

Newsletter

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Image: Early flowering on shiraz vines at Hahn vineyard, Barossa Valley, South Australia, November 2020.

Cover image: Macadamia development planting material at Nursery Farm, Bundaberg, central Queensland, August 2020.

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A world going nuts

David Bryant, RFM Managing Director

Over the past decade, the production and consumption of tree nuts has grown steadily, averaging 4.6% annually over that time. This is a fast growth, compared to say sugar, at 0.7%. Why?

Tree nuts are growing

Around the world trees are blooming, nuts are growing, and harvesters are shaking a crop worth \$54 billion. Every year, the size and value of this crop grows, with an increase of nearly \$3 billion forecast in this year and similar gains in future years. Over the past decade, the production and consumption of tree nuts has grown steadily, averaging 4.6%¹ annually over that time. This is a fast growth, compared to say sugar, at 0.7%.² Why?

Tree nuts are thinning

"Thinning", or at least "stable", are the findings of numerous epidemiological studies on the consumption of nuts. A study that followed 51,118 women for eight years found that those women who consumed nuts greater than twice per week, gained 0.41 kgs less than those who ate no nuts, with the

results being the same for normal, overweight and obese participants. As one report noted: "...the satiating effect of nuts with subsequent food compensation appears to be the main reason for their lack of weight-promoting effect".³

On average, four large and long studies found a 37% reduction in the risk of fatal coronary heart disease, including a study of 21,454 male physicians in the US, which found that nut eating doctors (two serves per week or more), were 47% less likely to die from coronary heart disease.⁴

Nutty commodities

While satiating and life-saving, this manna from the tree tops is still just an agricultural commodity – though mostly for rich people. Karl Marx, famous for thoughts on rich people, also provided a good definition on





agricultural commodities, stating: “From the taste of wheat, it is not possible to tell who produced it, a Russian serf, a French peasant or an English capitalist”. And the same can be said for specific nuts, since from the taste of almonds it is not possible to tell who produced it, a Spanish agricultora, an Australian horticulturist, or a Canadian pension fund.

Differentiating commodities may be difficult, but the rich prefer tree nuts to peanuts. With just 16% of the world’s population, rich countries gobbled 56% of the 4.5 million tonnes of tree nuts produced last year while the much more populace middle-income countries, with 76% of world population, consumed nearly all of the rest. They have however, been increasing their consumption of nuts at a much faster rate, as illustrated in **Figure 1**. This massive middle-income group also crunched through 91% of the world’s 41 million tonne peanut crop, which they mostly produced themselves.⁵

Peanuts are technically a legume, the same as peas and beans, but they contain much the same nutritional characteristics as tree nuts, providing similar dietary and therefore health benefits. Importantly for middle-income consumers, peanuts are probably the cheapest source of protein that money can buy. Based on their current purchase price at a large supermarket, unsalted peanuts provide 100 grams of protein for just \$2.36, compared to chicken breast fillets at \$4.06 per 100 grams, while almonds are \$8.13 and whey protein in a can is \$10.03. In middle-income countries, shoppers are aware of this, and have incorporated this nutritious food source into their cuisine.

While peanuts could be a bargain for body builders in high-income countries, this nutritious nut has encountered two difficulties. Firstly,

the proteins in peanuts differ from tree nuts, causing a higher incidence of allergic reaction.⁶ Secondly, as a snack food, they are pretty hopeless without salt – and once you add salt you probably need beer to quench your thirst. Which sort of defeats the purpose, since salt is really bad for your heart, and beer is not famously satiating. With the trend in high-income countries to safe schools and healthy diets, it is no wonder that the once ubiquitous peanut, has been banned from schools and perhaps soon, my house.

Healthy eating trends, and the trend to greater consumption of tree nuts, can be seen in café menus, and the data presented in **Figure 1**. For rich countries, tree nut consumption has been growing at 3.9% per annum over the past decade. For middle-income countries, peanut consumption has grown at a pedestrian 0.7%, while tree nuts are booming with a growth rate of 10.8% per annum.

These trends are very significant for tree nut producers, since markets in middle-income countries are enormous. This group includes China, India and in total 5.8 billion people, compared to a market of just 1.2 billion people making up the higher income countries. Within these giant middle markets live millions of high-income earners able to afford the same healthy diet desired by people in high-income countries. Due to the greater economic growth rates experienced in middle-income countries, prosperity is creating millions of new consumers with the education to pursue healthier lifestyles and the income to afford it.

