

Outsourcing Business Strategies & Development of Fully Integrated Business:

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Introduction

I would like to start out by quoting Phil Ruthven in Business Review Weekly, when writing about farms of the future;

“The first and most important reform is farm financial structures. Like other modern businesses, farms need to jettison passive and transitory assets such as land, buildings, equipment, stock and debtors. They can do this through leasing, factoring and outsourcing.

Agriculture has the worst ratio of revenue to total assets of any industry in the economy. The average revenue per \$100 of total assets on a farm is about \$25, compared with a national average of \$100. Manufacturing makes \$110 in revenue for each \$100 of total assets – retailing makes \$350.”

Our business 2005 – 2006 financial years was \$151; 2006 – 2007 will be higher. By 2010 it will be over \$200 and climbing.

Phil goes on to say *“When land was free or cheap (in early days of colonisation) the ownership of land was not a problem. Nor was equipment, as there was little of it. Today, hard assets dominate the balance sheet of most farmers. These enterprises are more like property operators than farmers. This means a low rental income (imputed) and some capital gains are all that can be achieved. The size of holdings is consequently too small for today's business world – limited by access to capital for hard assets – and revenues are about a third of the optimal size. The ratio of revenue to total assets for farmers is the worst of all industries and profitability is also the lowest of all industries.”*

I pose a question to all of you here.

Are you in the land business, owning land as your major source of wealth with a long term capital gain of about 5%?

Are you in the agricultural business as your major source of income, providing a good living standard, with wealth creation and investment to match your city cousins?

OR

Are you in the farming community because it is a way of life, slowly eating into the assets left to you by past generations so that you can survive?

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History

I am a fifth generation farmer, born near Mount Gambier S.A. My grandfather had sheep and beef cattle. My Dad purchased half of the family farm and started milking cows in readiness for when I left school. The farm had to be paid for and it was envisaged that in time it would have to support two families.

At age 22 I was offered a job with a stock firm. We thought it was a great idea for five years, to get out and see what other farmers did, pinch their ideas and come home. With the sale of the family farm in 1976 due to Dad's health, I spent eleven years as a stock agent. It was some of the best training I received, especially in marketing. I married Julie and we had four children. On a stock agent's wage it was impossible to raise a family and buy a farm.

During these years (in 1979) I started Australia's first commercial on farm Embryo Transfer programs. E.T. has stayed as a big part of our business to this day.

In 1982 I left the stock firm and started share dairy farming in the Adelaide Hills. It was at this time I realized how hard it was to build up capital. With few assets, nobody wanted to lend us money. We had to be creative, work hard and "have a go"

In conjunction with dairy farming, and to build on the Embryo Transfer business I had developed, we formed a company with partners that also involved export of live cattle. In about 18 months the E.T. business had grown to an extent that we had to concentrate on the new company and come to another arrangement for our dairy herd, which we wanted to keep as an extra source of income. We contracted a dairy farmer to milk our cows on his farm with his management and labour. This gave us a steady income with no management or expenses, and set a pattern for our future business decisions.

Over the years I have been able to travel the world as part of our business, still pinching ideas and coming home. In 1988 while visiting Texas A & M University I found Wagyu cattle.

Here was an ugly breed of cattle from which I realized we could make money. I remember two quotes from this time. A U.S. Jersey breeder was addressing an Australian Jersey Conference. He was asked "What were U.S. Jersey breeders doing to improve the popularity of the breed in the U.S." He replied "We went out and found a cow that made us money and learnt to like her." The other quote was when I was looking at the first Wagyu with the owner/breeder in the U.S. I said to him "Don, these cattle are so ugly that I don't know how I am going to go back to Australia and describe them." In his Texas drawl he said "Son, they just look like money to me!"

By this time our Embryo business had imported over 10,000 embryos from all breeds, dairy and beef for clients all over Australia. A lot were from the new breeds like Salers and Gelbvieh plus the traditional breeds. I fell in love with a lot of great cattle, structurally correct, big, and good looking but except to increase growth rates, I couldn't work out how I could make more money than was traditionally being done in Australia. This wasn't going to get me the capital that I would need to go farming full time.

