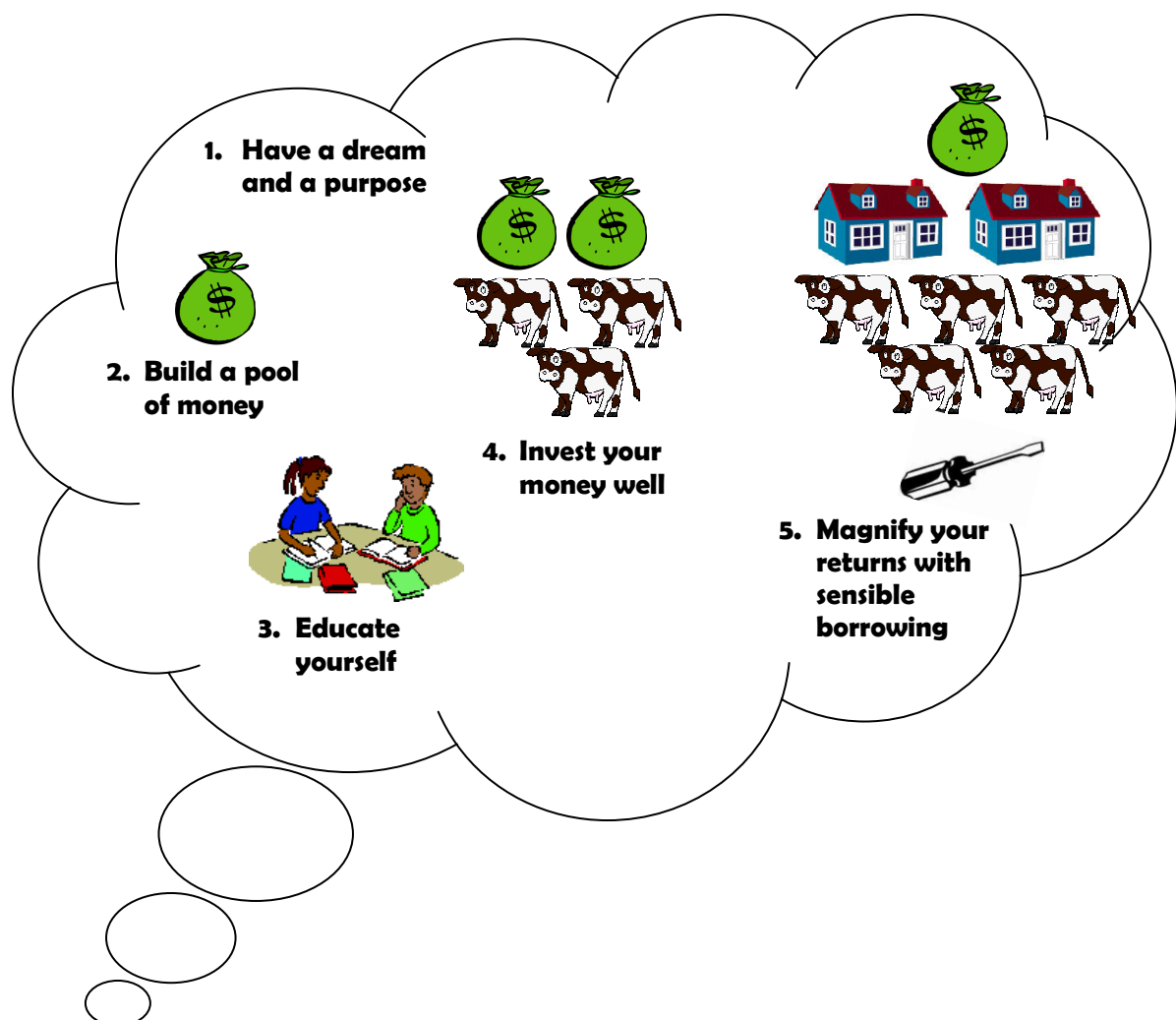


Steps to Wealth Creation in the NZ Dairy Industry

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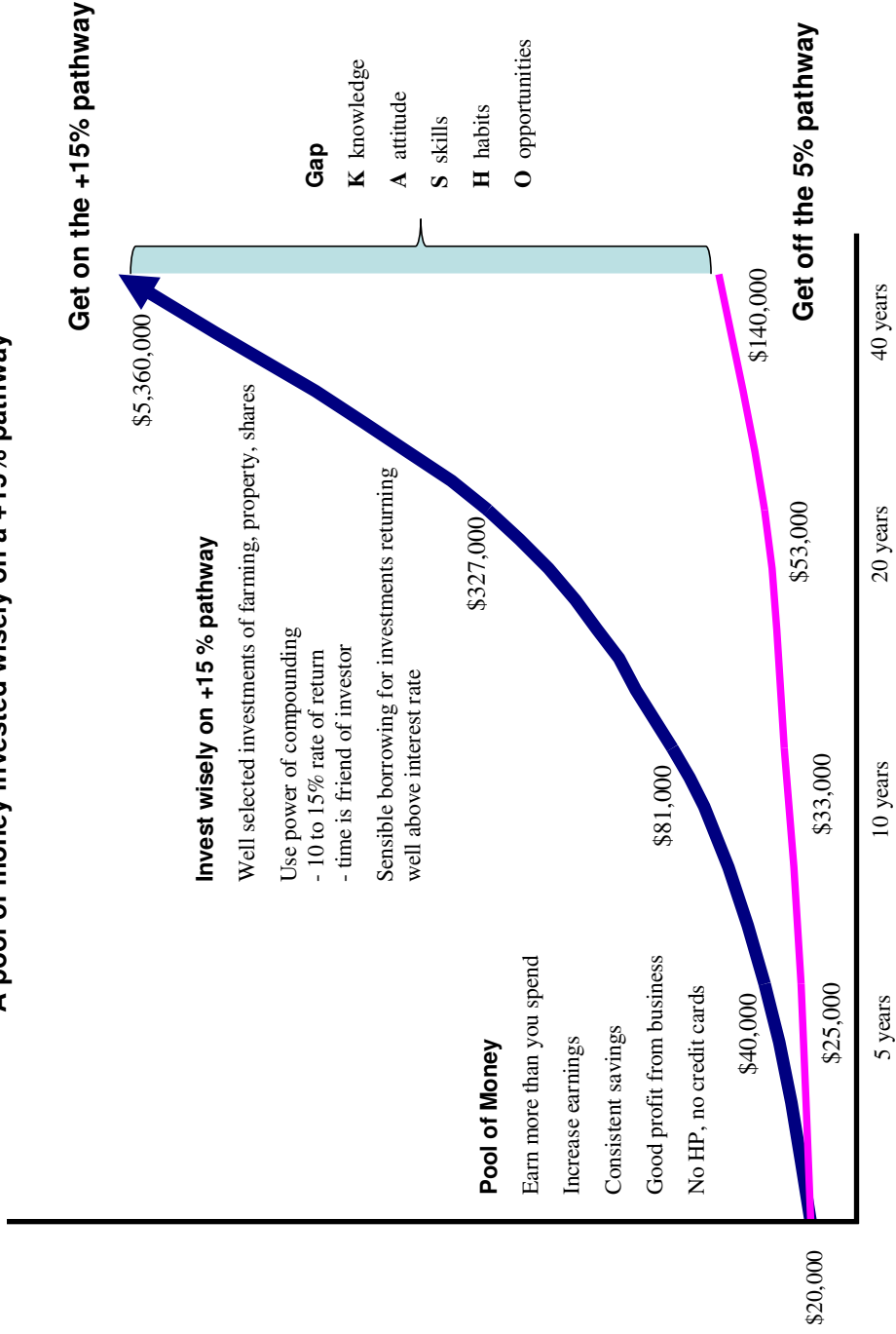
The NZ Dairy Industry offers a wonderful lifestyle, career path and wealth creating avenue for anyone willing to work diligently and develop their knowledge, skills and attitudes so as take advantage of the opportunities that come along. Look around at the many success stories evident in the industry – people who have worked their way from farm staff, via sharemilking, to farm ownership; people who have come from the city or have changed career and joined the dairy industry. Recently I have been asking myself “Why do I see some people who have spent ten years in the industry and have successfully accumulated over half a million dollars of assets, while I see others who are diligently working away, but have only got together a few thousand dollars or still have quite a few debts or hire purchase.” Have you ever stopped to wonder “What is it that makes the difference?”