Like all agricultural commodities, tree nut prices will vary annually due to seasonal factors, such as a drought in a key growing region, which reduces supply and increases prices. Over the medium term, prices will vary due to structural drivers, such as government

policy encouraging over planting, or consumer trends demanding safer and healthier food. Fortunately, with few exceptions, tree nuts have not been the subject of government agricultural programs, typically encountered in bulk commodities such as grains, oilseeds and dairy. This has enabled a global industry accustomed to expanding production, when increased sales send a price signal, that the customer wants more nuts.

Macadamias are a commodity

Figure 2 presents the growth in macadamia production and the change in price over a decade. Macadamia production has increased at a compound rate of 8.1% per annum, while the price paid for this commodity has also increased – because demand has increased. Seasonal factors have and will affect

supply and therefore prices, but over the long term the challenge for the macadamia industry is to maintain prices as production continues to expand.

From time to time, macadamia prices will decline because good seasonal conditions create a larger crop. Additionally, it is possible excessive plantings of new trees can cause periods of excess supply that can depress prices long enough for “low prices to make high prices”. These are periods where new plantings contract and orchardists reduce inputs to save money, which in turn reduces production, thereby allowing prices to recover.

Managing a macadamia business through periods of lower prices requires several strengths of character.

Firstly, macadamia trees require about a decade to reach full production, so business owners and managers must have a long-term commitment and perspective when making decisions. They must also have the balance sheet or financial capacity to survive, or even prosper from, opportunities created during downturns. Finally, they should have a cost of production that is lower than their competitors, so they can still turn a profit, or minimise their losses, when all else are haemorrhaging.

Attaining this last strength is best achieved not only through cost control, but development of orchards that can grow the highest yields. This in turn is achieved through highly precise irrigation and fertigation, a reliable and clean water supply, selection of fertile soils, and by

Figure 1: World tree nut and peanut consumption by Gross National Income (GNI)⁷

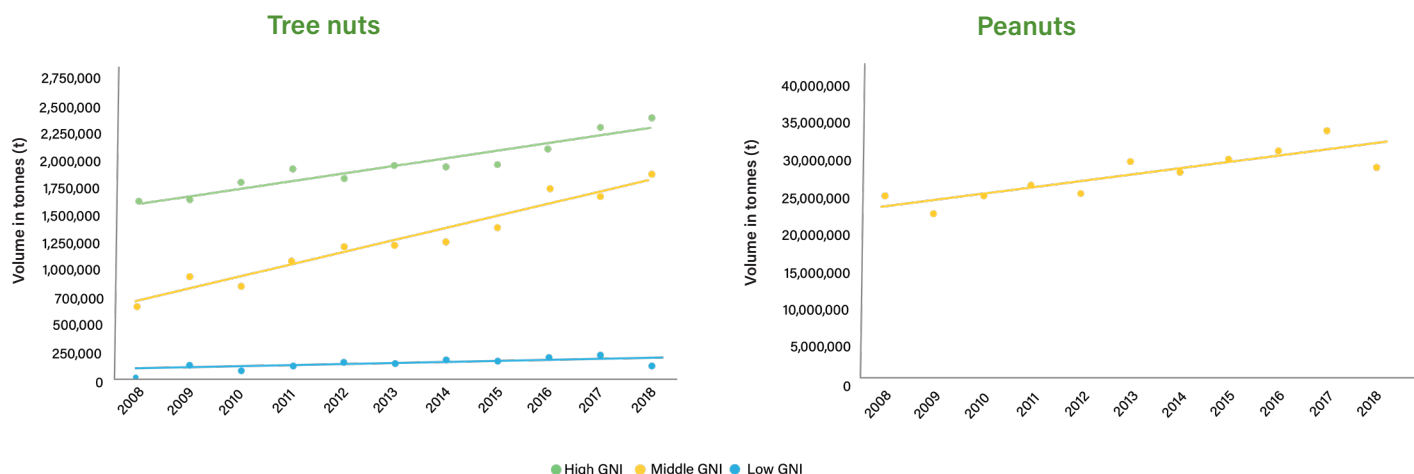
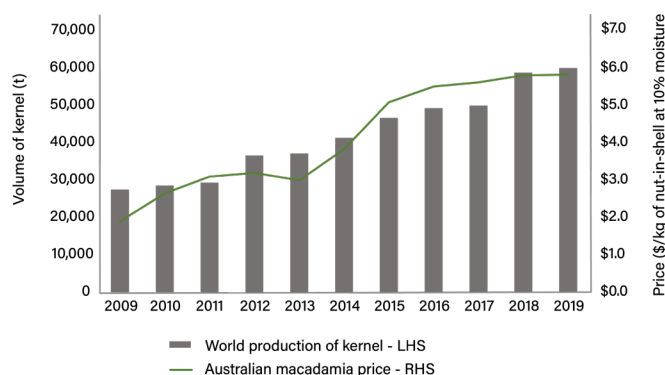


