happen.

As stated above, strong on-farm performance remains our primary expectation for Landcorp, both in fulfilling its core objective as an SOE and for Landcorp to have credibility to take a leadership role in good farming practices. [34] We would like you to provide a briefing on on-farm performance initiatives and activities by 21 May 2021, setting out your position on Landcorp's farming performance relative to comparators and the pathway to lifting performance.

In developing your Statement of Corporate Intent, please consider this letter as you would a Letter of Expectations, giving consideration to the expectations above and their implications for your current strategy and business model. [34]

As per section 14(4) of the State-Owned Enterprises Act 1986, we have decided to extend the time by which you deliver your final SCI for 2021/22 to 31 August 2021. This is to ensure that there is adequate time for the considerations noted above. You are still required by legislation to deliver your draft SCI by no later than 31 May 2021. However, we acknowledge that this may be a simplified form whilst further discussions are ongoing.

We appreciate that considerable time has gone into engaging in, and responding to, the Review. We expect you to continue working with the Treasury on your response and implementation.

Hon Dr David Clark
Minister for State Owned Enterprises
On behalf of shareholding Ministers

Annex 1: Summary of the Landcorp Farming Limited Independent Review report

This performance summary is structured around the key themes that emerged from the review. What follows reflects the views of the independent reviewer. Performance was assessed over the period FY16-FY20 (the period) unless otherwise specified.

Governance, Strategy and Business Plans

The principal objective of Landcorp, as a State-owned enterprise (SOE), is to be "as profitable and efficient as comparable businesses that are not owned by the Crown" and the Board should consider the cost v benefit of activities that may be contrary to this in order to clearly demonstrate the trade-offs.

Landcorp's strategy was refreshed in 2015. This review considers the performance of Landcorp following this refresh.

Every SOE is required to produce a Statement of Corporate Intent (SCI) outlining its strategy, objectives and performance metrics to assess performance. Over the period, the SCI has had two consistent themes, a farming strategy focused on the Pāmu promise and a value-add strategy focused on value chains and markets. However, Landcorp's longer term strategy and targets have also changed every year, contrary to the principles of performance management, undermining accountability for long-term commitments and strategic direction. For example, financial targets have changed from "12% total shareholder return (TSR)" in FY16 to "EBITDAR of $61.1 million" in FY20, the latter of which changes year on year depending on the budget for that year.

The Review also notes that it is not clear that Landcorp needs to venture 'off-farm' to achieve the strategic objective of diversifying revenue risk. Landcorp has already added value on-farm through its diversification programmes and land-use changes.

Financial performance

Revenue has increased by 22% over the period, mainly due to the improved performance of the dairy and livestock sectors. Operating expenditure has remained relatively stable. Although revaluations have had adverse impacts on Landcorp's financial results in recent years, over the period there has been a net positive impact of approximately $23.4 million (an average of $4.7 million per year).

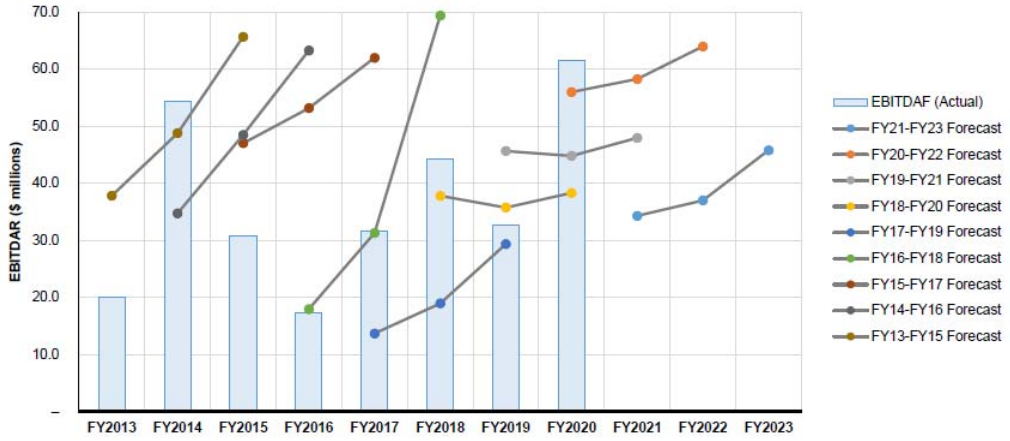
Actual TSR for the period has totalled an average of -0.8%, which is well below the FY16 target of 12% and also below the long-run average for farming of 1.9%.