I believe there are five steps that lead to financial success:



Wealth Creation Pathway

A pool of money invested wisely on a +15% pathway



Let's look more closely at each of the five steps to financial success:

1 Have a dream and purpose

Having a big enough dream will be a great motivator – it will provide the purpose and energy to achieve financial success. You need a strong enough purpose, or a desire so large, that you will make the effort to set up a regular savings programme, learn ways to invest wisely, further your education or go that extra mile at work to build your reputation. One young man who bought his first farm at 28 years of age, after coming from a town background, told me: “I always knew I could find a way to own my own business. I couldn't tell you all the steps to this success, but I can tell you ... I always believed that if I worked and thought hard enough, that one day I could buy a farm and be my own boss. I just knew I could do it.” Having a dream and belief is important.

What's your dream?

2 Build a pool of money – earn more than you spend

- a Increase your earnings
 - become more valuable as an employee eg increase your skills, your experience, qualifications and attitude
 - build your reputation, networks and contacts so you are in high demand as a great employee
 - if you are in business eg sharemilking, get a better profit from your business
- b Complete a personal budget so you know where your money is going. Set yourself some good savings targets. Use the DairyNZ Personal Budget form in Appendix A.
- c Develop good savings habits. Some people are savers, some are spenders. Learn the good habits of the savers. Decide how much you can save a week or fortnight, and get this direct debited from your pay before you see it. Give the control of this account to someone who is great with money.
- d Do not use credit cards or hire purchase – if you can't pay cash for something then don't get it. You will never get ahead if you are trying to pay the high interest charges for credit cards or HP.
- e Do spend some money on clothes and a good hair cut – because finding the right partner is one of those other great lifetime decisions!!

How much can you save?

3 Educate yourself

Once you have started building a pool of money, the next step is to start learning how to get that money working for you. Spend time learning how to get on the +15% investment pathway. Study successful people who have travelled the +15% investment pathway before you. Ask them what they have done, how they got started and what recommendations they would give you.

Read widely – there is so much to learn by reading. Some ‘must read’ books include *Rich Dad, Poor Dad* by Robert Kiyosaki, *The Richest Man in Babylon* by George Classon, *The Seven Habits of Highly Effective Teenagers* by Sean Covey, and *The Luck Factor* by Dr Richard Wiseman.

Get out there and build your knowledge, skills, interests, networks and ability to find opportunities.

What will you learn?

4 Invest your money well – get on the +15% Wealth Creation pathway

You want to get your money growing for you on the +15% investment pathway, and off the ‘going nowhere’ 5% pathway. The Wealth Creation Pathway diagram shows the power of compounding. A lump sum of \$20,000 will compound to \$5.36 million over a working lifetime of 40 years if invested at 15%, compared with a meagre \$140,000 if left on the ‘going nowhere’ 5% pathway. The two keys are getting a good rate of return, eg 10-15%, and having time for the investment to grow. The power of compounding takes time to snowball – even after ten years there is not a huge difference in the amount invested, but the differences become enormous after 20 years.

Think of this another way. Let’s assume we are sitting among a group of 20 year olds and each person has \$20,000. Those that grow this money at 15% will have over \$5m by the time they are 60 years old, while those that grow at 5% will have \$140,000. Which group would you rather be in? Again what makes the difference? In the Wealth Creation diagram I have explained the gap between the pathways is determined by how you position yourself or the strategy you take. This is determined by the knowledge, attitude, skills, habits and opportunities that you choose to build.