Figure 2: World macadamia production (tonnes) and Australian price since 2009^{8,9}



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It is the combination of healthy, flavoursome fats that makes macadamias a desirable ingredient for thoughtful, health conscious consumers, chefs confectioners and food scientists.

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planting varieties selected for their site-specific yield performance. In short, it is achieved by combining skilful management with high quality natural resources.

Once good orchards have been established, management need to be mindful that continuous improvement will occur in the wider industry. For this reason, continuing to invest in technology and particularly variety improvement, are long term but decisive factors in maintaining a business that will prosper through cycles as they will most certainly occur.

An unsaturated commodity

Over the past decade, macadamias' market share of world tree nut consumption has remained unchanged at around 1%. With 60,000 tonnes of macadamia kernels produced in 2019, the industry is tiny compared to almond production of 1 million tonnes and sugar production of 166 million tonnes. But macadamias are neither a delicacy or niche product consumed only by a specific culture or on a special occasion. Instead, they are a new and versatile food, sought after by consumers, from an industry that is still developing production methods and capacity.

Macadamias have the highest fat content of tree nuts, with 80% being unsaturated fats – the class of fats that have been found to reduce the risk of cardiovascular disease. This high fat content gives macadamias the distinctive complex flavour that makes it a pleasing food on its own, or an excellent ingredient in both savoury dishes and sweet foods. It is this combination of healthy, flavoursome fats that makes macadamias a desirable ingredient for thoughtful, health conscious consumers, chefs, confectioners and food scientists. And if you are wondering about the market for less thoughtful consumers, share a bowl of mixed nuts with your friends and see which nut is first to go.

It is these attributes that will allow the macadamia industry to continue to increase production without causing entrenched oversupply. However, maintaining or even improving quality will be a prerequisite. The macadamia's high fat content must be freshly preserved for the consumer, since if allowed to oxidise, they become rancid like all oil rich foods. To preserve the attractive flavours and avoid the unpleasant ones, macadamia producers must

ensure that nuts are harvested, dried, processed and then stored in oxygen free packages that capture the full flavour of the nuts and preserve them until you are ready to eat.

Conclusion

The Rural Funds Group is in the process of securing high-quality natural resources, being land and water entitlements, to establish 5,000 ha of macadamia orchards capable of producing 10,000 tonnes of macadamia kernels annually. Developing these orchards will take some years to complete, but continuous improvement will begin immediately. This includes researching macadamia varieties to select the highest yielding and highest quality genetics for propagation in RFF's recently acquired macadamia nursery.

In addition, RFM will be working with processors seeking larger volumes of fresh and flavoursome nuts, and ways of better capturing and preserving their flavour. By combining these new natural resources with skilful management and continuous improvement, we have in place the elements of what can be a highly profitable investment for RFF and its lessees.



Rural Funds Group update: developing higher returns

James Powell - General Manager, Investor Relations and Marketing

"Agriculture is indispensable for quality of life – not only as a supplier of food, but also because of its contribution to GDP and employment."

This quote from the report "Agriculture's Contribution to a Better World: Transition of the Global Food System" (RaboResearch, October 2020) highlights the essential service that farming, and specifically food production, provides to our society.¹

The reliance on agriculture has been acutely evident in 2020. Industries around the globe ground to a halt due to the COVID-19 pandemic, but

agricultural production continued from necessity. In fact, if history is a guide, production probably accelerated.