Wagyu was a different story. Our largest market was Japan. They also paid the top price per kg., but research showed that Australian beef was the cheapest in Japan. They were paying a premium for lot fed U.S. beef, but still not as much as for their own beef produced from using Wagyu genetics. It was a no brainer, I had to get into Wagyu. There was a huge market at a premium price.

Over the years we have made a lot of radical farming decisions. Ones that have seen us grow and develop our business. Just about every development decision was forced on us because we didn't have any money or property assets that we could borrow against. These decisions were made after we sat down and worked out what was the best result, how we could achieve the best gain in moving forward, with what we had.

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These decisions forced us not to own land, or machinery but to outsource everything we could. We contracted people who were experts in their fields to work for us when we needed them, experts that you couldn't afford full time. We are even moving to the stage where we won't need to own a breeding herd, but can still produce 2,000 calves a year of our own genetics.

When looking at future growth strategies, our first move is always to look outward to see if we can achieve our goal.

Initially we agisted our cattle, but it got to the stage with numbers building up we needed something more secure, so we leased a property near Melbourne that belonged to Sir William Angliss' family. A beautiful blue stone homestead set in an old English garden. We would pick up our Japanese customers from the Melbourne airport and bring them to "Marnong". They would get out of the car impressed. Then they would say to me "Ah you are a wealthy man owning all this!" to which I would reply "No I lease this property." Their answer was "Ah a smart man – Banks don't own their own buildings!"

Our business was growing nicely, but it wasn't growing fast enough for our customers. We decided to sell our small farm and put all our money into the business. I guess that is when we became virtual farmers. We farmed without owning any land. We employed a few staff of outstanding ability and gave them control of their areas. Everything else we outsourced.

Fully Integrated Business

Our business aim is "to become the benchmark for beef quality in the world". The business is a family owned, fully integrated beef production and marketing company. Over many years we have been able to develop a supply chain which provides greater control over all stages of production.

Our six pillars of business strategy are; Genetics, Farm Management, Feeding, Processing, Distribution and Marketing.

1.1. Genetics

My passion has always been around genetics. The business has forced me to reduce my first love of farming fulltime. I keep sane by working on our breeding strategies. I have spent hours learning about the traditional secrets and history of Japanese Wagyu beef. I have studied all the family trees and bloodlines, tracing most back 10 or 12 generations. I love working on pedigrees, and using the carcass data to make improvements. If I can put an extra 1kg into each of the strip loins and cube rolls from each carcass it would increase the carcass value by \$520. That shouldn't be too hard to put 4kgs weight into the primal of a 470kgs carcass.

My goal has always been to select genetics best suited to Australian grazing conditions, and to adopt traditional Japanese management practices wherever possible.

1.2. Farm Management

Along with the bank we did purchase a townhouse in Melbourne. That was not only to give us a house to live in if things went bad, but it was used for accommodation for our four children while they went to University. It was purchased as a back up but used not as we intended. It was sold to help purchase the feed to get us through the 2003 drought. By this stage we had leased the property across the road giving us 5,000 acres of leased country. We couldn't afford to breed all our calves by embryo transfer, so we were breeding F1 cattle – Angus/Wagyu cross.

We grew our herd to about 1200 breeding F1 and F2 cows with natural breeding, plus grew our Fullblood herd with embryo transfer. But with F1 and F2 crossbred breeding we couldn't get the consistent quality in our carcass that we wanted. Even though we called our cattle Wagyu, in reality they were 50% and 25% Angus.

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We have a terrific young couple who manage the E.T. operation and leased farm. We see their role changing to operating the production side of the business in the future. They are looking forward to this role which will involve the production of embryos from females in the feedlot, liaising with our partner/farmers to produce the calves, raise and send them to the feedlot. Currently we produce about 30 carcasses per month. Infrastructure is in place to produce 200 carcasses per month – needing about 4000 cattle on feed at any one time. We currently have cattle on 8 different properties.

Outsourcing was the option taken for expansion.

Wagyu Breeders

We have agreement with breeders who have been following our breeding and management plan. They own their own farms, cattle and management. Their steers go the feedlot to be fed our ration which they pay for. At the time of slaughter the beef is sold under our label, they receive the same price as we do and we charge them 5% management fee for the work we do. This helps to increase our production levels.

