EQUITY PARTNERSHIPS - OUR JOURNEY

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Farmers

Introduction

Some cultures allude to the dream of a "white picket fence". The images that are bought into our head are around an ideal setting, a perfect house, kids running in the yard, a money tree yielding a fantastic regenerating crop, and Ma & Pa (us) chilaxing in a couple of hammocks, under a couple of mighty oak tree, with a cosmopolitan martini in one hand and a fundamentally relaxed and comfortable out look on life in the palm of the other.

Our "white picket fence" is outlined above; yours can be whatever you chose it to be. Our path to ours, will, along the way, still require some huge decisions, but to date we have made some telling ones. This paper is a story of where we have come from, the decisions we have made to date, and where we hope to head into the future to achieve our ultimate goal.

Disclaimer

What we offer in this paper is some insight of what has, and has not worked for us, and what we have learnt. We do not profess to be experts and therefore it is imperative you seek out your own advice.

Our background

Natalie and I were not really from farming backgrounds.

Natalie's family at writing have 3 acres in the Horowhenua with 3 killer cattle, a cat, and the associated problems of small blocks. But before that she hailed from Tawa, Wellington. The daughter of a Public Servant, Natalie's first interest in Agriculture was horses. So with a myriad of Pony Club ribbons and certificates, she ventured to Telford in the Deep South to study Equine. However, it was soon to be realised that she did not see much of a future in the Equine industry and her focus shifted to Agriculture. She collected her knowledge from the Ag students and on her release into the work force did a dairy season at Leeston, before an award winning cadetship and 10 years in total working for John & Ide McManaway in Marton.

Hamish was born in Ashburton, son of a grain rep who became an Agricultural Trainer at Flock House in the Rangitikei. With this exposure, at the end of secondary school, Hamish

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shunned the idea of becoming a "legal eagle" in Auckland and after a year of labouring earnt his first position on a dairy farm at Linton, out of Palmerston North. A couple of seasons into dairying, the grass looked greener and a career in the Stock and Station Industry beckoned for the next 6 years before a return to agriculture and specifically dairying with his new bride, Natalie Davidson.

We then embarked on the serious side of our working career, building our assets, firstly through home ownership, then farm managing, then sharemilking and currently as a managing equity partner on a 465 ha property in Canterbury, milking 1700 cows. Prior to this our sharemilking career is what got our "skin in the game" in the dairy industry. And after 3 years 50/50 sharemilking 240 cows, whilst managing a 440 cow farm and associated runoffs and dry stock trading, it was time to make the next step.

The next step

The year was 2005 and we wanted to keep progressing in the dairy industry. The next logical step for us was stick with what we knew. This was sharemilking, so we embarked on the task of finding a new job.

What were our criteria for a new position?

- We needed the right people, in the form of a progressive employer.
- We needed scale. So we felt for us with our skills that a position in excess of 750 cows was required.
- Whatever we did needed to be profitable, enjoyable and sustainable.
- And the job had to have high quality infrastructure. We did not want to milk 1000 cows through a 30 A/S herringbone, or have our staff living in squalor.

So "roll on" the perfect sharemilking job. In the market at the time we applied for plenty of jobs, and looked at plenty of opportunities, but unfortunately they all came up short. Surprisingly, on more than one of our criteria outlined above.

It was however whilst job hunting in Canterbury that we discovered a very different beast than what we were used to. There was irrigation, large herds, big teams of staff, highly motivated farm owners, high quality infrastructure, and the ability to feed cows all year. This is what attracted us to Canterbury in the first instance. We then threw a management job on a large scale property into the mix as an option. And the way it panned out for us meant the job we took had the opportunity to invest in the farm.

So we developed some new lingo in our vocabulary: Equity Partnerships (EP).

What is an Equity Partnership (EP)?

Our layman's description of an EP to those out side of farming is:

"An equity partnership is a group of like minded people that pool together capital, skills, and motivation to purchase a property. It is normal that one of the partners in the business is employed as a managing equity partner."

What did we require from an EP?

On selection of our next step, we had clear goals on what we wanted out of our EP. This was on top of what we already knew we wanted from a sharemilking position.

