

Equity Partnerships



A Guide

Roger Landers

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Introduction

This paper will try to explore some of the reasons why Equity Partnerships are becoming more common, and look at some of the variables that should be investigated if wishing to enter an Equity Partnership.

I have tried to list some things to look out for, for those considering entering or setting up an Equity Partnership.

I have tried to look at different forms of Equity Partnership, and the Case studies show a range of different ways these are used.

Some of the points will cover elements common to all the investors, either passive or more involved, and the Equity Manager, who lives and breathes the operation on a daily basis.

Understanding the different roles partners play in Equity partnerships can be a major factor on whether or not the venture is successful. This can often be quite different to the business that the investors are currently in.

Key questions or objectives

1. What are some of the reasons that Equity Partnerships in the Dairy sector are gaining popularity?
2. What things do Equity partners/managers need to understand before entering an Equity partnership?
3. Show a diverse range of Equity Partnerships.

I have five case studies that illustrate the different types and circumstances that Equity Partnership can fill. These range from the stereo typical larger dairy farm with multiple shareholders down to the Equity Partnership between just two partners, and a family Equity Partnership.

The larger scale equity partnerships have been created all over New Zealand, but mainly done in recent times in the South Island in Canterbury, or Southland areas, and this is due mainly down to the opportunity of larger areas available, either as conversions, or plenty of dry land available next door to a working dairy farm.

The smaller Equity partnerships can be on any farm all over the country.

All types of people are looking at the dairy industry and wanting to become part of Dairying, and Rural NZ". Equity Partnerships have been the preferred vehicle amongst investors. Opportunities have arisen from Companies and individuals looking outside the square, and having the vision to see the finished product. This could be a fellow investor, or a company syndicating the property.

These Companies look for properties that have plenty of potential, or scope to increase production, and/or profitability. This along with a favourable “Buy price” adds up to an opportunity.

Julie and I along with our four children farm in the South Taranaki, approx 2 kms outside of the small town of Kaponga. We currently milk 250 cows on 73 ha, and have owned this property for approx 16 years.

We are also involved in an Equity partnership in South Waikato, which has been running for 4.5 years.

This farm milks 820 cows, and has Modern facilities with an 80 bale rotary, feed pad, and three modern houses. This is a conversion out of forestry, and started milking in July 08.



Purpose

This paper has been done as part of the 2012 Kellogg's Rural leadership programme, but also serves as a source of information for anyone considering a share in an Equity Partnership.

Any information may also be valuable for sharemilkers considering their future options, and/or investors looking at expanding their investment portfolio. These investors will come from all walks of life, and may include dairy farmers, sheep and beef farmers, rural professionals, and urban investors, and overseas investors, as well.

The words "Equity Partnership" are a very broad term, and can cover a lot of partnerships, leases, sharemilking joint ventures, or any venture that different people have put in capital into any project.

For the purpose of this paper, I have looked at Dairy farming only, but other sectors of farming or industries these principles may also apply.

Types of Investors.

Investors/ Shareholders come from all walks of life, and are generally looking for a safe longer term investment. They are ideally looking for both short and long term returns. Dividends and capital gain.

As with any investment, how successful it is depends mainly on how it is run.

This starts at the top with the board and Chairman, in a Governance role, setting the direction, then onto the management that will include the Equity Manager and his staff.

Investors usually fall into one of the following groups

1. Passive investors – This group want to invest in the dairy industry, but don't either have the time or skills to run a dairy farm. They may or may not have enough capital to buy their own farm on a smaller scale, and may not consider themselves experienced enough to oversee, or run a dairy farm. These investors can either be NZ urban, or rural based.
2. Active Investors- This group want to invest in the dairy industry, and may already have an investment in land, but due to other factors consider Equity partnerships as the way to go. They can come from both NZ urban or rural backgrounds, but consider themselves having something to offer the group.
3. Overseas investors- Overseas companies are buying into NZ Equity Partnerships, but usually have shareholding under 25% so not to trigger OIO approval process. Typically these investors have an appointed representative as a director, looking after their shareholding.
4. Equity Managers – This group typically have been sharemilking, and don't have enough capital yet to invest in their own right of suitable size. They wish to progress in the industry, but ownership of a farm in their own right, may or may not be the final goal.

Equity Partnerships give equity managers an opportunity to sell their asset (cows) and invest into land and buildings, machinery and shares as well as cows .This spreads the risks of land going up faster than their incomes or assets ability to keep up with capital gain especially in land.

They can secure a job and an investment at the same time.

Some Sharemilkers seek Equity Partnerships as the next step in their progression through the industry, to farm ownership. This may be because of the increased popularity of equity partnerships, and the reduction of the traditional 50/50 sharemilking jobs, especially ones that are larger scale.