Over the past 50 years, when the world's population more than doubled, food production has not only kept pace with the world's fast-growing populace, but appears to have outpaced it. Evidence for this is found in the decline in the number of undernourished people globally. In the 1970s, about one-third of the world's population was undernourished. Today, it is around one-tenth.

How has agriculture managed to increase output such that the

prevalence of undernourished people has reduced against a backdrop of significant population growth? The answer is: productivity gains.

For example, immediately before the 1970s productivity gains occurred through the wide-spread use of manufactured fertilisers and improved plant varieties. Termed the "The Green Revolution", agricultural output per unit of land area dramatically improved. From 1951 to 1968 US wheat yields increased 72% and corn yields 117%. Many other innovations throughout history have also contributed to productivity improvements, such as higher crop



The Rural Funds Group (ASX: RFF) is an agricultural real estate investment trust (REIT). RFF aims to increase distributions by 4% per annum, by owning and improving farms that are leased to good operators.

Image: Developing irrigated cultivation area (foreground). Existing irrigated cultivation area of forage sorghum (background). Comanche, central Queensland, November 2020.

yields, faster animal growth rates, and higher quality produce.

Productivity improvements, therefore, are intrinsic to agriculture's sustainability. For this reason RFM has a long held strategy of improving farm productivity and developing assets to higher and better use. RFM's experience is being used to the benefit of existing cattle and cropping properties and the planning and execution of the recently announced macadamia developments.

A history of productivity development – poultry and almonds

In recent months, RFF's poultry farms and the Moorall almond orchard were sold. Both of these assets were developed or improved by RFM.

Updating poultry sheds to increase growing performance

RFM initially invested in the poultry sector in 2003 with the acquisition of 110 poultry sheds. After their acquisition, RFM upgraded the sheds. One upgrade was to achieve

higher ventilation speeds. Improving ventilation within the sheds, and the conditions for growing the birds, provided better daily weight gains, which is a primary productivity measure in the poultry sector.

As well as upgrading existing facilities, RFM constructed an additional 44 sheds on land which had been used for comparatively lower-value operations, such as rice farming. The new sheds were more productive than the older ones, despite their upgrades. Approximately twice the size of the original sheds, the new sheds benefitted from lower labour costs. Concrete floors provided better insulation and lower pathogen levels, reducing the costs of electricity and disease. More modern componentry and technology in the new sheds also contributed to performance.

The poultry example outlines two productivity initiatives: converting land to higher and better use and improving the performance of the assets themselves. The development of the Moorall almond orchard provides a similar example.

Converting grazing land to a high yielding almond orchard

In 2006 and 2007, RFM developed Moorall by converting over 800 ha of grazing and cropping land to an irrigated almond orchard. The conversion enabled associated water entitlements to be applied to a considerably more profitable agricultural commodity.

A state-of-the-art drip irrigation system and soil moisture monitoring equipment was installed on Moorall. The use of these technologies was designed to improve the yield potential, through timely and accurate water delivery. The capacity of the irrigation system also exceeded the industry average, enabling more water and nutrients to be applied to the trees to also achieve higher yields.

Similarly, throughout FY21, RFM will work with lessees to improve the productivity on a variety of natural resource predominant assets, with the aim of increasing their value and income earning potential.

Ongoing productivity developments – cattle and cropping

In the cattle sector, expanding water points, developing cultivation areas, and improving pastures is a productivity improvement focus.

Improving carrying capacity, weight gain and breeding potential on cattle properties

The **Natal aggregation (A)**, located near Charters Towers in north Queensland, was purchased in 2017 (see **Figure 1**). The productivity development focus for this property has been additional water points including new dams, tanks, and troughs.

By adequately dispersing drinking water on large properties, the number of cattle able to be stocked (referred to as carrying capacity) can be increased. An additional 22 water points were completed on the Natal aggregation to 30 June 2020, with 13 water points planned for FY21.

Figure 2 shows the location of these water points on Longton, one of the properties comprising the Natal aggregation. Each circle signifies the approximate grazing area that is unlocked through the development of a water point and subsequent access to water for cattle.

