# H.W. Greenham & Sons Pty Ltd

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*Meat Exporters*

Manager
Small Business Entities & Industry Concessions Unit
The Treasury
Langton Crescent
PARKES ACT 2600

25th July 2018

Email: RnDamendments@treasury.gov.au

Dear Sir/Madam

I am writing in relation to the proposed changes to the Federal Government's R&D Tax Incentive program, identified in the Exposure Draft released on 29 June 2018.

**H.W. Greenham & Sons Pty Ltd** (Greenhams) is one of Australia's largest, privately held meat processors, with facilities in Smithton Tasmania, Tongala in rural Victoria and our recent acquisition, a facility located in the Gippsland region of Victoria. Greenhams buys livestock from over 9,000 suppliers throughout Tasmania, South Australia and Victoria and employ more than 600 people in primarily regional locations.

In order to compete with the multinational companies that dominate the Australian meat industry (i.e. JBS Swift – based out of Brazil, Cargill – based out of the US and Nippon meats – based out of Japan), Greenhams has had to invest heavily in various R&D projects over the years, a number of which have received Government support (i.e. via direct grants) and a number of which have been supported by the Federal Governments' R&D Tax Incentive program ('RDTI').

Greenhams has benefited from accessing the R&D Tax Incentive for a number of years and the program has supported a number of R&D projects, including:

- Development of a unique combustion system based on the use of pyrethrum waste material,
- Development of innovative technologies to reduce the level of contamination waste water discharge from meat processing facilities,
- Development of novel processes and techniques to extend the shelf-life of chilled products (to access more diverse export markets),
- Etc.

Each year, Greenhams dedicates (on average) between $2 million - $3 million on R&D projects. This investment in R&D diverts funds away from other important purposes within the company (such as training, marketing, hiring more staff, etc), however we have historically engaged in R&D activities to ensure that we are able to compete with overseas multinationals (in both the domestic Australian economy and with respect to international demand for beef), safe in the knowledge that some of the expenditure we divert to our program of R&D activities is supported by the Government's R&D Tax Incentive program.

### General comments regarding the proposed RDTI changes

Australia's R&D program has been the subject of a number of significant reviews, with 3 different programs in operation over the past decade and multiple minor changes to the program during that time, including most recently reducing the R&D tax benefit for companies with an aggregate turnover of more than $20million, from 10₵ in the dollar to 8.5₵ in the dollar.

In the most recent proposed changes (with draft legislation released on 29 June 2018), Treasury noted that the proposed changes to the current R&D Tax Incentive program are required in order to enhance the additionality,


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integrity and fiscal affordability of the program, whilst rewarding businesses that spend a higher proportion of total expenditure on R&D activities. In seeking to achieve these objectives, the proposed changes to the current R&D Tax Incentive introduces an 'R&D intensity' test, which involves determining what proportion of an R&D entity's total expenditure was spent on R&D activities. While it may be the Federal Government's intention to improve the integrity of the current program, whilst ensuring genuine R&D is rewarded with an increased rate of benefit, it is our view that the proposed changes won't achieve these stated objectives. It is also our view that rather than promoting the conduct of additional R&D activities (in order to achieve an increased rate of benefit), the proposed changes will actually disincentivise companies such as Greenhams (who are subjected to volatility in inputs into the processes) to increase their level of R&D activities, primarily due to the inherent uncertainty associated with aspects of the program and the inability to predict the level of R&D intensity **prior to the start of the financial year**, when R&D projects and budgets are being formulated.

As the proposed legislation currently stands, if the changes are enacted in their current form, Greenhams has forecasted that its benefit from the revised R&D program will reduce by around 50% or more, depending on how 'total expenditure' is interpreted. The tiered structure of R&D benefits within the revised program will actually provide limited incentive for Greenhams to increase our level of R&D investment, due to the fact that the $150 million R&D limit (introduced as part of the proposed legislation) would preclude Greenhams from ever accessing the top benefit of 12.5% (given our total expenditure).

Greenhams supports any changes to the current R&D Tax Incentive program aimed at ensuring the integrity of the program is maintained and the program provides benefits to companies engaged in genuine R&D activities. With that said, we have significant concerns regarding the impact of some of the proposed changes and the lack of predictability associated with the calculation of the 'R&D intensity' of a company, which we would like to specifically address in this response.

**Impact of the proposed R&D changes on H.W. Greenham & Sons' ability to make an R&D claim**

The proposed changes are due to be retrospectively enacted (as of 1 July 2018), which in and of itself has created issues in planning our program of R&D, given there are uncertainties regarding various aspects of the legislation. However, if we use our financial data from the 2017 financial year, the following are our concerns:

- The proposed legislation relies on the calculation of an 'R&D intensity test', based on R&D expenditure as a proportion of total company expenditure. In the 2017 financial year, Greenhams' total R&D expenditure was between $2 million - $3 million, which would result in an R&D intensity percentage of between 0.54% - 0.81% placing us in the 0% - 2% intensity category. In the 2017 year, Greenhams' received an R&D Tax Incentive that equated to around 0.25% of total company expenditure. If the proposed intensity test were in place in the 2017 year, Greenhams would have received a benefit that represents 0.026% of total company expenditure, significantly below the value of innovation under the current R&D Tax Incentive program.

