

WRIGHTSON ANNUAL REVIEW 2003

Thursday 21 August 2003

Reshaping the business

Some time ago Wrightson signalled that it was not content to simply ride the commodity cycles, and the Company is progressing well with its two-pronged strategy of commodity business leadership and Solutions development. The transition is evident in many areas of the Group.

The quiet reshaping of Wrightson from an old style stock and station agency into a modern agribusiness is making solid progress, using strategies that add value to agriculture, differentiate the Company from its competitors, and position it for improved earnings over the long term.

During the year, Wrightson made progress across five areas of strategy:

- **Solutions:** Existing Solutions stimulated revenue growth, and development work continued on new Solutions to help clients improve productivity and profitability.
- **Business initiatives:** Various initiatives aimed at strengthening commodity-type businesses such as Livestock and Rural Supplies were implemented, as well as initiatives to develop those businesses, such as Seeds and Finance, that offer growth potential in terms of margins or leveraging IP. Group-wide capabilities were also enhanced with investment in new IT infrastructure.
- **Cost reduction:** Total operating expenses were reduced \$4 million by tight management of costs throughout the Group. This is especially important where the business is most exposed to the effects of commodity price cycles.
- **Biotechnology:** The partnership with Genesis Research and Development Corporation Limited was extended through acquisition of a strategic 15.4 per cent shareholding in that company. This shareholding strengthens Wrightson's ability to secure value from new biotechnologies.
- **Industry leadership:** Wrightson took a lead on issues critical to developing the potential of New Zealand agriculture, including the debates on genetic technology and global warming, the need for collaboration in research and development (R&D), and the need for industry restructuring in the strong wool sector.

Financial performance

Results for the year ended 30 June 2003 were satisfactory, although down from the previous year when the rural sector was exceptionally buoyant. Earnings before interest and tax (EBIT) for 2002/3 were \$26 million, compared with \$31.7 million the previous year, while net profit after tax (NPAT) declined from \$21.2 million to \$18.5 million.

After expenditure of \$4.2 million (pre tax) on strategic and restructuring initiatives, and a \$0.7 million share of the equity accounted loss from the Genesis investment, the New Zealand operation's net profit after tax was \$14.8 million compared with \$18.1 million last year.

Wrightson is required to equity account the Genesis loss because it is in a position of significant influence in relation to Genesis. Its 15.4 per cent shareholding makes it Genesis' single largest shareholder, and it is the holder of two Genesis board seats.

The strategic and restructuring expenditure included improving the Company's IT infrastructure, investigating opportunities to achieve scale in various businesses, investing in biotechnology and climate change research, and building scale and developing new products in the Solutions business.

The year saw a reversal in strong commodity prices and low exchange rates, as well as particularly volatile weather in the spring of 2002 and the autumn drought in some regions, both of which disrupted production in parts of New Zealand. Reduced livestock values and a contraction in rural spending impacted on Wrightson's results for 2002/3, but underlying performance was sound - a pleasing reflection of the focus on reducing exposure to commodity and exchange rate cycles, producing more sustainable earnings, and leveraging more value from IP.

The Australian after tax profit was \$3.6 million, up from \$3.3 million last year.

While down from \$7 million last year, the Group's Economic Value Added (EVA) of \$2.4 million (unaudited) was still pleasing, given the slide in sector conditions.

Cash flows from operating activities were very strong at \$32.7 million for the year, compared to \$25.4 million last year. Wrightson retains a very conservatively geared balance sheet, and is well positioned to maintain a high dividend payout ratio, and to consider growth opportunities in support of its Solutions and commodity cost leadership strategies.

The Directors have declared a final dividend of 8 cents per share, giving a full year, fully imputed dividend of 11.5 cents (the same as last year). The full year dividend represents 84 per cent of NPAT.

Business activities

The Solutions strategy is now embedded in Wrightson operations, with new ideas being developed in many areas. The 2002/3 year saw continued take-up of On-farm Solutions such as Whole Crop Silage, Integrated Farm Solution, and Elite Grazing, and of Industry Solutions such as Integrated Fibre Management and Integrated Livestock Management. In a move designed to build scale and capture intellectual property, former Agriculture New Zealand on-farm consultants were transferred to the Solutions team during the year.

New Solutions are being developed as opportunities are identified to boost clients' productivity and profitability, and to reflect the readiness of farmers, processors and others to adopt new ways of doing business. Solutions revenues within each business are set to grow over time, as various Solutions become embedded as a normal part of the business.

The Seeds business performed well on the strength of Wrightson proprietary varieties in New Zealand, Australia, and internationally. The New Zealand business performed strongly, despite product shortages due to the poor 2002 harvest. Developments included the opening of a new \$1.5 million seed coating plant in Christchurch. Its new technology improves productivity in our seed coating operation, leverages the substantial IP we have around seed coating technology, and enables more product innovation.

The Australian seeds business improved its profit in 2002/3 despite drought impacts on supply. The business had strong second half sales as anticipated.

