

Equity Partnerships

The Peaks and the Pitfalls

Presented by:

Justin Geddes

(03) 477 5790

(021) 597 963

justin.geddes@crowehorwath.co.nz

Equity Partnerships are a great vehicle for progression to farm ownership for new dairy farmers, grow wealth for investors and transfer ownership as part of succession planning. There are many peaks and pitfalls to equity partnerships.

Peaks and Pitfalls in equity partnerships is just another way to look at “Risk & Return”

1. Peaks = increasing your return and lowering your risk
2. Pitfalls = being exposed to risk but not achieving any greater return

So what we need to focus on is **managing our risks** and **maximising our returns**.

To **manage our risks** and **maximise our returns**, we need to focus on three key areas:

- The Board
- Finance and Reporting
- The Quality of your Investments

The Board

Successful Equity Partnerships will have a Board of Directors. The main role of the board will be to govern. This means managing risks and directing activity to produce high, long term returns to all the stakeholders. These include shareholders, sharemilkers, farm workers, suppliers, Fonterra, Regional Councils, bankers, insurers & your community. The board will not be milking cows but balancing the demands of the farm. The role of the board is to ensure the business complies with all legal obligations including environmental, local body, tax and employment laws. It also ensures the business

balances the review of returns to investors, budgeting, capital investment, compliance matters, banking covenants and oversight into the efficient operation of the farm.

The Board will initially meet frequently and then quarterly after the new partnership is up and running. The Board will set an annual calendar to ensure key issues are not overlooked. This means setting the main agenda items ahead of time so that the board can consider critical decisions at each meeting during the year. Board members are expected to come to meeting having read the papers and prepared for decision making, not just have a general unguided discussion. During each meeting, the Board needs to know how the farm is performing, address key predetermined agenda items and any areas of concern. At the end of each meeting the Board will want to ensure issues are dealt with, opportunities taken and compliance met in all areas of operations. Good minutes and action plans are vital. It is important that regardless of the debate during a meeting, decisions made by the board are supported unanimously outside the meeting. Often this can be the cause of problems in the efficient running of the partnership if this is not adhered to.

Finance & Reporting

To properly carry out their duties, the Board must have access to good financial and non financial information. This information will also be required by:

- Bankers
- Investors
- IRD
- Insurance Broker
- ACC
- Regional Council
- Fonterra

The quality of your financial and management information is also critical (invaluable) when you come to sell or refinance. Each equity partnership will have a combination of systems to provide this information depending on the structure. The information will often include financial information (eg Banklink, Cashmanager or Figured), Fonterra reports, farm consultant reports, animal health plans, and livestock records. The Chairman of the Board,

the accountant and the farm manager combine to ensure this information is compiling in the board papers and circulated prior to each meeting.

We generally find there are four key areas for reporting.

1. Cows
2. People
3. Property
4. Financial

The reporting needs to be simple and effective. If we use reporting on cows as an example, the report might show key performance indicators which are colour coded to help all interested parties quickly determine the current position.

Cows		
Production	400kg/ms	<input checked="" type="checkbox"/>
Animal Health	SSC 500,000	<input type="checkbox"/>
Empty Rate	15%	<input type="checkbox"/>
Replacements	20%	<input checked="" type="checkbox"/>
Quality	PW 120	<input checked="" type="checkbox"/>
	BW 100	<input checked="" type="checkbox"/>

The same format would be used to quickly summaries the people, property and financial position for Board Members.

Quality of Investments (Getting it right)

There is no substitute for the careful selection and investment in critical assets

• The Farm

- The Stock
- The Investors

• The Farm Manager

• The Advisors you rely on

The Farm

Consider these factors when evaluating a farm

1. Potential for Growth (adjoining land / under performance)
2. Water (irrigation / availability)
3. Soil Type (free draining / nutrient loss)
4. Contour (rolling vs flat)
5. Location to town, staff, community and suppliers (ease of employment, schooling)

Watch for these

- Poor Soil types (drainage)
- Poor Fertility (growth rates)
- Local Council Rules (stocking rates limits / water use)

- Poor infrastructure (buildings & equipment)
- Paying too much (return on investment)
- High Debt (high exposure to interest when payout low)

Stock

Look for these

- Match stock to location (cows shifting islands can take time to settle in)
- Good Breeding / Records (saleability, production history)
- Bargains (profit on sale)

Watch for these

- Making sure you get what you paid for (swapping out)
- Calving dates (Long vs short)
- Historical Feeding System (grain vs grass only)
- Change of milking shed type (rotary vs herring bone)

People

The people that you are investing with should be people you respect. They will be willing to commit to a shareholders' agreement early on in the process. Consider people who have skills as well as money. If you can find someone with any health and safety skills they can add value to the group as this is becoming a large area of focus on dairy farms. Equity partnerships are often long term investments so investors who show commitment to the long term are preferable.

Investors who just have a lot of money but no practical application generally should be avoided. Often people heavily reliant on big dividends from year one can cause problems.

The farm manager is one of the key people in an equity partnership. Make sure they express the following qualities

- Someone you respect
- A proven record of performance
- A supportive family

- Commitment to the long term
- Seeking ownership in the partnership

Watch for these

- Regular changes of employment/ districts
- Focused purely on financial returns
- Lack of responsibility

The team of advisors who support the equity partnership should be **experts**.

- Specialists who know farming
- Grass management
- Crop / Wintering Systems
- Animal Health
- Business Management
- Tax
- Legal (Commercial / Employment & OSH)

They will be good at what they do and will be referred by several other industry experts. These advisors will give you the edge and are prepared to challenge what you are doing. Always be brave enough to say when you need help as this is how partnerships grow and succeed.

Summary

The peaks and pitfalls of equity partnerships are all about **Risk & Return**.

Manage your Risks to maximise your Returns. Work on the business not just in the day to day work.

Focus on the following

- Being Good at Governance
- Get the Best Management and Financial Information you can afford



- Invest in
 - ✓ Good Property
 - ✓ Good Stock
 - ✓ Good People
 - ✓ Good Advice