Tables 1 to 4 show the effect of saving \$50 to \$400 a week for up to 40 years, at various rates of return.

Table 1: Saving \$50 per week

Years %	5	10	20	40
0	13,000	26,000	52,000	104,000
2.5	13,800	29,500	67,000	177,000
5	14,700	33,500	88,000	321,000
10	16,600	43,400	156,000	1.2m
15	18,800	56,600	285,000	5m
20	21,187	73,900	531,000	20m

Table 2: Saving \$100 per week

Years %	5	10	20	40
0	26,000	52,000	104,000	208,000
2.5	27,600	59,000	134,000	354,000
5	29,400	67,000	176,000	642,000
10	33,200	86,800	312,000	2.4m
15	37,600	113,200	571,000	10m
20	42,300	148,000	1,063,000	40m

Table 3: Saving \$200 per week

Years %	5	10	20	40
0	52,000	104,000	208,000	416,000
2.5	55,200	118,000	269,000	708,000
5	58,800	134,000	352,000	1.3m
10	66,400	173,600	624,000	4.8m
15	75,200	226,400	1,142,000	20m
20	84,600	296,000	2.1m	80m

Table : Saving \$400 per week

Years %	5	10	20	40
0	104,000	208,000	416,000	832,000
2.5	110,400	236,000	538,000	1.4m
5	117,600	268,000	704,000	2.6m
10	132,800	347,200	1,248,000	9.6m
15	150,400	452,800	2,284,000	40m
20	169,200	592,000	4.2m	160m

Table 5 takes a lot of time to understand, but it is well worth making the effort. It demonstrates that as long as you are saving well, you can relax and take the time to learn how to get onto the +15% investment pathway. It is more important to learn about getting on the +15% pathway, than rushing to get on it, and making mistakes. Too many people lose their hard earned money by rushing into an investment, rather than taking the time to do it well. The following example compares someone saving \$10,000, \$20,000 or \$50,000 a year for five years and investing that at either 5% or 15% compounding. After five years of saving, they invest the money for a further 15 and 35 years. This example is similar to what happens in real life eg a young person saving money for five years, and then using this money to invest in farming.

Table 5: Five years of savings compounded for 40 years

Annual savings for 5 years	Investment %	Sum after 5 years 2014	Sum after 20 years 2029	Sum after 40 years 2049	5% return for 5 years then 15%
\$10,000	15%	67,423	548,625	9,000,000	5% initially then 15% \$7.4m
	5%	55,256	114,873	304,792	
\$20,000	15%	134,846	1,097,250	18 000,000	5% initially then 15% \$14.7m
	5%	110,512	229,746	609,584	
\$50,000	15%	337,225	2,194,500	45,000,000	5% initially then 15% \$36.8m
	5%	276,280	574,366	1,523,961	

Learn to invest wisely on the +15% pathway. Invest in appreciating assets or good businesses such as rearing calves, sharemilking cows, leasing cows, house rental properties, commercial property and well selected shares. Money spent on machinery, cars, sound systems or the latest TV or mobile phone is not an investment. These are depreciating items and they lose value.

Develop the skills to find and evaluate opportunities, and make good decisions. For every investment pathway there will be some people who will make a lot of money out of it, while some people will lose money from it. For example, buying and rearing calves. Many young farmers have successfully got started by rearing a few calves and selling them as R1 or R2 heifers. This can be a great pathway. But financial success is not automatic. You need to ensure you buy very good calves at the right price, find

economical grazing, rear the heifers to good liveweights, and have minimal losses. Some years it's a good idea, and other years the timing is just not right. When considering any investment you need to have the ability to calculate the figures, and know what you have to get right to make money.

What will you do to get on the +15% pathway?

5 Magnify your returns by sensible borrowing

If you can find an investment where the rate of return is consistently greater than the interest rate, then it might be a great idea to borrow money to invest. Then you have a bigger pool of money at work for you. This principle is commonly used in the New Zealand dairy industry. The following example shows a sharemilker generating a 16% return on asset from the operating profit on their business. In this example the sharemilker has \$800,000 worth of assets, of which they own \$350,000 (their equity) and they have borrowed \$450,000 from the bank at 8% interest. Because the sharemilker is earning a higher return on their asset than they are having to pay for the loan (ie earning 16% while only paying 8% interest), then the return on their equity lifts to 26%. They have leveraged their returns up by sensible borrowing.