Factors that bring Investors together.

Capital- by combining their joint capital they can invest in a dairy farm that is a more viable venture.

Scale- Equity Partnerships usually own farms that are of above average size.

The “economy of scale” provides greater returns on well run farms. They can achieve the benefits of scale without the high debt/risk to the individual.

Co-operative advantage- AS well as combining their capital, they also combine their life skills, and experiences. Shareholders can come from all walks of life, and investors that seek directorship can add different perspectives around the board table.

A diverse board is usually a more rounded board. A well rounded board will usually make better decisions.

Depending on the shareholding, directors that are willing and keen to further advance the direction, and profitability of the venture, should be sort.

All participants should be encouraged to seek directorship, regardless of their gender, or previous experience in a dairy farm, if they wish.

Depending on the involvement, directors will have some personal development along the way. They will encounter things that they may not normally see in their different outside enterprises.

Succession planning – Equity Partnerships can provide some form of succession planning for both family and non family. Allowing some release of equity from the farm property which can open up a less active role in the enterprise, and allow older members to investigate different lifestyles.

In family situations, when one child is farming the family farm, Equity Partnerships can provide a stable investment for the non farming family members, as well as the parents in their life time.

Agreements in all situations are very important, but in family situations, these can be sometimes over looked.

Growth-With increased profitability associated with larger well run farms, and improved Production techniques from quality Equity Managers that are keen to try new ideas and systems. Growth can be either as capital gain, debt reduction, and/or a dividend, as well as personal growth.

Diversification- By spreading your risk across a portfolio of investments or areas. Whether you are investing in a different area, either due to the price of land, or climate risk, or an investors coming from outside of the dairy industry investing in a part of a dairy unit, all these factors can spread your investment risk profile.

Investment- The prospect of good returns in farming can be very attractive to investors. Urban Investors may want to own a slice of rural New Zealand.

Motivated people- Young Farmers who wish to progress to their own farm usually are very motivated towards their goals. Shareholders that join with this group and have shared goals, benefit from this arrangement.

Security- In larger managed Equity Partnerships; Investors may feel very secure having a professional team running their Dairy Investment.

Retiring farmers wishing to either partly retire, or retire without selling their farm, traditionally have employed 50/50 sharemilkers. These usually move on after three years. Employing an Equity Partner gives security for both sides, without big changes in their enterprise every three years.

Sources of Information

Depending on your contacts and circle of friends/advisors, contact with opportunities may come from the following

1. Family and friends
2. Neighbours
3. Local district knowledge and contacts
4. Already part of your Team -Bankers and Accountants,' Advisors etc
5. Newspapers/media
6. Internet searches.
7. Syndicating Companies
8. Mail- flyers and leaflets

Equity Manager's Payment Methods

In order to incentivise the Equity Manager as a vital member of the Equity Partnership different methods of payments have been used.

Depending on the costs that the Equity Manager incurs, ie

1. How many staff they have to provide,
2. What equipment they have to provide, if any
3. Whether they pay for the electricity, water, and a percentage of feed/grazing cost.

All the above, along with their "Wages of management "will have an impact on the final level of payment. All the following methods of payment may all start in the same place in dollar terms, but all carry a different amount of income risk.

Lower order share milking – Under this method of payment, the Equity Manager receives an agreed percentage of the milk cheque directly from the Dairy Company.

Under this model, the Equity Manager's income going up when the milk price goes up ,and likewise goes down ,when it reduces.

They also bear the seasonality risk. If production is up, or down, due to the climate, their income changes according. They are considered self employed under the IRD guidelines

The lower order sharemilking system can be seen to over reward sharemilkers in the higher milk price seasons, and conversely they can be are poorly rewarded in lower milk price seasons , but in both cases the Company are in the similar position .

This method of employment carries the most income risk out of the three outlined

Contract milking – These are becoming more popular than lower order sharemilking. These pay an agreed amount per kg's of milksolids produced.

This system of payment has less risk for the Equity Manager, as they get paid the same amount in low or high payout seasons, but they don't benefit from the high milk price years, and don't suffer when milk prices are low.

Contract milkers only carry the seasonality risk. A bad drought versus strong growing season can make a big difference to the both the income and cash flow of the Equity Manager.



Due Diligence

The saying goes that “Equity partnerships are easy to get into, but hard to get out of”

While this can be correct, the work put before you sign up generally should pay off.