On the Queensland gulf cattle properties, **Mutton Hole and Oakland Park (B)**, development of an additional five water points is planned for FY21. Pastures will also be improved by aerially seeding 13,300 ha of stylo. Stylo is a legume high in protein and other nutrients which can improve the fertility of the breeding cattle herds.

In central Queensland other legumes, such as leucaena, will be sown to improve pastures. Planting legumes aims to improve the daily weight

Figure 1: Property locations

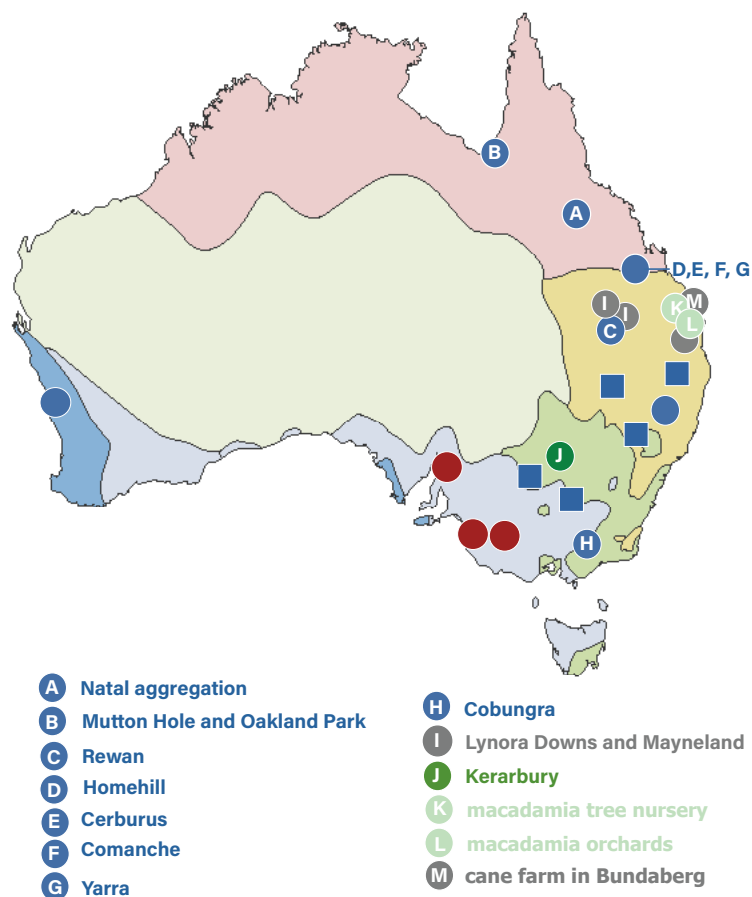


Figure 2: Additional water points developed on Longton (part of Natal cattle aggregation) FY20-FY21



gain of cattle and also increases the properties' carrying capacity. Additional areas of legume plantings are planned on **Rewan (C)** and **Homehill (D)**.

A further productivity initiative in central Queensland is the development of cultivation areas; areas in which annual crops can be grown, and on which cattle can feed. Annual crops, such as oats, provide an alternative, counter-seasonal feed source to sub-tropical grasses. During FY21, over 1,000 ha on **Cerberus (E)**, **Comanche (F)**, **Homehill (D)** and **Yarra (G)** is planned to be developed to irrigated and dryland cultivation area.

In south eastern Australia productivity on cattle properties, such as **Cobungra (H)**, is planned to be improved by enhancing the quality of existing grazing areas.

Increasing the reliability on cropping properties

Productivity developments on cropping properties, **Lynora Downs** and **Mayneland (I)**, include 641 ha of additional irrigated cropping area and associated irrigation infrastructure. The water storage and use of irrigation provides more reliable

production of annual crops.

RFM has also commenced a strategy of converting other cropping properties to macadamia orchards.

FY21 and beyond – macadamias

RFM announced in August 2020 that it had acquired various cattle properties in Rockhampton and sugar cane properties in Maryborough. The assets were acquired to convert them to macadamia production, a higher and better use.

Generating income from cattle and sugar cane properties before macadamia conversion

Before converting to macadamias, RFM expects to lease the cattle properties in Rockhampton. In Maryborough, approximately 25% of the sugar cane properties are already leased. The balance of the area will be cropped by RFM on behalf of RFF, RFM having previously owned and operated a sugar cane property.