Changes in accounting standards (IFRS 16 - Leases) in FY20 has also had a significant impact on Landcorp's latest financial results. Earnings before Interest, Tax, Depreciation, Amortisation and Revaluation (EBITDAR) increased by $30.6 million from FY19 to FY20 [37]

The Review also finds that of the fifteen EBITDAR forecasts presented over the period, only five were within 10% of the forecast. This gap is shown in Figure 1 below.

In general, Landcorp has been fairly accurate in its commodity price forecasting and the Review commends Landcorp's shift to forecasting based on long-run averages in out years. While there have been variances between operating revenue and expenditure projections, on-farm significant deviations from budget could not all be explained by on-farm activity. It is, therefore, noted that off-farm activities [25] all performing well below budget and having a disproportionate effect.

Figure 1: Actual v Budget EBITDAR performance:



Wairakei Lease

The Review finds the Wairakei Lease to [25], [34], [37] The total cost of lease and rates are expected to increase [25], [37] The Review also notes that a [25], [34], [37]

[34]

Corporate overheads

Corporate overheads [37] are deemed as large by the Review. [25], [37] However, corporate overheads are not allocated to operating divisions, thereby understating the full costs for performance comparison purposes. Corporate overheads are also not reported in any public documents. Transparency over the corporate costs and their allocations would encourage performance uplift to meet benchmarks.

A Landcorp commissioned corporate services review in 2019 (the Jane Judd review) did not identify material savings, however, noted that the need for a deeper dive into certain parts of the business. This review also found that Landcorp needed a stronger focus on its core role and more specialist farm business managers. Landcorp has reorganised its corporate office slightly to take account of these findings, upskill its farm managers and reduce its span of control.

The Jane Judd review was premised on Landcorp's current strategy and business model and did not consider whether either of those were right. Therefore, it was not in a position to form a view on the potential for cost savings to be made by switching to a different model.

The Review finds that Landcorp's high corporate overheads are due, in part, to its complex strategy of vertical integration and off-farm investments and its strategic control approach. The Review also notes that the trade-offs associated with the current strategy have not properly been scrutinised, specifically whether there is a net benefit to its current complexity versus being a more focused and efficient farming/land-use enterprise.

Review has used Dairy Holdings and Southern Pastoral as a potential comparator for parts of Landcorp's business, noting that it is not a direct comparator. Landcorp has challenged the use of Dairy Holdings, which has considerably lower overhead costs, as a comparator given its simpler, more compact business. The Review raises questions around whether the lack of direct comparators is a sign that the current business model is sub-optimal.

Industry good

The Review notes Landcorp does and should continue to participate in industry good activities, however, it has reservations about the extent to which Landcorp's activities qualify as 'industry good' per se. In order to quantify an activity as 'industry good', the view of the Review is that one must understand the sector-wide impacts and how much of that can be attributable to Landcorp. The Review notes that there is room for improvement in Landcorp's current practices including quantifying end-to-end benefits and partnering with other sector participants more. It is important that where activities are deemed non-commercial a cost benefit analysis is undertaken.

Environmental and people performance

The Review finds that Landcorp has made significant advances in its environmental performance since 2016. It notes a 23% reduction in net GHG emissions per hectare and 9% decrease in total nitrogen leaching per hectare. The Review also finds that Landcorp is well prepared for compliance with Farm Environmental Plans.

Landcorp's health and safety practices have improved significantly since 2016, with lost time through injury metrics decreasing by 13% per annum on average and staff turnover decreasing by 14% per annum on average. This is as a direct result of targeted employee awareness programmes and development of its own farmers.

On-farm performance

Although large relative to most other farmers, Landcorp's on-farm operations account for only 5.9% of New Zealand's total livestock farming area and 1.1% of the national dairy farming area with a wide geographic spread. This limits the potential for economy of scale benefits.

Over the period, livestock and dairy revenue has grown by 14% and 31% respectively and expenditure increasing by 5.6% and 3.3%. While on-farm performance has improved significantly, the improvement is still average or below industry averages for conventional livestock and dairy farms. The benchmarking of Landcorp's organic farms demonstrates above sector Earnings Before Interest and Tax (EBIT) performance and reduced environmental footprints.

Corporate overheads are not allocated to on-farm divisions, distorting performance relative to benchmarks.

The Review also notes that Landcorp has undertaken a number of successful on-farm value-add activities, including the diversification of revenue streams to attract higher premium prices, land-use change and the shift to organic farming on a number of farms. This is critical as dairy revenue is 91% correlated to the Fonterra milk price. The shift to value-add diversification and organic farming has added [37]
additional revenue per season.

Landcorp's land-use diversification strategy has seen a shift into forestry and horticulture on marginal farming lands. This is a relatively new part of Landcorp's business.