- The majority of total company expenditure relates to the cost of inputs – i.e. cattle. I have attached a page from a recent meat and livestock Australia, which indicates that the cost of some cattle has risen from $300 per head in 2010 to almost $700 per head in 2016. This price volatility is often due to a multitude of factors over which Greenhams has no control (drought conditions push prices up, multinationals with more resources buying cattle at higher prices which also push Greenhams' cattle costs up, etc). Given the volatility in our main cost (in cattle), it will be difficult to predict our R&D intensity at the beginning of the financial year and therefore, we will be unable to calculate our R&D intensity for the upcoming year. If we are unable to accurately predict our R&D intensity at the beginning of the year, we are less likely to commit to the same level of R&D expenditure and projects, as it will not be possible to accurately calculate an internal rate of return on R&D activities, due to the fact we will only be able to calculate our actual R&D intensity until after the end of the financial period (after total expenditure is known).

- One of the problems associated with trying to calculate Greenhams R&D intensity (and why it is so low under the proposed new legislation) is that, as previously noted, the cost of cattle is included in the denominator in the calculation, but is not able to be included as R&D spend (the numerator in the calculation). If the cattle are used in R&D activities, their costs have historically been 'netted' out of Greenhams R&D claim, due to the operation of the feedstock provisions (i.e., in instances where the R&D activities produced a marketable product, the cost of cattle was treated as a notional deduction, but clawed back via the feedstock provisions). By not allowing feedstock related expenditure to be included as R&D spend, but that same expenditure must be included in 'total expenditure' it creates a situation where the

R&D intensity of a company is artificially suppressed (due to the inability to include feedstock expenditure in both the numerator and the denominator of the equation). The result will be a reduction in access to the new R&D Tax program by companies impacted by this issue (i.e. the majority of large manufacturers, meat processors, agribusiness, in fact any company that utilises raw materials and energy in the conduct of its R&D activities).

- Reducing our level of R&D expenditure (which is discretionary expenditure) will have an adverse impact on Greenhams' ability to compete globally in a highly competitive market. The inability to fund R&D activities for the projects related to increase yield, reduce input costs, improve the quality of cattle (i.e. reduce dark cutters, reduce contaminants, etc.) could directly impact our export sales. Currently, the majority of Greenhams products are exported to markets with very stringent quality requirements. Reducing our investment in R&D due to the additional cost of such projects (related to reduced Government support) will have a knock-on impact for the business, being reduction in access to export markets, reduced sales, and potential job losses, particularly those personnel involved in our R&D program.

- The changes to the R&D program are being made under the guise of trying to restore the integrity of the R&D program and stop companies claiming for 'business as usual' activities. Greenhams' has had its R&D claim and processes reviewed by AusIndustry and AusIndustry found that Greenhams' was in compliance with all eligibility requirements. Given Greenhams has complied with all required eligibility requirements of the program (as confirmed during its AusIndustry review), it appears inequitable that Greenhams' access to the R&D Tax Incentive program (in terms of benefit) should be reduced, just because other companies may be making claims that are inconsistent with both the intent of the legislation and the application of the legislation.

As a final point, the Consultation Paper starts by citing the 2016 'Review of the R&D Tax Incentive' and the 2018 'Innovation and Science Australia 2030 Strategic Plan'. The Consultation Paper goes on to state that the Government's response (i.e. the proposed changes to the Tax R&D program) acknowledges the findings within these reports "with a package of reforms to enhance the additionality, integrity and fiscal affordability of the R&D Tax Incentive program". It is our view that the proposed changes to the R&D Tax Incentive program ignore the recommendation of both the 2016 and 2018 report and instead the Federal Government has developed an alternative 'R&D intensity test' to the one proposed in the 2016 report. It appears that in drafting the proposed R&D Tax legislation, the Government has ignored its own experts and proposed a program that is primarily aimed at reducing the Government's investment in innovation.

In addition to responding to the public Consultation process, Greenhams has also taken the liberty of writing to the members of parliament where our rural facilities are located, to ensure they are fully aware of the impact of the proposed R&D changes on the plants and employees in their local constituency.

Greenhams supports innovation within the Australian economy and has benefited significantly from the current R&D Tax Incentive program. Greenhams hopes that this submission will draw attention to the flaws and consequences of the proposed changes to the current R&D Tax Incentive, and that the Government will reconsider the use of 'total expenditure' in calculating the R&D intensity premium, to ensure that Australian companies are incentivised to continue to innovate, rather than defer or abandon such plans due to the inequity and complexities associated with the proposed changes to the current R&D Tax Incentive program.