Some of the things to consider as follows

Physical farm

1. Is the farm in a proven dairying area?
2. If not, do the projections reflect this?
3. What is the main contour of the farm, rainfall amount and spread.(being Summer safe has a different expectation from seller to potential investor.)
4. Is the farm a conversion, It will have greater risk, if not budgeted correctly. Are there quotes or estimates for any planned work?
5. Does the farm have any future growth inside and outside the boundary?
6. Does the regional Council support the levels of production planned.
7. Does the farm meet current and future (as known) Regional Councils consents regarding water, and effluent and fertiliser use. Are the systems able to meet the requirements of the Job?
8. Seek the local knowledge of the property/area
9. Is there capital require to get the farm up to speed, and is it budgeted adequately.
10. Have the legal titles been checked. Does the effective area add up as a percentage of the total area? Has the farm been GPSed to show effective hectares.
11. Is the stocking rate and production in line with the stage of development and the local area?
12. Stock Quality, health, and Condition.
13. Young stock weights, Are they up to industry standards for breed.
14. Are the facilities suitable for the size of the farm?

Budgeting

1. Do the figures stack up?
2. Is the production budgeted for, in line with the district and the stage of development?
3. The main expensive items, feed, fert and grazing, and capital expenses. Do they sound correct?
4. How much capital gain have they factored in the returns?

5. What is the % return (dividend) indicated, remember the “greater the marketed return, normally greater the risk of receiving it.”
6. Is there a need to purchase more dairy Company shares?
7. What is the planned debt level?
8. What milk price level is break even after all costs and finance costs are met?
9. Will the system used be able to handle to steep changes in Milk price?

Governance

1. Do you understand the difference between Management and Governance? Do the other directors/shareholder’s understand this?

The above point can make or break any set up

2. Does the Equity and Board have any of the following?

A. Show a clear purpose, or strategy.

Do you agree with the strategy? Is this a low cost system, or one that needs brought in feed for a good part of the season?

B .An effective culture

C. Accountability

D. Effective Compliance

Reference- Best practice of Governance, the four pillars as set by the Institute of Directors NZ.

3. Does the chairman come up for re- election each AGM, and is there a clear democratic progress with decision making?

4. How many directors? Too many directors can lead to slower and poor decision making.

People

- Look in the Mirror. Are you Compatible with the other potential shareholders? Are you community minded and happy for someone else to make decisions, and are you happy to go along with the Board decisions, especially if they are not aligned with your views.
Past this test first, before doing anything. Be honest with yourself.
- Do you wish to meet new people, learn some new skills along with the way, and have an investment that will be a long term interest?
- Can you work well with other shareholders? Do you work well with people, does your past experience s reflect that. Do you have very strong views?
- Nothing wrong with having a strong view point, the problem can be when the democratic decision goes against your views, can you accept that.
- Do your due diligence with an open mind, trying to leave the emotive aspects of investment to the side. Easier said than done.
- Can you trust others to make key decisions, especially if you are looking to have a passive investment?
- If you have no dairy farming experience, this does not stop you from adding something to the greater good. Good Directors come from all walks of life, and being able to offer a non dairy prospective can be a great advantage from time to time.

Usually Constitution/shareholders/ partnership agreements, there should be some sort of checks and balances, so appointed leaders have some workable spending limits, before coming back to the shareholding.

Below is an example.

- | | | |
|---|---------|-------------------|
| 1. Equity manager | example | \$2000 unbudgeted |
| 2. Chairman | | \$10,000 "" |
| 3. Management or Governance Committee | | \$20,000 "" |
| 4. Full board. | | \$50,000 "" |
| 5. Then voted on by all shareholders by shareholding proportionally | | |

The above model relies on the Budget getting approval by Shareholders.

The major factors of risk to all dairy farmers are the weather, and the milk price they receive from the milk they supply to the dairy company.



Extra points for a potential Equity Manager to consider

1. Are you an open communicator?

Communication between EQ and Chairman will need to be very good. Both parties don't want any undue surprises. Do your due diligence on the key members of the equity partnership.

2. Are you able to follow an agreed budget, especially when it don't line up with your own expectations. What is good for the company may not be always good for the Equity Manager.

3. Do you have a "Can do "attitude?

Having a positive attitude can be the difference between something working well, and failing. Usually this is transferred onto staff, so work place efficiency reflects the direction/attitude set by the employer.

4. Are you a good employer? As herd sizes increase, your role will be less "hands on". Getting this balance wrong will affect both your staff and the relationship between you and the Chairman and shareholders.

5 Writing reports will become necessary in an Equity Partnership. Having better than average computer skills is a big asset. These take both time and energy.

6 .Understand if you are a director, that you wear two hats. Understand each role well. Both as a director, and Equity Manager.