Sugar cane is a tropical grass. After planting, the cane grows for approximately 15 months, after which it is mechanically harvested (or cut). Once the cane is cut, the plant begins

to regrow. The regrowth (called a ratoon) is then harvested each year for up to six years. As the cane on the Maryborough properties is already established there is minimal ongoing management required for future harvests. Therefore it is sensible for RFF to harvest the sugar cane on these properties, rather than leasing them. This strategy is intended to provide both higher returns for RFF, and more flexibility in commencing macadamia developments.

Applying almond and macadamia experience to the developments

As almonds and macadamias are both tree nuts, RFM's almond orchard development and operational experience is applicable to macadamias. The macadamia developments are also expected to follow a similar schedule to prior almond orchard developments.

The capital expenditure schedule for the initial 1,500 ha of almond orchards on **Kerarbury (J)**, is shown in **Figure 3**. The first three rows of the table show the amount and timing of capital expenditure for land, irrigation water, infrastructure, and almond trees. The fourth row shows orchard maintenance expenses funded by RFF in the first five years. As the almond

“In the cattle sector, expanding water points, developing cultivation areas, and improving pastures is a productivity improvement focus.”



Image: Mustering cattle on horseback in central Queensland, October 2020.

Figure 3: Kerarbury 1,500 ha development timetable (disclosed September 2015)

	FY16	FY17	FY18	FY19	FY20	Total
Land purchase	19.8					\$19.8m
Additional water entitlements	18.5	6.9				\$25.4m
Infrastructure and trees	10.8	15.1	6.7		1.1	\$33.7m
Orchard maintenance	0.4	3.8	6.7	8.4	11.4	\$30.6m
Total development	\$49.5m	\$25.7m	\$13.4m	\$8.4m	\$12.5m	\$109.5m

trees do not produce significant yields or revenue in these early years, this structure provides a cash flow benefit to the lessee and additional income to RFF.

The limited availability of suitable macadamia planting material will constrain the rate at which the macadamia orchards are able to be developed. To address this issue, and better control quality, seedlings will be produced for specific varieties at RFF's recently acquired **macadamia tree nursery (K)**. Improvements in plant varieties is another way in which productivity gains are achieved – for example, in the 20 years RFM has grown cotton, average yields per hectare have nearly doubled due to new cotton plant varieties. RFM is currently expanding the output of the macadamia nursery, which is planned to treble over the next few years to supply the developments.

The macadamia orchards will not only benefit from improved tree varieties, but also the latest industry knowledge regarding orchard and infrastructure specifications. This has parallels with previously described poultry shed developments. That is, the "new" poultry sheds constructed by RFM benefitted from a more modern design, technology, and were more productive than the older sheds. Another example was the irrigation system installed by RFM on Moorall, which through greater capacity sought

to achieve better almond yields.

In addition to developing and operating almond orchards, RFM's macadamia expertise has been established through the acquisition of three **macadamia orchards (L)** in 2016. Since their acquisition, RFM has implemented a program to improve the yields of the Bundaberg orchards. Yields increased by approximately 50% (2017-2020) as trees matured, but also because of improvements to the orchard and management.

Funding macadamia developments

Planting 5,000 ha of macadamias is expected to take approximately five years. Consistent with the Kerarbury development, it is likely RFF will fund the first five years of orchard maintenance of each planting. Funding by RFF is therefore likely to occur over a 10-year period. A benefit of this duration is that the majority of funding may come from a combination of the recent asset sales described in this article, gearing

capacity and internal cash flow surplus to unitholder distributions.

The development will also generate local economic benefits. Approximately 500 jobs at full steady-state production are expected to be created, as well as demand for goods and services to supply business operations and the new workforce.

RFM has already completed the small-scale conversion of one **cane farm in Bundaberg (M)** and will develop an additional 500 ha in Maryborough during 2021. Plantings are expected to occur in spring and autumn.

Discussions with lessees for the orchards are ongoing. In the interim, RFF has capacity to fund the initial developments while, importantly, continuing to fund unitholder distributions.

Financial metrics and outlook

FY21 forecast (f) distributions of 11.28 cents per unit represent a 4% increase on FY20 (**see Figure 4**).