Business partners

We required business partners with the same investment objectives. They needed to require a cash return from the business, as well as a capital return. We required this because other than our salary we had no way of servicing extra debt or generating money for reinvestment. And as the cliché says, Cash is King; and Capital Gain doesn't pay the bills.

Our partners had to have the same farming philosophy. There was no point and having partners that wanted to run a farming system that as a manager we wouldn't be happy with. Even if the investors were non-farmers they needed to have "buy-in" to the system implemented on the farm.

Most importantly the business partners needed to have the same values as us. Honesty, Integrity, Peace, Love, Honour, Respect to others and God Fearing! These were not negotiable and these values had to relate not only to their businesses but also their personal lives.

Professional development

We required a job that allowed for us to develop our careers and ourselves as people.

Skills we learnt managing a large farm had to be transferable into other industries. From Human Resources, through to the Business Analysis and Planning, we had to think of the future and what life held for us after farming.

The job had to allow for us to expand our network and to build on our reputation we had spent years on already.

Lifestyle

Our absolute not negotiable was Lifestyle.

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We needed work life balance, especially if we wanted to start a family in the future. A lot of the comments we got at the time were along the lines of, “why would you want to milk 1000 plus cows, you won’t have time to think, let alone have a life.” Natalie & I always consider these opinions now. These people, our family and friends are correct, if you are not prepared to let go. There is always something to do on a farm. But the fundamental reason for us considering large herds was the staff factor. And what staff gave us, most people now will be nodding their heads thinking “problems”, but what staff gave us is flexibility not to have to be there all the time. Labour is our biggest asset! We are just as busy as we were sharemilking in the North Island, if not busier, but it’s different.

Location

The other thing we targeted with lifestyle was around location. We had to be close to schools, health services, recreational opportunities, a “good” rugby team (no disrespect intended for Manawatu), and handy to our families. We managed to tick all the boxes here, including handy to families. We can be in the Manawatu in 3.5 hours from Canterbury, at a little more expense.

Fair entry and exit

Finally, what we had to target was a way of achieving fairness around value on entry and exit. Some equity partnerships required a farm sale or a “fire sale valuation”. This was born of our biggest fear whilst sharemilking, that the year you were told you had no job for the coming season, quite often is the year there are no jobs and cow prices are low.

What we ended up with

So after turning every stone we ended up in Canterbury. Our first 3 years were a battle with a new conversion, teething issues, learning on the job and financial turmoil.

Farm Statistics

- 685 Hectare irrigated property in Ashburton.
- Split Site operation
- 80 bail farm dairy (completed at the end of October of our first season)
- 50 bail farm dairy with grain feeding
- Irrigation including 2 x Pivots, 7 x Rotorainers
- 14 Ag 100 Yamaha motorcycles
- 10 Houses
- 2500 Milking Cows
- Autumn & Spring Calving

- 14 Full time + 5 Part time at peak
- 95% ESL (English 2nd Language)
- 1,200,000 kg Milk solids
- 1750 kg MS / Ha, 440 kg MS / Cow
- 4 Cows / Ha, 1.6 t.DM of total Bought in Feed / Cow including grazing.

A successful equity partnership

A successful equity partnership has enough scale to generate sufficient income to give a worthwhile return to investors, plus a positive cash flow, with strong financial performance that will allow all shareholders to benefit from a reliable dividend stream.

A professional business approach from start to finish will ensure that the farming operation is run in a profitable, efficient and sustainable manner. Even if it is a "few mates" that want to buy a farm and have a few laughs, ensure there sound business practises that back up all decisions.

There needs to be a healthy friction amongst the partners to ensure that the business is driven hard enough to generate a return to shareholders. If everyone feels too comfortable around the board table then potentially the business is lazy, or being lead by one of the partners. It is particularly important when it comes to non farming investors, that the managing equity partner is made accountable for all decisions made operationally in achieving high levels of performance.

All partners need clear roles and responsibilities within the business. The managing partner's role is obviously clear, but should be backed with employment agreements and a market salary based on performance. A sharemilking contract would be our preference, between the managing partner and the farm business.

Everybody has different strengths and it is important that each partner's roles reflect their strengths. The board of directors, by law, need to be fully engaged and work at all time in the best interest of the business. This can get a bit vague when you get into multifaceted, multi-partner corporate arrangements.