7. Treat any planned dividend as a bonus. Plan to be able to finance your borrowings from your employment contract.

8. Do you need any extra security? Does the company provide for this?

9. Does the Company promote any incentive for meeting targets? Maybe being able to buy more shares at a set price, after three years.

10. Dont sell yourself short, during employment contractual negotiations. You will probably only get one shot at this. But be aware that you will need to walk the talk afterwards.

12. What are your long term goals? Do you need to own a farm outright? Be honest with yourselves, are they realistic, and have a plan.

13. What size farm do you wish to Farm? Do you current skills reflect thi

Major issues that may affect Equity Partnerships

Some of the major issues affecting Equity partnerships, assuming that the company has a Good Equity Manager, and the Governance is of a high level

1. Dividend or lack of one.

Budget on not receiving a dividend, and treating these as a bonus, when they do arrive. Debt levels need to be a lot lower than they would usually be in your own enterprise. You generally cannot borrow against the money invested against any capital gain.

Ask yourself what level of dividend do you expect, and then work out how much profit is needed after farm costs and bank charges are taken away.

(ie, if you want a 3% dividend in a company with \$10 million shareholder equity (original investment), \$300,000 dollars must be falling out of the company after all costs are paid. Do the budgets suggest this can happen?

Debt levels lower than 40% are more likely to produce a dividend.

Shareholders will put up with no dividend for a number of years, even when a dividend was sold to them up on entry.

Reasons for this will change from company to company, but the lack of dividend will have an impact at some stage.

Reasons could be debt higher than predicted, the Global recession and its impacts, being unable to take advantage of lower interest rates,(locked into high interest rates) ,severe weather events, environmental projects that may have to be done, which were could not be foreseen in a ever changing world.

2. Exiting an Equity Partnership.

Selling your shares may be harder if there is no Dividend, and/or the market generally is depressed.

Pre-emptive rights are a sound thing to have in either the company constitution, or the shareholders agreements. But if other shareholders don't wish to purchase your shares, at your stated price, you may have to go to the open market to try and sell the shares.

Having said all that, anything is possible, and depending on the market conditions and the price of the shares, (versus Valuation) shares do sell at unexpected times.

Remember everything is saleable depending on the price. You may have to discount the share price, if you want a quick sale.

The lack of liquidity can impact greatly on an exiting shareholder if they cannot sell their shares in a reasonable length of time.

Shareholders circumstance will change over time, and the money invested in any investment may need to be redeemed, sometimes in short notice.

Companies that sell shares has shown some interest in marketing Equity Partnership shares. As Equity Partnerships mature, more providers will appear to fill the need. Only time will tell if this helps with share sales.

These share portfolios may be marketed both in New Zealand and overseas. Costs charged normally paid by the seller are in the range of 4-8% of the value of the shares sold.

3. Inability to mortgage against any capital gain

The inability to mortgage off any capital gain can be a major drawback, especially if you have invested a large amount of money. While it is prudent not to have too much leverage against the money invested in the equity, this may have a major effect to what you be able to do in your own enterprise.

4. Equity Manager Progression

Inside an Equity Partnership, there should always be opportunities for the Equity Manager to increase their shareholding, if they wish .Always having light at the end of the tunnel is a key point that motivated young farmers seek.

They will have a plan of where they want to be in 5 -10 years, and future growth either in shares, or money invested can be part of that.

If they see the farm as part of their medium- long term future, they will be working towards that goal. Having driven people running the day to day operation of any farm, usually results in a better outcome, for all.

Currently there isn't the flexibility for Equity Managers to move onto another farm, as easily as a 50/50 sharemilker. Selling their shares in the Equity may be the issue that stops their growth, and enthusiasm.

The industry key players in this field need to adopt a set a minimum shareholding that Equity Managers could invest into a farm. Say \$500,000.

They could invest greater than this, but incoming Equity Managers would need to have the necessary \$500,000 to put into the equity to replace the money leaving.



Business Structures.

The type of business structure is an important decision that depending on the timing of your investment, you may, or may not have a lot of input into.

If you are part of forming an Equity Partnership, you may have some input into the various structures available.

There are pro's and con's of each structure, and a decision should be made in conjunction with your financial and legal advisors. The structure used will need to align with the goals of all the Owners.

Changing structures down the track will incur extra costs that could have been sorted at the start.

The types of structures looked at, are as follows;

Companies

Limited Liability partnerships

Partnerships

Sole traders

Trusts

Joint venture

Companies

Companies are the most common form of business structure, and this is reflected in Equity Partnerships as well.

A company is a separate legal entity from Shareholders (owners). Names can be reserved, and companies formed at the company office.