Table 6: 50:50 Sharemilker Example

<i>Return On Dairy Assets</i>	<i>Return On Equity</i> <small>Assume \$450,000 borrowed at 8% interest</small>
ROA = $\frac{\text{Operating Profit} \times 100}{\text{Asset Invested}}$	ROE = $\frac{\text{Operating Profit minus interest} \times 100}{\text{Equity Invested}}$
= $\frac{\$128,000}{\$800,000} \times 100$	= $\frac{\$128,000 - \$36,000}{\$350,000} \times 100$
= 16%	= 26%

Table 7 demonstrates three scenarios for someone who has \$10,000 of their own money to invest. In scenario 1, they invest that money directly at 12%. In scenario 2 and 3, they borrow some money to invest also; \$10,000 and \$20,000 respectively. Here are some useful definitions of the terminology used:

- Asset The total amount of money invested
- Equity The amount of money you have to invest ie your share of the investment
- Borrowings The amount borrowed
- Return on Asset = $\frac{\text{net return} \times 100}{\text{asset}}$ Return on Equity = $\frac{\text{net return} - \text{interest} \times 100}{\text{equity}}$

Table 7: Return on equity scenarios – \$10,000 equity invested at 12%

	Scenario 1	Scenario 2	Scenario 3
Asset	\$10,000	\$20,000	\$30,000
Borrowings	\$0	\$10,000	\$20,000
Equity	\$10,000	\$10,000	\$10,000
Return on Asset	12%	12%	12%
Return	\$1,200	\$2,400	\$3,600
Interest at 8%	\$0	\$800	\$1,600
Net Return (return – interest)	\$1,200	\$1,600	\$2,000
Your equity after 1 year	\$11,200	\$11,600	\$12,000
Return on Equity	12%	16%	20%

From these examples you can see that you can leverage up or magnify your returns if you have a greater pool of money invested and at work for you. But beware: this only happens when the return on asset is greater than the interest rate. If your return on asset is less than interest rate, ie you pay more to borrow the money than your investment is returning, then you will magnify the losses as well. Borrowing accentuates the gains or losses made.

What can you do to borrow sensibly?

In summary: The five simple steps to financial success

- 1 Have a dream and purpose *What's your dream?*
- 2 Build a pool of money *How much can you save?*
- 3 Educate yourself *What will you learn?*
- 4 Invest your money well *What will you do to get on the +15% pathway?*
- 5 Magnify your returns with sensible borrowing *What can you do to borrow sensibly?*

You have a great opportunity NOW to build for your future.

Save and learn.

Build your knowledge, skills, interests, networks and ability to find opportunities.

Appendix A: Personal Budget



Name _____

Budget Period _____

Your Income	Income \$	Comments
Salary/wages after tax		
Salary/wages after tax for partner		
Investments eg interest		
Business income eg stock sales		
Child support		
Other		
Total Income	\$	

Your Expenses	Expenses \$	Comments
House rental or rates, repairs, maintenance		
Food - groceries, takeaways		
Electricity, gas		
Telephone, mobile, internet, tv, sky		
Clothes, shoes, farm gear		
Hair and beauty		
Vehicle - car, bike – petrol, maintenance		
Vehicle - car, bike – WOF, registration, insurance		
Newspapers, magazines, books		
Education – self and children, school fees		
Child care, babysitting, housekeeper		
Social – eat out, drink, cigarettes, movie, concert		
Leisure - sport, hobbies, gym, pets, music		
Holidays and weekends away		
Gifts and donations		
Healthcare – doctor, dentist, chemist		
Professional fees – eg accountants		
Insurance – home, contents, health, etc		
Purchases – household appliances, furniture		
Loan payments – house, car, business, student		
Loan payments – HP, credit card, overdraft		
Desired Savings		
Total Expenses	\$	