Producers

We contract producers to put our embryos into their cows. We take delivery of the resultant calf at about 10 months of age after it has met the contractual arrangement, which involves health, weight, performance etc. We pay a bonus to farmers who exceed the specifications. This saves us owning land, cattle, machinery and management.

Farmers

We contract a farmer to manage our breeding cattle on his property. He supplies the land and management and he delivers the calf back to us at 10 months of age, meeting specifications.

In all instances we pay well above market prices so it becomes a win/win for all parties.

1.3. Feeding Facility

The hallmarks of the “Japanese Wagyu beef eating experience” are the quality and texture of the meat and fat, its softness and flavour. This is a combination of correct feeding and breeding. The real Japanese Wagyu beef has been described as having a buttery texture, with a sweet delicate flavour with a hint of caramel.

Ration and feedlot management is important in getting a predetermined weight gain, growth and marbling PROFITABLY. The cattle are on a feeding program for 500-600 days. The ration was designed in Japan by leading industry and academic experts, and customised by us over the last 10 years to suit Australian commodities, their availability and price, but all based on carcass appearance and results.

We don't feed antibiotics, our cattle don't receive growth hormones and our ration consists of all natural palatable products, none of which are genetically modified. The feedlot has signed confidentiality agreements to protect our intellectual property and our ration is “secret”.

Ten years ago we started with 12 steers on feed and didn't quite know how we were going to pay the feed bills but we got through and 12 paid for the next 24 and 24 paid for the next 48 and so on.

Feeding Facility

By outsourcing the feedlot to custom feed, we alleviate all infrastructure, machinery, management and staff. The feedlot buys the feed 12 months in advance. We pay for it 14 days after it is fed to our cattle, saving us a huge capital outlay.

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1.4. Processing

Our customers are the chefs; some are Japanese style restaurants, so to meet our customer requirements we can do up to a 22 cut specification. We can have different parts of the same carcass finish up in 6 different countries. The abattoir is contracted to carry out this work, again we don't own anything or need to employ expert staff. They prepare and present all the export documentation.

Of all the areas in our supply chain, the processing is my weakest point. I don't have experience in cut specifications and packaging. To combat this, I have arranged for our customers to speak directly with the processors to have their requirements fully met.

Abattoir

After 500-600 days on feed, we ship our cattle to the abattoirs to be processed, packaged and shipped to our customers, all who have different cut specifications. We chose a Japanese owned abattoir, knowing that they understood the requirements of our customers. They have a separate boning room (similar to Japanese facilities) where special cut requirements and full traceability can be carried out. We use the official Aus-Meat grading system, assessing at the 10th/11th rib site, we achieve a 96% marble score of 9 or 9+. We also unofficially grade using many of the 16 criteria used in the Japanese grading system (Australia has 6 criteria). This allows us to select genetics that successfully helps us achieve carcass quality close to the Japanese quality.

1.5. Distribution

In the majority of instances our packaged beef is sent directly to a distributor or food purveyor for distribution. The really good purveyors have constant contact with restaurants and chefs and provide all their needs, including all types of meats; rabbit, squab, crocodile and kangaroo.

Purveyors

The ones we have chosen have the reputation for selling the best and are great promoters of our brand. They give us immediate feedback if something needs attention. They make daily deliveries; supply the cool rooms, refrigerated delivery vans and staff. Importantly they carry the accounts of the restaurants.

1.6. Marketing

Our marketing has been an evolving process, with a lot of research and plenty of trial and error!

It is really important to differentiate yourself from the market – the market is your opposition. It might only be small differences, it might be the region you farm, it might be your farming practice or your management, it might be your bloodlines, or it might be only that you have a great logo. Use whatever you can. Is Nike different to Puma or Addidas? The perception says it is. They are probably all made in the same factory in China. It's how you differentiate yourself in the market.

In the beginning we marketed our steers exclusively to the largest Japanese meat company. They also owned an abattoir, feedlot and four farms in Australia. They saw first hand the success we were having with our Wagyu and started their own Wagyu program, for which I acted as a consultant. This was successful and helpful to both parties. I visited Japan 6 or 7 times, I went to all the major research farms, Agriculture Universities, Bull Studs, feedlots and farms. I saw our beef unloaded at the wharf and followed its progress to the supermarket shelves. It gave a wonderful insight into the industry. It showed me what the customer wanted and what he was prepared to pay for it.