Companies are governed by the Companies act 2003, and then have a set of rules called the constitution. Constitutions control what can be done, and how, and unless stated in the shareholders agreement, exiting provisions are usually contained in one of these.

Shareholders agreements usually have power over a constitution. Shareholders agreements are usually used in smaller companies, which require unanimous written

consent to change any clauses. Companies are managed by directors, which elect a chairman from either within, or outside the shareholding.

Usually one vote per director.

The advantages of companies are as follows

- Limited liability of the shareholders
- A separate legal entity (from shareholders, or owners)
- Share transferability to existing or new shareholders
- Death of a shareholder doesn't necessarily impact the company.

Limited Liability Partnerships -LLP

These partnerships are relatively new, having only been around for 3-4 years.

They have the similar benefits as a company with Limited Liability (limited to the amount the partner has put in).LLP's were created to replace LAQC's structures that are not available now.

All partners are Limited partners, but these structures also need a General Partner, which typically are a company structure.

Partners/investors can be in both structures, but are firewalled between the two. The general partner does all the governance and/or management as the case may be.

Depending on your personal structure, any losses will be a distributed to all partners'. (In proportion to their shareholding.)

These can reduce your own taxable profit, and therefore their tax liability. On the other side of the coin, when profits are produced in the partnership, these will likewise flow through to partners personal structures, and increase their tax liability.

You will need a partnership agreement, as well as a shareholders' agreement (if applicable) under this structure. Shareholding/partnership percentages in both entities will need to be the same.

Operators of LLP's will need to understand the rules well, otherwise the IRD may rule these structures void.

Partnerships

These are very similar to sole traders, but have a number of partners. Partners can either be people, trusts etc, and is a combination of two or more entities.

These are not separate legal entities, partners and the partnership assets/liabilities are owned jointly, and can bind the other partners in obligations with third parties.

Each partner is responsible for the losses and shares the profits of the partnership. One or more of the partners could have to pay for the debts of the business, if the other partners are unable to.

It would be prudent to have a partnership agreement amongst partners, to cover the operating rules and terms of the partnership. Exiting details would need to be addressed in this agreement.

Trusts

While trusts provide valuable protection to assets, they are run by trustee's that have to follow the trust deed.

A settler creates the trust, and then no longer owns the assets in their own name. The terms of the trust deed may be changed by the settler once the trust is created depending on the trust.

Those entitled to benefit from trusts (the beneficiaries) can include the settler, any group, or person, but they have no control over the trust assets. Trustee's control the affairs of the trust, whether this is to invest, or disperse funds to beneficiaries. A trust cannot continue indefinitely like some other structures like companies, and by law must disburse the trust assets within 80 years of creation.

In my opinion, while trusts are valuable structures in family/individuals, these are not suitable for an Equity partnership structure.

Joint Ventures

These structures have no legal definition, and can be used loosely to describe an Equity partnership .Typically these are when two or more partners provide equal capital into a venture.

Sole Trader.

These are where the individual bears the risks and losses/profits of the enterprise. These are low cost structures, which can trade under any name, as long as it isn't currently used name. They must comply with all relevant tax and business legislation.

By nature they are not able to be used in an Equity partnership, but individual investors may trade under one, but would need to understand if there is any increased liability by doing so.

In my opinion, these are not an ideal structure to run an Equity partnership, and less than ideal when a partner or shareholder is in an Equity Partnership.

Agreements

Regardless of the structure, the agreements used between partners/shareholders probably make up one of the important items that need to be in place. Some or all of the following may be used.

Company Constitutions

Sale and purchase agreements

Shareholders agreements

Partnership agreements

Deed of adherence

Property management Agreements

Lease agreements

Employment Agreement. - Contract milker/sharemilker /other.

Sale and Purchase Agreements (may cover):

Purchase price

Legal description

Stock price (if included), description, vendor warranties, condition scores, disease status, incalf rates, calving spread.

Supplements to be available on takeover date and agreed shut up dates for pasture, or average farm cover

Agreed fertiliser use to be put on, before settlement. (Either by vendor, or purchaser)

All consents necessary (agreed by both parties) as required by Local, or Regional councils.

Resource Management Act Warranties and any development undertaken by the vendor, until settlement.

Constitution- If applicable.

If using a company structure, the constitution is an agreement of the rules of the company. The company also needs to comply with the Companies Act 2003.

The Constitution may cover

1. Introduction
2. Call on Shares
3. Lien and forfeiture of Shares
4. Transfer of Shares
5. Refusal to register transfer
6. New issue of shares
7. Acquisition of companies own shares.
8. Procedures for meetings of shareholders
9. Directors
10. Directors Indemnity
11. Dividends
12. Notices
13. Liquidation
14. Removal from the NZ Register
15. Disputes

All of these titles may have sub clauses, and may have further clauses added as the version may differ from different sources.

