

## Dead meat

Affco's grizzly cadenza could be its swan song

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So you think it's a tough trading environment out there? Try being in the meat business for a change.

If you had a \$1 billion business selling commodities that were perennially up against negative cyclical conditions, oversupply, declining global demand import tariffs with depressed prices making it hard to make a profit, what would you do? Fire the management, refinance, sell-down assets, refocus core business within growth markets, throw in the towel?

To resurrect itself from the brink of foreclosure, publicly listed meat processor Affco Holdings has tackled almost all of the above. Yet it still can't turn a profit. Affco could be a company whose time has gone.

Ensnared in an old-world economy where primary-produce was king, former senior management refused to accept Affco's financial problems. The company's fortunes were supposed to turn after its bankers forced the board to appoint a chief executive prepared to take a ruthless, yet necessary scalpel to the company.

Enter new chief executive Ross Townshend amid robust claims that Affco would be back-in-black in the year to September 1999. Since then Townshend has:

- n Renegotiated a \$65 million refinancing deal with Farmers Mutual;
- n Staunches high internal costs;
- n Introduced efficient work practices; and
- n Tackled under-utilisation through "mothballing" or closing plants.

In spite of this restructuring the company still posted a bottom-line loss of \$4.84 million for the six months to March 1999. Although this was half the loss of the previous six months it exceeded Townshend's budgeted loss of \$3.5 million.

Worse, the losses were curtailed mostly through asset sales.

The net result for shareholders? Net tangible asset (NTA) backing at balance date was \$0.4077, down from \$0.742 last year. The ratio of debt-to-debt plus equity was 71%, up from about 62% and current liabilities exceeded current assets at balance date, due to the short-term nature of its borrowings.

Shareholders seem to be getting the message. Affco's share price, is around \$0.20, well under half the 1995 \$0.52 list price.

The company has produced good profits in the past. Its best-ever result was in 1996 when it produced a net profit (after tax) of \$26.5 million.

So what's gone wrong? Since then there's been a welter of cyclical woes and one-off hiccups tantamount to the seven plagues of Egypt. These include:

- n Being wrong-footed by the currency drop;
- n Falling lamb prices when Affco stock levels were high;
- n Huge processing overcapacity;
- n Severe drought;
- n Beef livestock down 8%;
- n North Island sheep stock down 15%;
- n Falling beef prices in the United States;
- n Late start to the season; and
- n United Kingdom supermarket chains cancelling lamb contracts.

Need we go on? Okay. With 40% of the North Island's beef processing capacity, Affco felt the impact of falling beef prices in the US. A 20-year low saw the US price for hamburger meat — half AFFCO's total beef sales distribution — drop from \$US1.35 to \$US0.70 per pound.

Since then a currency benefit has brought some relief to ailing lamb, beef and venison price margins. There's also been a slight recovery in stock levels. But with prices well down, margins remain dangerously tight.

The group's primary focus is North America and the European Union which account for 51.2% and 57.4% of beef and lamb respectively. But the contentious slapping of import tariffs on US-bound lamb scotched Affco's plans to expand its US market.

He blames greedy farmers for the interim loss. Falling stock numbers mean too many processing chains chase too little stock. This spells high stock procurement prices and declining margins.

Affco's chief financial officer Graham List says if the company continues to pay too much to farmers, it will go broke.

"It's a margin game, unless we can get a satisfactory margin, there's no reason to chase the stock," says List.

With debt accumulating at \$2 million a month, Affco badly needs improved earnings. But will Farmers Mutual Group give Affco enough time to turn a reasonable profit? If not, what financial institution will be brave or silly enough to give this monolith yet another chance?

And you thought Internet stocks made good reading.

## **Mark Story**