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HD **AACo's red meat man Strong happy to shoulder the load**

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Agriculture Tariff cuts and Darwin abattoir key to new CEO's vision.

Australian Agricultural **Company** is proof that there are no easy success stories in agriculture. While the food boom has done wonders for many producers – the extraordinary battle for WCB being the case in point – the nation's largest beef producer has struggled.

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Over the past five years it has reported small profits or losses, and has not paid a dividend. Since 2009 AACo's share price has fallen 18 per cent while the All Ordinaries Index has gained 50 per cent. Not that Jason Strong appears overly worried. Appointed AACo chief executive in January, Strong says he is relishing the challenge of leading the 190-year-old **company**.

"I'd be naive to say there is no trepidation, but it's very much a case of bring on the challenge," Strong says in his first interview since taking the top job.

"It's a big responsibility, and if you have a lifelong involvement in the beef and cattle industry it's hard not to have sentiments about the position.

"But that's not bankable. The focus has to be on driving the performance of the **company** over the next 10 years to get us to 200 years."

AACo is the nation's oldest **company**. It was founded in 1824 as a land development **company** with the assistance of the British Parliament's Crown Grant of one **million** acres in the Port Stephens area of the colony of NSW. Nowadays AACo runs more than 550,000 cattle over seven **million** hectares. This is about 1 per cent of Australia's land mass. A giant collection of sprawling pastoral country across Queensland and the Northern Territory.

Before taking on the CEO role, Strong was AACo's marketing executive. His previous job was promoting Australian beef and lamb in Russia and Europe for the Meat & Livestock Association.

He wants to use his experience selling red meat to convince big foreign importers – such as Angliss in **Hong Kong** and Broadleaf in the US – to **buy** premium beef such as AACo's Master Kobe, Kobe Cuisine and Darling Downs Wagyu range, and its 1824 signature grain-fed beef. These importers supply high-end restaurants and hotels that need to cater to customers that are increasingly familiar with beef marble scores and the benefits of dry ageing a sirloin for 100 days. Diners at the Rib Room in Dubai's Jumeirah Hotel will pay $160 for a 250 gram cut of AACo's Kobe Cuisine tenderloin.

Strong can talk in the language of marketing. "Our focus will be on capturing revenue and margin from high quality product around our branded beef program," he says. But the message is clear. The more people that chose Wagyu over grinding beef, the more profitable AACo will be.Replacing David Farley

Strong's ascension to the top job came earlier than expected. David Farley had been appointed CEO in 2009 and was expected to oversee the construction of AACo's biggest project – a $91 **million** abattoir at Livingstone, 50 kilometres south of Darwin. The massive meatworks, which is due to be completed in the second half of this year, is important because it gives AACo flexibility.

In the past, the company has been held hostage to the domestic market which is extremely volatile. In times of drought, the cost of feed and water goes up while farmers often dump stock. This depresses cattle prices.

With its stock in the north of Australia, AACo was also hamstrung by the fact that rivals JBS and Tees have big abattoirs on the east coast. Trucking cattle thousands of kilometres across remote northern Australian can cost tens of thousands of dollars per trip. In some cases it costs more to truck old or overweight cattle to the east coast than AACo can get for the load. Having your own meatworks near Darwin makes cuts transport costs and give the company more options in the face of volatile markets for different types of beef and cattle. It also means it does not have to pay rivals a fee for processing the meat.

Owning more of the supply chain is at the heart AACo's strategy. It allows the company to be more flexible to its customers' needs. But in the first half of last year – with Farley into his fourth year as CEO – cracks began to emerge.

Crippling drought across northern Australia and the Gillard government's unexpected ban on live cattle exports to Indonesia in 2011 had wreaked havoc with cattle prices. The beef industry was struggling.

Meanwhile, turnover in the boardroom and on the AACo shareholder register was also a source of instability. AACo had four different chairmen in 2009 and 2010, making regular headlines for board unrest.

The arrival of Donald McGauchie as chairman changed things. A hard-nosed farmer who took on the waterfront unions as head of the National Farmers Federation in 1998, McGauchie eventually decided he wanted a new CEO.

In June last year he told Farley that rather than keeping him on, he would be looking for a new boss over the next 12 months to 18 months, once the abattoir was completed. Farley, who is also a strong personality, decided he would not stick around and walked in July.

The departure came at the same time AACo was considering a $300 million capital raising to repair its creaky balance sheet. The raising fuelled speculation that AACo's biggest shareholder, British billionaire Joe Lewis wanted to break up the company. The break-up theory

There is some logic to a break-up.

AACo shares are trading around $1.28. At its half-year result in November AACo said its net asset value – the value of its cattle, land and cattle stations – was $1.58.

The break-up theory is about closing the gap between the share price and asset value by selling off the land and cattle assets but keeping the Darwin abattoir and Asian supply chain. Rural land and water company PrimeAg deslisted from the ASX in 2013 after persistently failing to trade above its asset value and make adequate returns on capital.

However, Strong says there is "absolutely no currency" in any break-up stories.

After a five-month search for a new CEO, the AACo board settled on Strong.

The appointment is somewhat ironic given it was Farley who employed Strong back in 2010 as a consultant to work on the Darwin abattoir.

Strong has spent his entire career in the red meat industry. The 44-year-old was born on a cattle station at Gunnedah in north-east NSW and bought his property in the region in the 1990s. He says he has forgotten what life is like outside work, but any spare time he has is spent with his wife and seven-year-old son, Max.

Farley describes Strong as "a man of moral integrity" and "the right man for the job". "I wish him well. His provenance is good for this time for the company," he says.