All of the above are important, as it sets the ground rules, and state what happens in certain events.

One of the clauses should cover the selling of shares.

While it doesn't help finding a buyer, it does spell out the process. Transfer of shares, probably causes the most issues with both potential investors, and Equity Managers alike.

Pre-emptive rights give non selling shareholders first rights to buy any shares on sale for a set period. Only after all pre-emptive rights are exhausted, can shares be offered to outside investors.

Shareholders Agreements

These typically define the other important issues to be covered. (Some items may be in either the constitution or the shareholders agreement, with the key difference that ;

1. The company constitution is viewable online by anyone with an internet connection and a computer.
2. Special resolutions in a constitution need 75% shareholders' approval .Normal resolutions only need 51% approval to pass.
3. Shareholders Agreement changes need 100% shareholders' approval, to change or amend any clause or amendment.

Typical items that may be included in a shareholders agreement.

1. Parties- list of all shareholders, who are the Directors, and who can be a Director.
2. Background
3. Operative provisions
4. Company Constitution- usually the Shareholders Agreement overrides the constitution of the company.
5. Business Objectives
6. Term
7. Capitalisation of the company.
8. Control, Management and reporting
9. Exit of a Party
10. Valuation of shares
11. General
12. Limitation of trustee's Liability
13. Force Majeure
14. Notices

As you can see the constitution and /or shareholders agreement can cover similar or the same things .The key point is that the item in question is in either one or the other, and that the shareholders agreement works well with the constitution.

Partnership Agreements

Partnership agreements are needed if using the Limited Liability Partnerships.

These agreements lay down the rules of using these Limited Liability Partnerships. It spells out what can be done and states the role of the limited partner, and the role of the General partner.

The rights and duties of partners, Allocations of liabilities, profits and losses, Distributions etc.

Any changes to the agreement, needs a variation of the LLP, which states the changes and updates.

If using a company and the Limited Liability Partnership, clause like the following will be present

“Each shareholder will be a partner in the LLP, and hold the same proportion of shares in the company, and the same proportion of committed capital in the limited partnership”.

Likewise if a shareholder sells their interest, (or portion of) they do sell the same portion in the company and limited partnership.

If not using a company structure, or any of the various structures, a partnership agreement will become a very important agreement, as it will need to cover most of the things covered in the Constitutional and shareholders agreements.

Deed of Adherence

Deeds of Adherence are an agreement between existing parties and the incoming party.”
The parties listed (incoming) is required to, and has agreed to be a party (shareholder/partner) to the shareholders agreement by virtue of the shareholders agreement”.

These deeds record the entry into the shareholders agreement by the incoming party

Property Management Agreements

These are only necessary when a third party oversees the property. This is typically when a Syndicated Equity is formed. The property management is a paid role which works between the Equity Manager and Company Chairman, and board.

Property Managers get their instructions/directions from the Board via the chairman. The Board do the Governance (set the direction), the management carry this out in conjunction with the Equity Manager.

The Equity Manager still has the day to day running of the farm, but the direction of the farm is set by the board.

The role of the property manager is to provide services and info to the other two parties. They would typically source any inputs, fertiliser, grazing and things like arranging service Bulls.

They could also provide for payment of accounts (subject to chairman/equity manager approval), and provide financial services, reports and meet with Bankers etc.

Their services may suit investors that want a passive investment, with little or no involvement.

Lease agreements

Lease agreements may be necessary if two or more structures are used, by leasing land and building between structures.

They may also be used to lease land other than that inside the equity, either in providing more grazing land for young stock, or winter grazing.

Depending on the location, leased land may increase the milking platform area, or help provide extra feed inputs, or winter grazing, which combined should increase the viability of the Equity.

Employment agreements

Whether the Equity manager is employed as a contract milker, lower order sharemilker, or on a salary, an Agreement is necessary. This is a legal requirement.

This agreement should state the requirements of each party, the role, and term. Remuneration, expenses, and staffing requirements'. Items like who pays for Milk quality issues should all be stated in these documents, as well as Health and Safety, and a disputes process.

Reporting is an important role of the Equity manager, more so than a usual sharemilking role, as these reports will be sent around to all shareholders/partners.

Typically the Equity Managers hire and fire their own staff, and it is their responsibility to have employment agreements with their staff.

Case Study One

Farmer David and Equity Partner Brent

Farming since 1979, David had worked their way through the sharemilking system before buying their first farm. Over the years they added to the original farm until it reached its current size of 180 ha.

