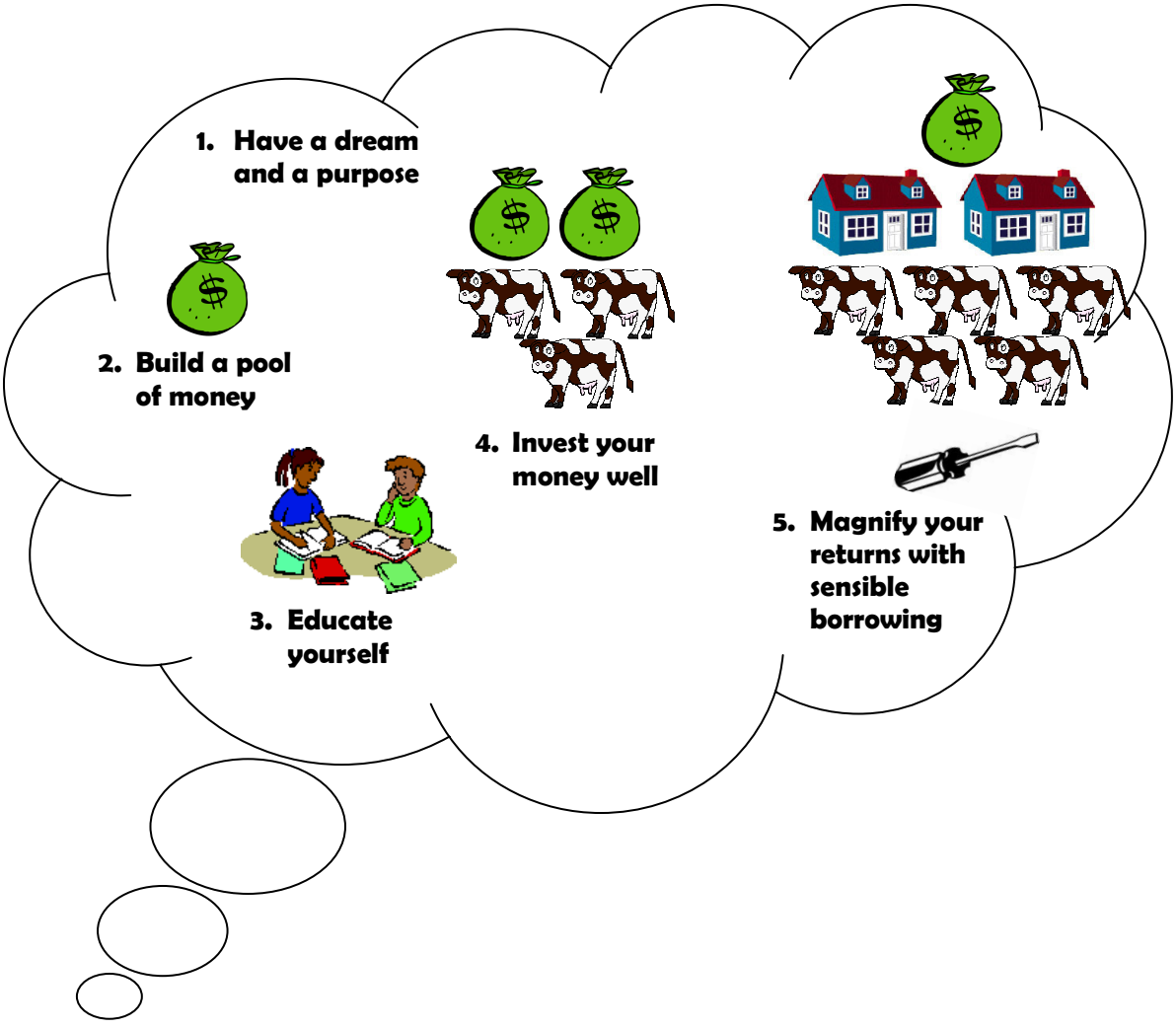
# Steps to Wealth Creation in the NZ Dairy Industry