After a while they started to do taste tests between my product, their Australian produced product, their Japanese produced product and some Japanese Fullblood product. Our product always beat their Australian produced beef and often beat their Japanese produced F1 product but never their Fullblood product. In frustration their Australian manager came to me one day and asked 'how come you always beat us, we do the same as you, and we follow your breeding plan, why?' I hit my heart a couple of times and said 'you have to include passion'.

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In 2002-2003 two things happened, first the drought used up nearly all our resources, and second (and more serious) was the confirmation of BSE in Japan and following that a labelling scandal that our customer was caught up in. They stopped buying our beef over night. The carcass price of F1 Wagyu dropped dramatically. We held our price and our nerve and found new markets outside of Japan. In some cases we held cattle on feed for an extra 100 days. Today we don't market any beef to Japan.

At the end of the drought we were able to sell our F1 and F2 breeders for good money which helped us get on our feet again and allowed us to buy a nice little farm on the Goulburn River with 650 mgl water licence and our own house again. Now we have changed over to 100% Fullblood cattle and carcasses.

We believed our quality probably had the edge on other producers involved in producing Wagyu beef, so we decided to create our own brand name, our own box lids and market to the best restaurants in Australia, Asia and North America. We also decided to create a website that we use to highlight the differences in our business methods than those of our competitors.

One of our promotional successes was when our beef was served at the Hollywood Oscars in 2005. Top restaurants started buying in Korea, Taiwan, Hong Kong, USA, China, Japan and Australia.

I find it is increasingly important to be talking to our customers – the chefs. Prior to the recent opening of Rockpool Bar and Grill Restaurant at Crown Casino in Melbourne, I spoke to about 50 staff, chefs, waiters and managers to explain the Blackmore brand and Wagyu, so they can converse with the customers, our end users. I am doing the same for the world renowned Nobu Restaurant opening at Crown casino in Melbourne.

Currently our beef is the highest priced beef being sold in the USA, predominantly to the world famous chef Thomas Keller who owns the number 1 rated restaurant, French Laundry near San Francisco and the number 2 rated restaurant, Per Se in New York. He recently visited our farm and during my next visit to the US, I am to speak with his staff.

Once it was only necessary to read the farming paper or breed journals, now I need to read the restaurant and epicure style magazines to keep up with what's going on and learning who's who. These are now my customers.

Recently we were awarded the "From the Paddock", overall "Producer of the Year" and are the inaugural inductee into the "Produce Hall of Fame" at the Vogue Entertaining & Travel Audi awards.

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Future Growth

My role is constantly changing. The genetic side is also growing, selling embryos, semen and breeding stock domestically and internationally.

We have four children who all have business degrees and are employed by big corporations. All want to eventually return to the family business – but none want to be farmers. I must have worked them too hard on the farm when they were little kids.

We have a succession plan in place, and one daughter joined our company twelve months ago. We plan for another to join us in about 18 month's time when we plan to expand our business into the EU. Currently we get 15 international enquires a month and can't supply any.

The fact that none of our kids want to be farmers, has been another reason that encouraged us to expand our business but become less involved in farming. To continue to achieve this, we will begin sending female cattle to be fed in the next few months. These will also become our donor herd. We will collect embryos from our females on feed to transfer into our partner farmer's herds.

It will also give us unbelievable carcass data to select our future breeders as we will have information on the dam, the sire, full brothers and sisters. Our genetic gain will lead to the consistency of product that we are striving for.

Conclusion

As you can see the process we have in place has seen its growth being fully self funded. It was forced on us because we had to find solutions to the fact that we didn't have any money or owned land that the banks want as security.

I will leave you with a true story about an acquaintance of mine. Professor John Morris was doing market research with Australian lamb in a major U.S. supermarket. They were handing out small cubes of lamb on toothpicks to taste test to customers. On approaching one lady, she turned and said 'oh no I am vegetarian'. Quick as a flash John replied 'so was the lamb'.

You have to be quick on your feet and ready to approach each hurdle as it arises and adapt to your customers needs.

Thank you for the opportunity for me to speak to you today.

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