“ RFF has capacity to fund the initial [macadamia] developments while, importantly, continuing to fund unitholder distributions. ”

The next quarterly distribution is forecast to be paid on 29 January 2021 with a record date of 31 December 2020. RFM will report the HY21 results in February 2021.

Conclusion

This article commenced with an observation that agriculture provides an essential role to several facets of a functional society: food production, economic growth, and employment. RFM will continue to use its operational and development experience, to increase both RFF's contribution to the Australian agricultural sector and returns to Unitholders.

Figure 4: Key Metrics

Metrics	As at 30 June 2020
FY21f Adjusted Funds from Operations (AFFO) per unit ¹	11.7 cents
FY21f Distributions per unit (DPU)	11.28 cents (4% growth on FY20)
Adjusted total assets	\$1,012.6 m
Adjusted net asset value (NAV)	\$655.7 m
Adjusted NAV per unit	\$1.94
Pro forma gearing ²	28.3% (target range 30-35%)
Number of properties/sectors ²	61/5
Weighted average lease expiry	10.9 years

Notes:

1. Figures shown are subject to rounding. FY21 forecasts include the disposal of Moorall.
2. Pro forma includes the acquisition of Maryborough properties, cattle property extension, and disposal of Moorall.

Image: Earthworks for orchard development (foreground). New plantings of macadamia trees (background), Nursery Farm, Bundaberg, central Queensland, August 2020.





Image: Forage sorghum sown in between Leucaena rows under centre pivot irrigator at Comanche, central Queensland, January 2020.

RFM and Meat & Livestock Australia: reducing emissions on cattle properties

RFM is playing an active role in contributing to improved environmental outcomes within the livestock sector. The Australian red meat and livestock industry is currently responsible for 10% of all of Australia's greenhouse gas (GHG) emissions – 50% less than 2005. While the industry has already halved its GHG emissions, it continues to seek to reduce its environmental impact through a target to be carbon neutral by 2030.

As part of achieving this target, RFM and Meat & Livestock Australia (MLA) worked with Research Scientist, Dr Natalie Doran-Browne to analyse a selection of RFF's cattle properties.¹ The study focused on assessing the *emissions intensity* of livestock production on the properties.

Emissions intensity calculates the GHG emissions generated per unit of farm product. In simple terms, lowering emissions intensity can be achieved by producing more kilograms of beef for the same level of GHG emissions.

The report calculated that of the RFF properties analysed, from 2016-17 to 2018-19 GHG emissions intensity declined by 17% on the New South Wales properties, and 43% on the Queensland properties. A reduction of this magnitude is the equivalent of not running about 2,800 average Australian cars for a year.

The report identified productivity improvements such as increased feed quality, as well as improved animal management practices, as contributing factors to the results. As outlined in the preceding article, RFM is enhancing the productivity



on RFF cattle properties by improving pastures and developing cultivation areas. These productivity improvements aim to accelerate daily weight gain of cattle, and therefore lower emissions intensity.

Tim Sheridan, RFM Chief Operating Officer commented "We're pleased that the productivity gains achieved on RFF's cattle properties have also resulted in lower emissions [intensity]. In essence, more productive cattle properties are also better for the environment."

RFM and MLA's work will benefit the industry by increasing the awareness of emissions analysis, and by providing a process which can be followed by others in the industry to take steps towards carbon neutrality.

“A reduction of this magnitude is the equivalent of not running about 2,800 average Australian cars for a year.”

About Rural Funds Management

Rural Funds Management Limited (RFM) is one of the oldest and most experienced agricultural fund managers in Australia. RFM has a 23-year history and operates from a head office in Canberra, and offices in Sydney and Queensland. The company employs more than 100 staff in fund and asset management activities.

Established in 1997, RFM manages approximately \$1.3b of agricultural assets. This includes three investment funds for which RFM is the responsible entity. Assets are located across New South Wales, Queensland, South Australia, Western Australia and Victoria.

The Rural Funds Group (RFF) is RFM's largest fund under management. RFF is an ASX-listed real estate investment trust and owns a \$1.0b portfolio of diversified agricultural assets including almond and macadamia orchards, premium vineyards, water entitlements and cattle and cropping assets.

RFM's company culture is informed by its long-standing motto of "Managing Good Assets with Good People". Scan the QR code to learn more.



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A world going nuts

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