**Lynaire Ryan, DairyNZ Business Developer, Christchurch**

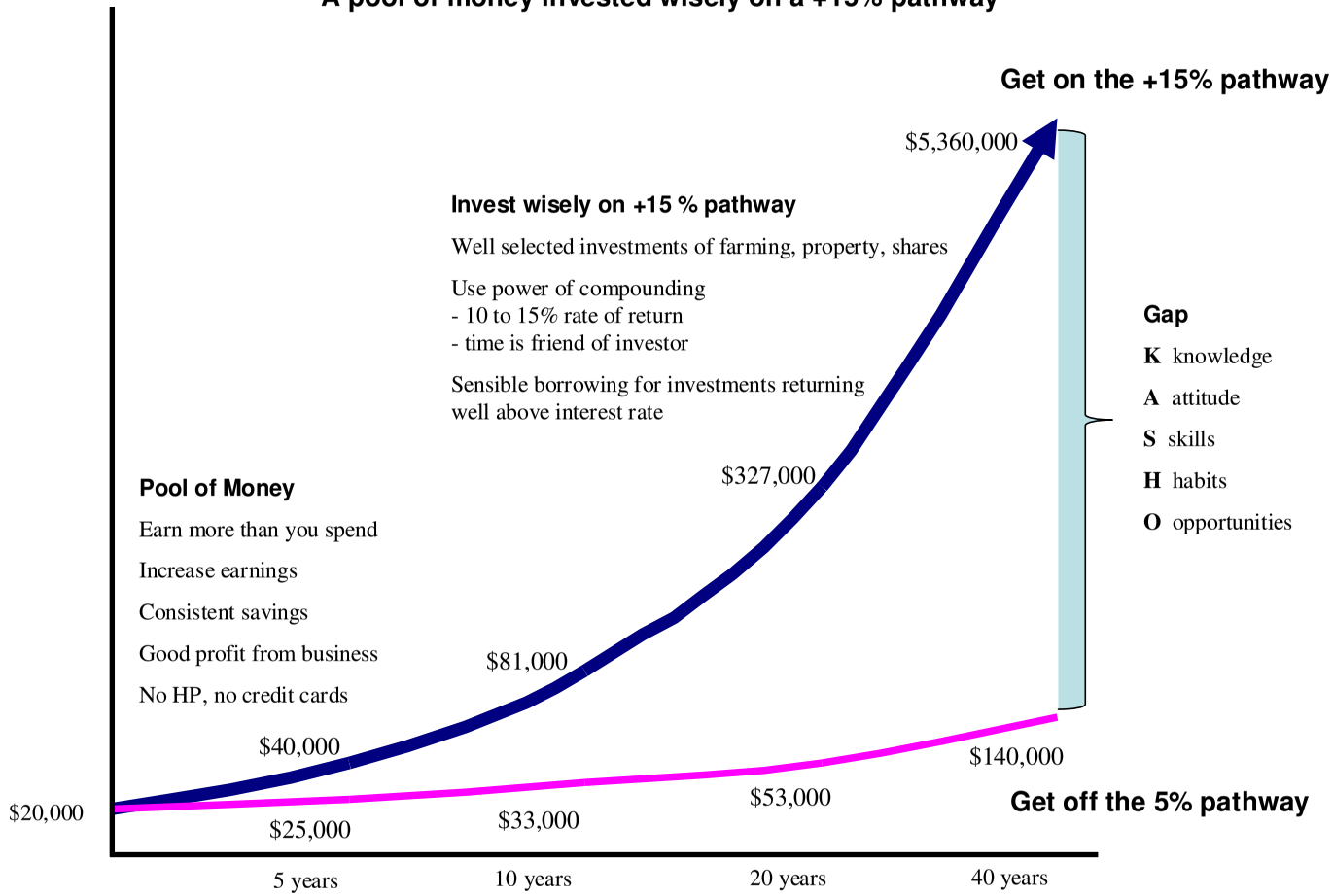
The NZ Dairy Industry offers a wonderful lifestyle, career path and wealth creating avenue for anyone willing to work diligently and develop their knowledge, skills and attitudes so as take advantage of the opportunities that come along. Look around at the many success stories evident in the industry – 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 you 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<br>% | 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<br>% | 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<br>% | 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<br>% | 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**

| *Return On Dairy Assets* | *Return On Equity* *Assume $450,000 borrowed at 8% interest* |
|---|---|
| ROA = $\frac{\text{Operating Profit x 100}}{\text{Asset Invested}}$ | ROE = $\frac{\text{Operating Profit minus interest x 100}}{\text{Equity Invested}}$ |
| = $\frac{\$128{,}000 \times 100}{\$800{,}000}$ | = $\frac{\$128{,}000 - \$36{,}000 \times 100}{\$350{,}000}$ |
| = 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 | = $\frac{\text{net return x 100}}{\text{asset}}$ |
| Return on Equity | = $\frac{\text{net return–interest x 100}}{\text{equity}}$ |

**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**<br>Surplus for debt repayment / investments | **$** | **$** | **$** |

| Tax Guestimate Calculator<br>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**<br>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<br>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