Landcorp's current forestry portfolio spans approximately 10,000 hectares with an additional 2,000 hectares per annum planned over the next 30 years. Forestry, which benefits from carbon credit allocations ($3 million worth held currently), has become a profitable and self-funding part of Landcorp's portfolio.

Landcorp opened its first horticulture venture (avocados) in Northland in 2019. It is too early to assess the performance of this venture. [37]

[37]
The Review also notes some significant risks in the avocado sector, namely the risk of over-supply in the market [37]

Off-farm performance

The Review considers Pāmu Foods, Spring Sheep and Melody Dairies to be part of the "Foods" group with linked strategies. The Foods Group has significantly underperformed against budget [37]

[25], [37]

Focus Genetics and FarmIQ are both deemed to play an industry good role [25], [37] an important part of Landcorp's business.

The Review notes that there has been government investment in a number of these ventures, however, this does not need to be through Landcorp and there may be more effective ways to channel public funding to achieve the desired outcomes.

Spring Sheep

Landcorp is a 50% shareholder in Spring Sheep. Spring Sheep competes with at least five other companies in the New Zealand market. Under the original partnership agreement, Landcorp was to develop and operate four sheep dairy farms. This has not happened and the Review notes this is due to Landcorp's limited capital resources being prioritised elsewhere.

The Spring Sheep venture anticipated an internal rate of return (IRR) of [25] and budgeted for [25] cash flows by FY21, which is now not expected. In 2018, Landcorp reported [25] planned volumes and [25] to budgeted milk production in FY18. Despite this reforecast, the Review found that actual milk revenue is still approximately [25]
[25] Net operating cash flows and EBITDAR in FY20 was approximately [25]
[25] NPAT has [25]
[25] The annual investment from shareholders [25]
[25]

The Review notes that Spring Sheep has formed its own genetics brand "Zealandia" rather than using Landcorp's Focus Genetics.

[25]

The Review also notes that the 2020 PwC review commissioned by Landcorp included a value creation bridge which estimated the value of its shareholding in Spring Sheep [25]
[25] [25], [34]

Pāmu Foods

Pāmu Foods operates as a business unit of Landcorp. It was established to achieve value-add in the wool, lamb, venison, sheep milk, bovine dairy and deer milk industries. It requires expertise in product development, marketing, branding and sales in order to create products for end users. These are capabilities that are outside of the core competencies required for a pastoral farming company. The Review has focused on the bovine dairy business as it represents the largest part of the venture.

The premise for the original business case was that Landcorp's business model was under threat, in particular:

a) Its exposure to commodity prices impacting on its ability to manage cash flow risks around dividend payments and debt covenants;
b) Low cash returns from assets requiring recycling to pay dividends;
c) Continual scrutiny from the government as a result of the above; and
d) Frustration in Landcorp due to constraints on investment with a risk adverse and capital constrained shareholder.

[37]

[37]
the main economic component of Pāmu Foods [37] made revenue in FY20 of [37] compared with a budget of [37] . The other key component of Pāmu Foods [37] was expected to return revenues of [37] in FY18 and [37] in FY19, [37] in FY18 and [37] in FY19.

Significant write-downs of inventory were required in 2019 totalling $3.8 million. [34]

Landcorp conducted an internal review into Pāmu Foods in 2019, which saw a pivot from a B2C[3] model to a B2B[4] model. A further business case was prepared in FY20 and forecasts a five-year IRR of [37] EBIT in FY22 and sales of [37] . [34], [37]

[34], [37]

It deems the starting overhead costs [37] per annum to be high for this type of business. [37]

Melody

Landcorp holds a 35% share in Melody, which is essentially a milk dryer located at the New Zealand Food Innovation Waikato site. [25]

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[37]

[37]

3 Business to Consumer

4 Business to Business

The Return on Investment was originally forecasted at [25] in FY19 and has been revised to [25] in FY20. [25]

For Q1 and Q2 of FY20, production days were [25]

Focus Genetics

Focus Genetics is a fully owned subsidiary of Landcorp and manages the largest red meat stud in New Zealand, has the biggest DNA recorded gene pool and a team of animal breeding scientists. Focus Genetics has become an integral part of Landcorp's on-farm operations and is returning modest profits. The Review found no matters of concern relating to the performance of Focus Genetics.

FarmIQ

Landcorp currently has a 26% shareholding in FarmIQ which started within a Primary Growth Partnership in 2010. [25]
[25]

The Review finds it is a relatively small investment with ambitious targets. [25]
it is integral to Landcorp's farm management and will be critical to assist with the changing regulatory environment.