A flexible CEO (Manager) is also important. Although it is their baby, they cannot expect to win 100% of the time.

Robust but simple systems, structures and processes around Reporting and Decision Making are imperative for protection of all the partners. As well as being able to identify an

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opportunity and move on it without letting bureaucracy take control. It is also vital the business is transparent for all partners from the financials through to all operational decisions made.

The most important thing a successful equity partnership should have however is a business plan. The plan should cover everything to do with the above: from financial planning to debt structuring, from environmental standards to staff training, from milk quality to production, from business start up to business wind up.

Documentation

Documentation is important. And all facets of the business (as highlighted above) need to be documented with policies and procedures. Some of the important documentation required for an equity partnership is listed, with a brief description below.

- Heads of agreement. This covers in the beginning a timeline of how everything fits together and what the expectations are from each party, who is responsible for what.
- Comprehensive Shareholders Agreement. This is the most important part of any equity partnership. Whether you are dealing with family or institutional investors this document outlines your “Rules of Engagement”. It forms the basis of you relationship (Prenuptual). The key things all agreements should have is an Entry and Exit Clause (Valuation Process) and a “Sunset” Clause (when the business is to be wound up).
- Company constitution. Covers what the company is and what it is going to do. And can be as simple as “Dairy Farming”. It should also outline the Appointment of Directors
- Business Plan. This should be split into 2 parts. An Operational Plan that covers the nuts & bolts. And a Strategic Plan that covers the “Big Picture”.
- Individual Employment Agreement. How the Manager Remuneration will be negotiated each year, Targets, Job Description, Tenancy Agreements etc.

These are the essentials.

Investment returns

As an equity partner you receive your returns from two avenues.

- Cash Return from the business
- Capital Gain

As a managing equity partner your salary should not be included in your total return you expect from the business. You do however receive a level of security from your salary that does allow for debt to be raised against the serviceability of your salary.

Your total return is calculated over all parts of the business, land, dairy company shares (if applicable), stock and net profit of the business.

Our personal equity growth

With a couple of years of exceptional capital appreciation in land and stock we have had exceptional growth in our personal equity.

The way forward for us is not a simple decision. We would like to continue to grow our personal business and eventually own our own farm, preferably the farm we are on at the moment. This is a vague area however, as it relies on a fair bit of sacrifice from our existing partners, and them selling down their share over time.

There are some key fundamentals we will continue to use, whatever our decision may be.

- Continue to use the bank funds and leverage to grow our own equity.
- A major focus on generating cash out of our business. The higher your EFS the more powerful position you are in, especially if you are able to replicate your system on any farming business. Cash is King!
- Debt Repayment? This depends on interest rates, but, high gearing can only work if capital gains are a constant. If land does not appreciate in value year on year, then at some point your only means of growth is via paying money bank to create equity for your next move.
- Live for the Moment, Still have a Life!

What we have learnt

Investing

When investing as a managing equity partner, remember the first day you buy in is normally the cheapest value. Your management will add value to the farm over time and you will have to pay for that value.

This comes with a caution however, when working out how much to invest, extend yourself, but, be realistic. Ensure you allow for above average living costs, interest rates at a high level, and ensure you always have a buffer.

Don't rely on dividends to service debt!

Business partners

Ensure your business partners are team players, honest, open, attitude, giving, competent, and have integrity. What other people think is important, but, listen to them and ensure you vet them as much as they vet you.

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Ensure work with the best interests of “your” business at heart and consider their other interests.

Equity

Ensure you have access to your share of the company equity. It can become vague as to whose equity it is. Make sure there is the ability for you to access your personal equity in the business.

Conclusion

What we feel we have achieved is a sense of farm ownership has been realised by us. Even if we don’t own the entire business, we own part of it. We have managed to learn the basics all over, including the fundamentals of cows and grass, irrigation, through to how to run a multi faceted business.

We have leant how to overcome (not totally) “large herditis”. All those things that happen perfectly on small farms can happen on big ones.

We have experienced and learnt a whole lot of new stuff, including people management, leadership skills, business skills, negotiating skills and most importantly how to give and take. We also have learnt that what people especially your mentors teach you is PRICELESS!