In recent times, David had employed managers as David was wishing to reduce his level of day to day involvement in running the farm. After a series of what David calls "poor choices", they were looking for something else, considering all options.

Equity partner Brent approached farmer David, after learning of his frustrations. Both David and Equity Partner Brent farmed in the local area, and were aware of each other in the district, but were not close friends.

Equity partner Brent before this, owned his own farm, but this was a smaller farm (200 acres), but this wasn't providing any challenges to Brent.

After selling his smaller farm, they combined their assets together as 50 /50% owners of the new Equity partnership. EP Brent now has a lower order contract of 24% ,and hires all the farm staff.

Due Diligence was done by both parties before they entered into this agreement which has been running for 3 years.

Communication was identified as a key part of the EP, including monthly meeting with farm reports with minutes of meetings kept.

They run a company structure and have a shareholders' agreement also .All agreements are signed.

Key points identified

Having a "can do" attitude. Being realistic with budgets and reports. Having trust in your partner, and mutual respect. Being well suited, like minded with similar, or the same goals.

Case Study Two.

Equity partner Brent

Pre 2008, equity partner Brent, invested in a large Equity partnership in the South Island. There are 15 shareholders in this partnership which milks 1400 cows on 420 ha.

Out of the 15 shareholder's there wasn't a lot of dairy farming knowledge, so after a year or so, Equity Farmer Brent was elected Chairman.

Good land and facilities, but it didn't perform in the early years. Some hard decisions where needed, and one of these was the replacement of the Equity Manager.

Poor early cost controls, and decisions have impacted on this as well

No return on capital to date, but progress is being made, reducing debt.

Good equity manager employed on a 24 % sharemilking agreement, who employs all staff, and provides all machinery.

They are running a Company structure, having both shareholder capital and shareholders loans accounts. All agreements are signed.

Directors paid \$25,000 between the 5 directors, and they meet 5 times /year

Summary

Timing of buying just before the recession has impacted on the EP. The "buy cost" too high in the current environment.

Employing the wrong first Equity manager also had a major effect. New EP manager has turn things around, and has been able to improve production and reduce costs.

Dividend may be over three years away.

Key to have a united direction amongst shareholders

Case Study Three

Farmer Thomas

Milking 600 cows, on 200ha effective.

Equity partnership set up by the parent's in-law, with them having the majority interest, (but passive involvement) and siblings having the same amount of shares at the start.(13%)

Farmer Thomas is employed as a manager on \$80 k, plus production bonuses of up to \$10k. Operating for 3.5 years.

They are running a company structure, with shareholders agreements, but are not all signed off.

They have received a dividend in the last two seasons of about 5-6 %, but the company has increased debt. Is this sustainable?

All shareholders have different skill sets and are working well together.

This is a kind of succession /investment plan provided by the parent's in-law, with the offspring servicing their own debt themselves.

All parties had to stay in the equity partnership for four years.

Goal for farmer Thomas, increase his shareholding to greater than 51% shareholding.

Summary

Agreements need signing.

Being a family enterprise, I wonder on the need for an independent director, as the dividends paid, were paid some from debt.

Case Study Four.

Farmer Tony

They brought into an Equity Partnership early 2008, just before the recession.

Farmer Tony is the current chairman.

This property has excellent facilities, 80 bail rotary with all the bells and whistles. Feed pads, in shed feeder, protrack, feed pad etc.

A Conversion from forestry into a dairy farm. It still has a portion of trees in the poorer areas.

Area 411 ha, dairy effective 275 ha.

Milking 800-820 cows with over 25-30 % of feed brought in

23 shareholders.

After the recession effects, (early 2009) a capital raise was held. This money was used to break a "Swap", and reduce some debt. All shareholders loans converted into share capital at this time.

Shareholder capital was down at around 55 cents in a dollar compared to the original \$1 investment.

Regular share price valuation are currently put out and released at the Companies AGM each year.

Share price has recovered to 90 cents in a dollar in 2011, with the latest valuation coming in at 105 cents in a dollar (October 12)

The company structure changed in late 2009. Originally a straight company structure, this has changed to a company structure, and a limited partnership.

This has delivered a defacto dividend of approx \$20,000 for the last two seasons for the average shareholder. Losses from the Ltd partnership are used by the shareholder's in their own accounts to reduce their taxable income.

Currently employ a contract milker, who employs all staff.

The farm has 10 directors with 5 directors more actively involved in the running of the farm.

Budgets are updated as necessary, reviewed at least twice a year.

Shareholder Open day once a year, in February.

Currently reducing debt, which is around \$17/kilo /milksolids.

At present they are working on ideas to enable the company to pay some kind of dividend.

