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Grain Sector - Rural Awakening

October 2016

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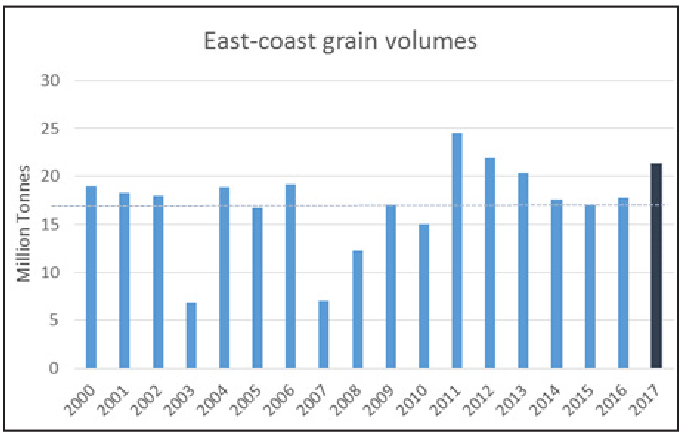
A bumper year ahead?

At Ausbil Investment Management, we believe the near-term outlook for the grain sector is increasingly positive and that participants exposed to grain handling and associated farm-inputs should be beneficiaries from a strong summer grain harvest.

If you have ever tried to grow vegetables in your backyard, you will know that soil moisture, sunlight and a touch of fertiliser are the key factors to success. Large-scale grain farming is no different. In Australia, wheat accounts for the majority of east coast grain volumes and we are most familiar with wheat as the key ingredient to breads and pastas. Barley is another grain used in livestock feed, but it is increasingly diverted to higher value malting, which is used in beer, whisky and other alcoholic beverages. Canola crops are important for their seeds which are crushed into canola cooking oil. Conducive moist conditions in the April-May sowing period resulted in a solid start to the season, while adequate follow up Spring rains also increased expectations for a relatively high yielding crop. Following the initial growth phase, wheat crops typically require a period of dry, warmer weather to foster crop growth. Dry conditions also inhibit fungal diseases and allow for easier access during the upcoming harvest period.

We were initially concerned after seeing news footage of extreme wet weather in some parts of NSW and associated crop damage. In response, we visited the other key growing region in western Victoria to assess first-hand the conditions of the grain crop. We witnessed luscious green wheat and barley, contrasted with the abundant yellow canola fields. We also spoke to a number of the Victorian farmers who have substantial grain crops. They informed us that this could be the best crop on record in Victoria. We suspect that the robust crop yields in Victoria will be enough to offset the unfortunate crop losses seen in NSW from the flooding and associated diseases.



Source: Ausbil & ABARES

It would appear that forecaster ABARES (Australian Bureau of Agricultural and Resource Economics and Sciences) believes the same, as it recently upgraded its predictions for the east coast grain harvest from 19 million tonnes (mt) to 20mt. ABARES also expects the yield per hectare to be the highest recorded in the past three years and if this occurs, it would be the third largest crop in recent history.

Agriculture is supportive of a structural transition away from resources

We know that resources investment has been in decline for a number of years. However, it is often forgotten that the outlook for the Australian agricultural sector has been very robust over this time period.

For the five years to 2017, the average value of farm exports in $A terms, was up over 17% compared to the prior 5 years. High livestock prices have provided a further boost to farmer incomes.

Importantly, the sheer scale of grain volumes currently being harvested and transported is a positive boost to rural employment, farmer incomes and the broader economy.

ABARES expects that earnings from farm exports will remain relatively stable at A$44 billion with the majority of this in the form of export earnings for crops ($23 billion).

While these farming export values are relatively small compared to resources, where iron ore exports alone are close to $50 billion,

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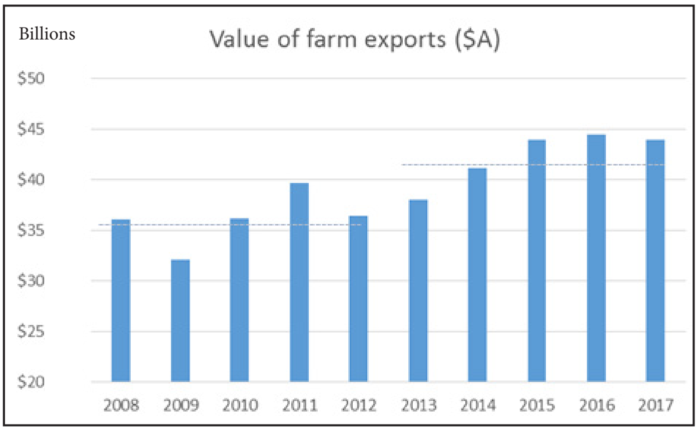

it nevertheless supports an improving trade balance for Australia.

Combined with the very positive outlook for east coast infrastructure, which is another area we are positive about, the outlook for the Australian economy is improving. The Australian economy is successfully navigating its way through a structural transition as the drivers of growth adjust away from the previous resources boom. We expect real GDP growth to remain at trend, which is estimated at 2.8%. While the lower cash interest rate is providing ongoing support to aggregate demand and the Australian dollar is helping to drive domestic production.

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