For his part, Strong is quick to point out he is not being thrown in deep end.

"While there is the appearance that I've inherited this good idea [the Darwin abattoir], I was there at the early stages.

"I think it will be a fantastic addition to our suite of assets, capturing extra supply chain margin."

This point does, however, pose an obvious question. If Strong represents a continuation of the Farley strategy, what was the point of appointing a new CEO?

McGauchie rejects the assertion that Farley was dumped due to a clash of personalities. He says a new boss with new skills was needed. He argues the **board** was attracted to Strong's deep knowledge of the meat industry, the consumer and meat marketing.

"This is where we are taking the **company**. It's all about putting high quality meat into the highest value markets," the chairman says.Making Darwin work

The main job at hand is finishing the abattoir in Darwin and securing partners to put additional cattle through the facility. Farley had hoped to build the project with an equity partner to reduce the pressure on AACo's balance sheet.

The cattle **business** requires plenty of capital and AACo has long struggled to generate meaningful cash flow. Construction costs associated with the Abattoir worsened its debt position.

But Farley decided to go it alone when a suitable partner was not found. Nevertheless, some observers would still prefer to see an equity partner involved.

"They said it would not go ahead unless they had partners who would guarantee supply of cattle," PAC Partners analyst Paul Jensz says. Jensz argues the Darwin facility needs 200,000 head of cattle each to work. He says AACo can only account for one-quarter of that requirement.

"No other farmers have equity or any compulsion to use the facility. They have taken on a lot of trading risk," he says. "It would be good if they could sell half of it tomorrow."

According to Strong, there are no current plans to take an equity partner. But he says AACo is focused on "building strategic relationships". He is talking with other northern cattle suppliers to shore up the volume going through the abattoir.

After AACo forged ahead with construction of the abattoir, the **board** moved to reduce debt. They decided to push ahead in August with the $300 **million** capital raising at $1 a share, which reduced borrowings to manageable level. The capital raising also meant Lewis's Tavistock **Group** became a far bigger presence on the register.

Lewis, who owns English Premier League club Tottenham Hotspur, ended up with a 20 per cent **stake** after backing the raising. The shareholding could hit 30 per cent if he decides to convert an $80 **million** convertible bond which can be exercised at $1.15 a share from September 1.

There is a view that Lewis has taken effective control of AACo without paying a premium. But Strong says Tavistock – which has one director on the **board** – is a good shareholder and rejects the assertion Lewis is steering the ship behind the scenes.

"We see them regularly," Strong says. "Everything about our relationship is positive and they participate appropriately."

McGauchie believes the historic instability that has plagued AACo was due to politics associated with big shareholders on the register including Elders and Peter Holmes a Court. These are now gone and he argues that Tavistock has helped restore stability.

"We have shareholders who are interested in the **business** as a meat, cattle and land **business** for the long term. There's great alignment on strategy," he says.Key tariffs cut

As part of Strong's strategy to sell more premium products, AACo is making a push onto retail shelves in Asia by building customer relationships in key markets. One example is the three-way partnership AACo has with food importer OK Meats and South Korea's biggest retailer, e-mart.

"The relationship provides us with fantastic **brand** presence at retail level," Strong says. "Obviously our own **brand** has pull, but you do get a good free kick from having **brand** Australia behind you.

"We are a clean, green, high quality producer. The imagery of Australia is received very positively."

While Strong is trying to market premium beef to the world, the trade environment and demographic trends are promising.

Prime Minister Tony Abbott has helped re-open the live cattle export market to Indonesia. The Coalition has also inked free trade agreements with Japan and South Korea that cuts heavy tariffs on beef exports.

South Korea is the third biggest market for Australian beef (behind Japan and the US) and the biggest importer of high value Wagyu beef. It will progressively eliminate its 40 per cent tariff on Australian beef over 15 years.

This is good news for AACo. It has 67,000 head of Wagyu cattle, making it the biggest producer in Australia. Choosing beef has become a bit like choosing **wine** in some high-end restaurants.

As well as supplying ritzy diners in places such as the Venetian in Macau and Stonegrill in **Hong Kong**, AACo is branding itself with events.

The World Chefs Association Society is hosting a competition in Norway this year to find the world's best chef. The contestants will be using AACo's Master Kobe Wagyu.

"Wagyu now makes up about two-thirds of our meat **business** even though it is only half the number of cattle that we do," Strong says. "There is this perception that Wagyu is a cottage industry, but it's also scalable as well."

The trade deal with Japan means the frozen beef tariff has been cut from 38.5 per cent to 19.5 per cent over 15 years. For fresh beef, it drops from 38.5 per cent to 23.5 per cent over 15 years. The Japan concessions alone are estimated be worth $2.8 **billion** to the beef industry over 20 years.

"Both of them are really big wins," Strong says. "Australia is very export-focused. It's what we do. We can compete with anybody on the right conditions. It's really important not having a disadvantage relative to anyone else."

Abbott and Trade Minister Andrew Robb are now pushing for a free trade deal with **China**. The world population is forecast to grow from seven **billion** to nine **billion** by 2050, and increasing wealth in Asia is driving dietary changes toward greater consumption of protein.

There is no doubt AACo is well positioned to take advantage of these opportunities. But it has never lacked a large number of cattle. The trick to winning over a sceptical market is turning its assets into meaningful cash flow. Getting Darwin up and running profitably is critical. Running the operations efficiently is also essential.

"AACo has the best cattle stations in the developed world for export, fantastic breeding grounds and its on the doorstep of customers who need this cattle," Jensz says. "[AACo] just need to deliver positive cash flow and the market will look at it again."

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