Patience with the business in Uruguay is paying off, with Wrightson PAS making a positive EBIT contribution of \$0.2 million in 2002/3, compared with a loss of \$0.3 million last year. Wrightson PAS is now positioned as the leading forage seed company in Uruguay, and the value of Wrightson's proprietary seeds has been recognised by Conaprole, Uruguay's largest dairy company, which has entered into an exclusive five-year seed supply contract with Wrightson PAS.

Seeds is a business that generates attractive margins, and it has further growth potential based on increasing recognition by farmers of the value of Wrightson's proprietary seed for improving stock performance, and the strong market position of the Animal Friendly™ brand. This provides a base for sustaining good margins over time.

Agri-feeds, Wrightson's other animal nutrition business, continued to perform well as it expanded supply in the South Island, and cemented its position as the leading national animal feed supplements company.

Rural Supplies sales and earnings declined as a result of a combination of factors. Sector-wide, rural expenditure slowed from its buoyant levels in 2001/2, with contraction in volumes most noticeable in animal health products, agricultural chemicals and fertiliser. In addition, margins came under some pressure, and the benefits from the logistics management project were not realised.

The challenges and complexities involved with the logistics project were underestimated, with resulting delays in its full implementation. The project is back on track and we are confident that it will, over time, deliver the expected benefits in terms of significant cost reductions and enhanced client service.

The next 12 months will see a strong focus on regaining lost ground in the Rural Supplies business.

Livestock results were impacted by falling cattle and sheep values. The average value of sheep handled by Wrightson declined 14 per cent, with beef cattle down 23 per cent, and dairy cattle values down 31 per cent. The export of dairy cattle to worldwide markets and the Integrated Livestock Management Solution, which contracts lambs for supply to meat processors, were profitable and expanding parts of the Livestock business.

In early 2002, Wrightson took successful steps to manage the exposure of its Livestock business to declining commodity values and exchange rate movements. The Group partially hedged the downturn in commission revenue through a series of foreign exchange options that resulted in a \$2.9 million pre-tax gain.

Results in the Wool business improved in 2002/3, although there was limited progress on fundamental issues still unresolved in this sector. During the year, Wrightson continued to lead efforts at sector-wide reform in the marketing and supply of strong wools, in an effort to reduce costs across the industry and provide better service to growers. The New Zealand Merino Company Limited, which was formed in 2001, and in which Wrightson has a 35 per cent shareholding, has demonstrated the value in new supply chain models.

Wrightson's wool cost structures are favourable after rationalisation of wool infrastructure in past years, but we continue to seek further gains. The Integrated Fibre Management Solution continued to grow, accounting now for approximately 12 per cent of all strong wool handled by Wrightson.

Financial Services is a profitable, growing business with lending of more than \$9 million at 30 June 2003. Finance is a powerful customer attraction and retention tool, and is part of the Wrightson bundle that will feature in many Solutions.

Financial services is a significant growth opportunity for Wrightson into the future, and the Company intends to introduce a wider range of financial products and services when the current alliance with Rabobank ends in November 2003. Currently, this alliance restricts Wrightson's lending to short-term finance products.

Real Estate performed well as markets remained buoyant, and Wrightson confirmed its position as the nationwide market leader in rural real estate during 2002/3, which was a record year for turnover in this business. Insurance broking also had a strong year although conditions were generally very difficult in the insurance sector.

Wrightson is actively seeking opportunities to build its role in biotechnology and to leverage the substantial investment made in forage grass R&D since the mid-1970s. The strategy was advanced by the \$5.4 million investment in Genesis Research and Development Corporation Limited (March 2003), with Genesis' capabilities in gene science complementing Wrightson's strengths in plant breeding.

Outlook

In reviewing 2002/3, the Board believes that Wrightson is in fundamentally sound shape. Good management disciplines are in place, the balance sheet remains very strong, with capacity for new investments as the right opportunities arise, there is a focus on those businesses, such as Rural Supplies, that require attention, and there is a solid base from which to grow the Group's earnings.

To improve earnings over the long term, the Group will focus on growing in scale, developing in new areas, and making more effective use of shareholders' funds. While New Zealand farmers will always be at the core of Wrightson's business, the Company will need to build greater offshore scale to get better leverage from its world-leading products and IP.

Wrightson will increase its exposure in those business activities that deliver a combination of good margins, value to clients, use of proprietary products and IP, and better use of capital. This will see growth in key areas such as Seeds, Finance and Agri-feeds. Commodity-type businesses, such as Livestock, will always be at the heart of the Company's client interface, but they offer less sustainable growth potential.

Looking ahead, the rural economy is expected to see a continuation of similar conditions through 2003/4. Product prices and farm incomes may moderate further, but farm profitability is expected to remain well above the levels of the 1990s.

Wrightson anticipates another satisfactory year of performance with good progress in key strategy areas, and further progress with its transition from an essentially commodity-driven, transaction-based business to a customer-focussed Solutions business with more sustainable earnings.

Ends