Presenting the Business Case for the Merino Ewe

Key Messages
The macro-scale fundamentals applying to Merino production are great:

1. Ewe numbers are tight, and will remain so for the foreseeable future
2. Wool volumes are tight, and exchange rate trend changes mean that prices should be good in the medium-term
3. Lamb prices projected to remain strong
4. Sheep production is increasingly seen as a sensible and indeed profitable risk management strategy in cropping enterprises
The Merino Ewes
A “must-have” Mum

Today more than ever, well bred and performing Merino ewes form the cornerstone of profitable sheep production enterprises in Western Australia. Due to the coming together of a number of important trends, the future looks very bright. Some facts:

1 Ewe numbers are historically low

The national sheep flock is now at around 73 million sheep, down from the highs of the 1960’s and 1980’s. The steady decline over recent decades reflects shifts to competitive land uses, and in the recent decade, recurrent droughts. The number of ewes joined in Australia is now at a critically low level.

Based on an AWI-funded flock demographic model, WA’s Kimbal Curtis has suggested that the national ewe flock is in danger of collapse.¹

Based on this modelling approach, the chart shows how numbers of ewes joined is projected to decline, reducing the number of lambs marked, and thus able to be sold for slaughter.

MLA’s projections are more positive in suggesting a levelling out of present declines. However, these are based on assumed significant increases in weaning rates, lamb live weights, and the proportion of prime lamb-bred breeding ewes within the flock.

2 Demand for sheep meat is projected to remain strong

MLA forecasts² are for lamb and sheep meat prices to remain high and move up again over the medium term, due to:

• A small rise in local and international demand
• Limited sheep numbers.

Supply constraints will also reduce mutton supply and live sheep exports

The combination of short supply and strong demand augers well for the price of breeding ewes – as seen in very strong saleyard prices for restocker ewes.

3 Wool supply is tight

With falling sheep numbers, the supply of wool has also declined and changed in composition.

As shown, since the end of the Reserve Price Scheme, the volume of the Australian clip has halved, and the clip has effectively split in two, comprising around:

• 200 million clean kilograms less than 24 microns
• 40 million clean kilograms above 24 microns

The Merino component of the clip now averages less than 20 microns.

With the decline in production in the 20-26 micron range, the Australian supply of wool is now much more aligned with global clothing demand trends.
Currency trends do assist

Since around 98% of the Australian wool clip is exported, and around 50% of sheep meat, foreign exchange rates have a major impact on the price for wool and sheep meat in Australia – especially for wool, since almost all wool export contracts are denominated in US$.

Fortunately for Merino producers, US:Australian currency exchange rate appears to have stopped its inexorable 2000-2008 climb, which saw it appreciate by 45% over 8 years – or at 5.5% per annum.

As a result, even though the US$ price for Australian clean wool increased by on average 3.4% per annum for the period 2001/02 to 2008/09, the average AU$ price received by growers fell by 2.5% per annum, simply due to the currency trend. So, while the world has been paying on average 3.4% more per kg of out wool per annum, the massive rise in the AU:US$ exchange rate has effectively reversed this rise.

Since market expectation is that the AU:US$ exchange rate will occupy the low-mid 90’s till well into 2012, the prospects are that the AU:US$ foreign exchange rate will effectively plateau in the short to medium term. With tight supply, this suggests that the average price of wool received by Australian Merino growers should now start to rise.

Comparative profitability of the Merino

Due to the recurrent droughts this decade, and the adverse impacts this has had on many cropping enterprises and their lenders, sheep enterprises within cropping systems are increasingly seen as a sensible cash income risk management strategy.

In providing the foundation of the self-replacing and dual purpose Merino enterprises, the Merino ewe underpins gross-margin the majority of Australia’s sheep enterprises. Enterprise benchmarking confirms this role.

For example, the Holmes Sackett AgInsights series represents perhaps the largest sample of agricultural enterprises in Australia, concentrated in Eastern Australia.

Their enterprise benchmarking data shows that:

- Dual-purpose Merino (first cross lamb) enterprises have averaged a higher gross margin than self-replacing Merino enterprises, or Prime Lamb.
- With the strengthening of wool and sheep meat markets from 2008, the gross-margins for all sheep enterprises have rebounded dramatically.
- While there has been so much focus on prime and first cross lamb enterprises in recent years, it is important not to lose sight of the potential for a well-run self-replacing Merino enterprise. As shown, high-performing (e.g. top 20%) self-replacing Merino enterprises outperformed average prime lamb or dual purpose enterprises most years.

The keys to having high performing Merino enterprises are the combination of right genetics and management – especially that which generates high weaning rates, fast lamb growth rates, heavy cuts of high value wool, and resistance to internal and external disease threats.
6 Genetic trends underpin the value of the Merino

Genetic trends analysis shows that the Australian Merino is adapting to the challenges of the current production environment. For example, genetic trends since 2000 within the MERINOSELECT database\(^1\) show that the contemporary Merino yearling is:

- Cutting more wool with longer staples
- Growing much faster
- Producing wool of lower CV of diameter
- Producing fewer worm eggs (WEC)
- Showing fewer breech wrinkles

West Australian Merino studs are at the forefront of this genetic revolution. Genetic trend analysis shows that WA Merino studs lead the way in the growth and reproduction traits which underpin dual purpose Merino production systems:

- Eye muscle depth
- Yearling and hogget body weight
- Lambs weaned per ewe joined
- 7% Dual purpose index

For more information about the contents of this publication:
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References
6. Genetic trend analysis data supplied by SheepGenetics on 29th June 2010. The data for 2009 drop animals has not been included since phenotyping for key traits is incomplete (is too early).

For the first time for many years, the macro-scale fundamentals applying to Merino production are great:

5. Ewe numbers are tight, and will remain so for the foreseeable future
6. Wool volumes are tight, and exchange rate trend changes mean that prices should be good in the medium-term
7. Lamb prices projected to remain strong
8. Sheep production increasingly seen as a sensible and indeed profitable risk management strategy in cropping enterprises

For these reasons, Merino ewes should be seen as the ‘must-have’ mums. Enterprises which have stuck with productive and fertile Merinos, and can wean and grow lambs efficiently, are very well placed.