Yours sincerely,

**Grant Ryan**
**Joint Managing Director**
**H. W. Greenham & Sons Pty Ltd**

# Prices

Beef and cattle prices are likely to come under some pressure in 2018 as international competition intensifies and supply increases. The impact of this will partly depend on the level of restocker activity and strength of the underlying demand for beef in Australia and overseas.

Australian cattle prices roughly realigned themselves with US beef and cattle prices in 2017. The relative price difference between finished cattle in both countries (in US dollar terms) returned to long-term averages with Australia at a 20% discount, after hitting a massive 57% discount in the grip of drought (and record US prices) and a historic premium when both indicators crossed over for the first time in 2016.

While Australia appears to be back in sync with the US, currency movements and the rise in Australian cattle prices over the past three years have made South America a more competitive supplier to the global market. Up until 2015, Australian cattle prices tracked relatively closely to those in Brazil, Uruguay, Paraguay and Argentina. However, steers in Australia are now tracking close to a 50% premium to those in Brazil.

Currently, the EYCI, heavy steer and medium cow indicators all remain below where they tracked this time in 2017, with finished cattle prices still historically high – above any level prior to mid-2015. Restockers have played a prominent role in the high levels the EYCI has maintained during 2016 and 2017. There has been a recent shift in the price premiums that restockers typically pay between the northern and southern states, with Queensland the driving force while Victorian restocker demand has eased.

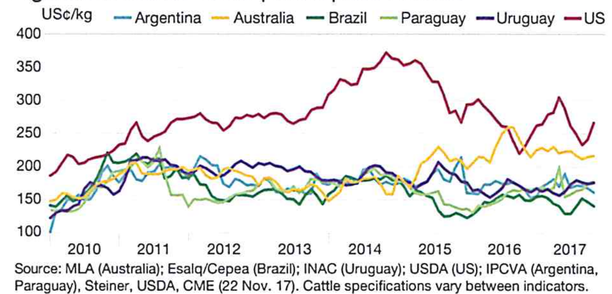
The rally of the EYCI seen in October/November 2017 (from a two-year low in late September) with some good rainfall across Queensland and northern NSW demonstrate restocker intent given the right conditions.

In the November price rally, Queensland restockers showed their appetite, purchasing 52% of EYCI eligible cattle in saleyards across the state at a 54¢/kg cwt premium to feeders. In contrast, Victorian restockers secured 14% of the market and premiums to that of feeder buyers narrowed from 20¢ earlier in the year to 7¢/kg cwt. Restocker requirements for cattle have lessened in Victoria as herds have been largely rebuilt – the state's herd size is forecast to return to average levels this year.

Queensland restockers may enter the market in force in 2018 if feed supplies allow. However, this may pull both young and finished cattle higher, again potentially placing Australia out of sync with global competitors.

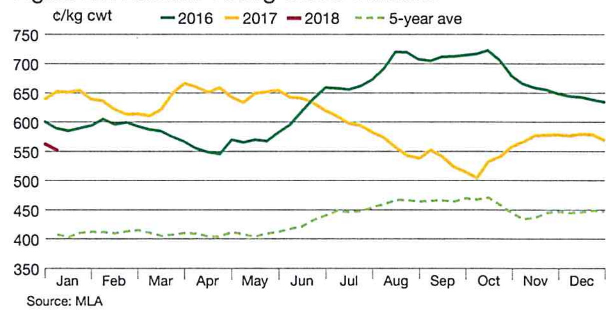
As always, prices will be impacted both positively and negatively by a number of variables such as seasonal conditions, trading environment, currency fluctuations and the pace of recovery in Australian beef production.

Figure 22: Global cattle price spread closes



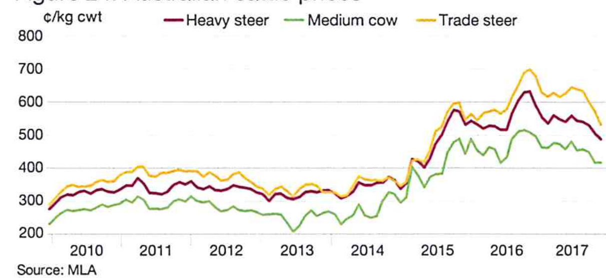

Source: MLA (Australia); Esalq/Cepea (Brazil); INAC (Uruguay); USDA (US); IPCVA (Argentina, Paraguay), Steiner, USDA, CME (22 Nov. 17). Cattle specifications vary between indicators.

Figure 23: Eastern Young Cattle Indicator




Source: MLA

Figure 24: Australian cattle prices




Source: MLA



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