Your Total Income	\$	
minus Your Total Expenses	\$	
Surplus/Deficit	\$	

Appendix B: Quick Farm Budget



Name _____

Budget Period _____

Farm Details					
Milksolids kg		Hectares		Peak cows milked	
Milksolids kg/cow		Milksolids kg/ha		Cows/ha	

Income	\$ Total	\$/kgMS	\$/ha
Net milk sales			
Net livestock sales			
Other			
Net Cash Income	\$	\$	\$

Expenses	\$ Total	\$/kgMS	\$/ha
Farm working expenses (FWE)			
Interest & rent			
Tax			
Drawings			
Net capital transactions			
Other			
Total Expenses	\$	\$	\$

Cash Surplus/Deficit Surplus for debt repayment / investments	\$	\$	\$
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Tax Guestimate Calculator			
Ensure your accountant estimates tax to pay			
	Net Cash Income	\$	
minus	FWE, Interest, Depreciation	-	
equals	Taxable Profit/Loss	=	
times	25% to 30%	x	25%
equals	Tax	=	

Appendix C: Detailed Farm Budget



Name _____

Budget Period _____

Farm Details					
Milksolids kg		Hectares		Peak cows milked	
Milksolids kg/cow		Milksolids kg/ha		Cows/ha	

Income	\$ Total	\$/kgMS	\$/ha
Net milk sales			
Net livestock sales			
Other			
Net Cash Income	\$	\$	\$

Farm Working Expenses	\$ Total	\$/kgMS	\$/ha
Wages			
Animal health			
Breeding & herd improvement			
Farm dairy			
Electricity (farm dairy, water supply)			
Net feed made, purchased, cropped			
Calf feed			
Young & dry stock grazing			
Winter cow grazing			
Run-off lease			
Fertiliser			
Nitrogen			
Irrigation			
Regrassing			
Weed & pest			
Vehicles			
Fuel			
R&M - land & buildings			
R&M - plant & equipment			
Freight & general			
Administration			
Insurance			
ACC			
Rates			
Total Farm Working Expenses	\$	\$	\$
Interest & rent			
Tax			
Drawings			
Net capital transactions			
Other			
Total Expenses	\$	\$	\$

Cash Surplus/Deficit	\$	\$	\$
Surplus for debt repayment / investments			

Appendix D: Compounding and Discounting on an Inexpensive Calculator

Compounding Example

Compound \$2000 at 15% for 20 years

1	Turn interest rate into a decimal	15% → 0.15
2	Add 1 to give compounding effect This compounds the interest and principal figures	1 + 0.15 → 1.15
3	Enter 1.15 into calculator	1.15
4	Multiply by the principal to be compounded	x 2000
5	Push the equals button for the number of years	push = 20 times
6	Our answer	\$32,733

Helpful Hints

- If you put in the principal figure first and then try to multiply by the (1 + interest rate) your calculator will spit out nasty error messages to you.
- For some calculators in step 4 you need to hit the times button twice before entering the principal.

Discounting Example

Discount \$100,000 at 8% for 20 years

1	Enter principal	\$100,000
2	Divide by (1 + discounting rate)	÷ 1.08
3	Push equals button for number of years	push = 20 times
4	Our answer	\$21,454.80

Helpful Hint

- This only works on about 50% of inexpensive calculators.

Scientific or financial calculator or on the computer

The formula for **compounding** is

$FV = P(1 + i)^n$ where FV is future value, P is principal, i is interest rate and n is number of years.

Helpful hint: use the x^y key on your calculator. Eg \$1000 at 15% for 20 years. Enter 1.15 then push the x^y key, then enter 20, then multiply this answer by the \$1000 and push equals to get your answer. And if this doesn't work ask someone under the age of 25!

The formula for **discounting** is:

$P = \frac{FV}{(1 + i)^n}$ where FV is future value, P is principal, i is interest rate and n is number of years