Shares sales are starting to happen, but not too many buyers of shares in the current environment.

Case Study Five

Farmer Bob and Equity Partner Harry

Harry was 50/50 sharemilking for 4 years on Bob's farm.

Harry had worked his way up the sharemilking ladder, manager, lower order sharemilking, and then 50/50 with 200 cows before getting the Job with Bob with the current 400 cows for another 4 years.

Harry was looking for a way to buy into a dairy farm, and looking at all opportunities as they arose. He did this keeping land owner Bob fully informed.

After a couple of months, Bob rang Harry and asked for a meeting. Harry thought the worst, thinking the farm was on the market, or something similar.

Bob offered to sell part of the farm to Harry, and asked Harry to come back with a proposal. Harry didn't want to own the cows again so some thinking outside the square was required.

In conjunction with Harry's accountant they come up with the following.

Harry to stay under the 50/50 sharemilking agreement, but moved the percentage to 70 % of the milk price. The other 30 % was split three ways equally. The Dividend is split 50/50 between parties.

One third paid to Bob, one third to a capital account, which pays for capital projects and tax, and the other third to Harry.

Harry is to pay all the costs of running the farm.

Bob has freed up half the capital of the farm, and still has capital gain/loss on the other half. He has a suitable income as well.

A company structure used for the 30% and it owns the land, building, shares etc. A 50/50 contract was used with the percentage changed to 70/30. All agreements are signed.

Harry has a family trust for the sharemilking part of the enterprise. Shareholder agreement to cover exiting and buying any further shares.

Monthly meetings with formal reporting.

Harry's ownership goals are to buy Bob out a little at a time when he can do so.

They are in their second season using this model.

Conclusions

Any investment has risks, and as such you can have to weigh up the proposal, and see if it is what you want. Use the Accountant, solicitor, and any trusted advisors especially in the investment, and dairy farming arena's.

If something doesn't add up correctly in your mind, seek experienced personal, (with no vested interest in the proposal) in that area, to help you decide if your concerns are correct, and is a big enough reason not to invest.

Have a good look over the agreements, performance to date, and budgets for the coming year or so.

Most things seem to be cyclical. What part of the cycle is the industry? Timing can have a major effect on the performance of any new or recently new enterprise.

Where are things globally? Has the market bottomed out a bit after the global recession?

The performance of the company may have been poor, due to factors outside of its control. The worst may be behind them, and growth may come and be on the way up. Sometimes the problems will be in the first couple of years, cost over runs, unforeseen costs all add up, especially in a conversion. Joining after the major issues have been sorted may be a good time to invest.

Structures

The structures normally used in an equity partnership are either a company structure, or a combination of a company structure, and another structure, like the relatively new Limited Liability partnership.

While structures play an important part of the whole picture, they are secondary to the strategy and agreements and therefore shouldn't be the reason not to proceed with the investment.

Agreements

As you can see, there may be a number of agreements that may need to be “signed “in an Equity Partnership

As with any legal document, Investors should take these documents to their own legal team, and be happy with their content before signing. Understand the issues that may impact on your shares.

People factor

The quality of the team running the venture, the equity manager, the Chairman, and the board. Do these people inspire confidence?

Whether or not this group are on the same wave length will have a big impact on the success of the Venture.

A “can do “attitude by the key members of the Equity will be of great value, as things don’t always go the way they are planned. How challenges are meet when they arise, can be the difference between a favourable outcome and not.

Communication between the key members in an ideal situation will need to be inclusive and, respectful.

Case studies

The case studies show the range of different styles of Equity partnership.

It also highlighted to me, that opportunities can be closer than you think.

For every keen motivated potential Equity Manager, there will be farmers that are looking to selling their farms, without really having secure options for the Money.

For some, having the option of selling part of the farm, still have an interest in the enterprise, may be very fulfilling. Being able to live in a rural setting and not having to move into a town /city may be very appealing. Presenting a proposal like may or may not work, but what is the worst that can happen?

Equity Partnerships are a longer term investment. Make sure that is what you want to get into.

Finally, after an extensive Due Diligence process, do you or any of your team have any concerns, if not wet your feet.

Acknowledgements

I would like to acknowledge all the farmers/investors that I have interviewed and used as case studies. This information shows the different types of Equity Partnerships that are around. This information shows the different types of Equity partnership that are around.

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Disclaimer

Any Ideas or material used in this paper is intended as a guide only. It is not meant to be a complete guide, as some items may have been overlooked or omitted.

It is up to the reader to do their own research, and to seek legal advice .Consult with your Solicitor and Accountant along with your Banker Manager, before making any investment decisions.

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