Nick Hoogeveen
& Associates
CHARTERED ACCOUNTANT

1 Princes St. Paeroa.
PO Box 150, Paeroa 3640
DX GA 25005
Ph: (07) 862 9090
Fax: (07) 862 9091
Email: office@hoogeveen.co.nz
Website: www.hoogeveen.co.nz

Equity Partnerships

The following report is intended to provide an overview of the issues associated with establishing and investing in an Equity Partnership. This information is general in nature and is not intended to be specific advice to the reader. Independent professional advice is necessary when considering investment in a specific Equity Partnership.

Every Equity Partnership will be unique due to the nature of the property, people and investment objectives. There is no template that can be applied to every situation, however there are a range of issues that are relevant and need to be considered in each case and applied to reflect the specific circumstances.

We trust that this guide will provide an overview and understanding of the requirements of an Equity Partnership.

What is an Equity Partnership (EP)?

Equity is the capital available by an investor for investment. This can be in the form of cash funds available for investment or borrowed funds leveraged on existing assets owned.

An Equity Partnership is the grouping or combining of two or more peoples equity for the common purpose of investment in a particular venture. The Equity Partnership can be in any area of business, and are common in the farming and commercial property sectors.

The equity partners share the profit and losses of the venture in proportion to their capital input. Everyone shares in the pain and the gain, whether it is capital growth, operating profits or losses.

Although referred to as Equity Partnerships the legal form of these ventures is typically structured as a company, with each partner being a shareholder of this company in proportion to the capital contributed.

Why Equity Partnerships?

1. **High capital investment requirements:**

   Farm ownership by traditional methods (50 / 50 sharemilking, leasing farms, and family assistance) has become more and more difficult due to the increase in value of farm assets over time.

2. **Economies of Scale:**

   Larger more efficient and sustainable properties can be purchased, than could have been purchased individually. The scale of the property will allow a more cost effective acquisition (i.e. lower $ / kg MS or $ / hectare).

3. **Leveraging a number of different skill sets:**

   The ability to benefit from grouping people together with different skills, attributes, strengths and experience to achieve successful business outcomes. In some cases it can bring youth, energy and new farming technologies and practices to the table.

4. **Risk:**

   Within an equity partnership you effectively spread risk between partners and investors. As an equity investor you can diversify your own business risk between different industries and climatic locations.

Where Can Equity Partnerships be used?

Objective	Opportunity / Issue	E P Solution
Farm Ownership	Farming has become particularly difficult for young people to get involved with, due to factors previously mentioned; ***"High capital investment requirements"***	Secure a stake in a property investment and become an equity manager. For 50 / 50 sharemilkers with current cow prices there is a real opportunity to diversify equity from cows to property, and achieve aspirations of farm ownership.
Growth	Farmers / Investors who are looking to grow their existing business, but are not in a position to purchase another viable farm property from their own resources.	Leverage off your existing asset base / financial position and take a share in another property via an equity share, while limiting your exposure and risk.
Succession	With farm assets being so valuable, creating an equitable distribution between family or retaining part ownership has become very difficult.	Allows you to realise some equity and consider retirement, while maintaining an invested interest. It could allow you divide the property between family members. Or relinquish day to day management by incorporating an equity manager.
Investment	Current strong dairy returns and positive historical capital growth mean that dairying is an attractive investment option.	Anyone has an opportunity to invest in a farm business, whether they are involved in the farming sector or not. Invest in another farm business without having to be hands on or involved with day to day farm management.

Equity Partnership Structure

Ownership:

The majority of equity partnerships are run as 'companies' for the following reasons;

- **Transferability**

  The ability to transfer ownership via selling or transferring shares, ensuring continuity of ownership (individual shareholders can choose any entity to own their shareholding).

- **Formalised**

  A company can also provide a regulated and transparent operating structure, which defines clear objectives and governance, through The Constitution and Shareholders Agreement.

- **Limited Liability**

  Shareholders liability is limited to the capital contributed.

- **Tax management.**

  More flexibility in allocation of profits and/or losses.

Capital Structure:

- Shares will be issued to each shareholder according to the amount of equity / capital invested.
- The 'company' will own the land and buildings, livestock and plant.

Legal Structures:

The options for ownership structure can include:

- Ordinary Partnership.
- Limited Liability Company.
- Limited Liability Partnership.

The following example shows how a large scale dairy farm can be funded;

- *60% from equity input by shareholders and 40% from term funding from a bank.*
- *Each shareholder owns a different percentage of equity in the company based on the amount of equity that they contributed.*

Summarised Statement of Financial Position			
Assets			
Land and Buildings - 200 ha	$ 7,900,000		
Dairy Co Shares - (200,000 @ $4.52 / kg)	$ 904,000		
Livestock - (570 MA Cows @ $1,800 / hd)	$ 1,026,000		
Plant & Machinery	$ 170,000		
Total Assets			**$ 10,000,000**
Less Liabilities:			
Term Debt (Bank)		40%	$ 4,000,000
Shareholder Equity		**60%**	**$ 6,000,000**
Shareholders Equity Represented by:			
Shareholder 1	$ 2,220,000	37%	
Shareholder 2	$ 1,800,000	30%	
Shareholder 3	$ 1,320,000	22%	
Shareholder 4	$ 660,000	11%	
Total Shareholder Equity	**$ 6,000,000**	**100%**	

Operating:

The following Annual Budget sets out the income and expenditure of the Company resulting in a surplus of $151,280.

This is available for the following:

- Capital expenditure
- Debt reduction
- Distribution to Shareholders

Summarised Annual Budget							
Kgs MS			**$ / Kg MS**			**%**	
	200000	$	5.80				$ 1,160,000
Stock Sales		$	0.25				$ 50,000
Dividend		$	0.30				$ 60,000
Gross Farm Income (GFI)							**$ 1,270,000**
Less Expenses:							
			$ / kg MS				
Farm Working		$	2.20	$	440,000	34%	
Wages / Management				$	200,000	16%	
Grazing				$	60,000	5%	
				$	700,000	55%	
			Rate %				
Debt-Servicing (I.O)			7%	$	280,000	22%	
Tax			28%	$	72,000	6%	
Plant Replacement			10%	$	17,000	1%	
Total Farm Costs							**$ 1,069,000**
CASH DEFICIT / SURPLUS						16%	**201,000**
Dividend Distribution by Percentage (%)							
Shareholder 1		$	74,370		37%		
Shareholder 2		$	60,300		30%		
Shareholder 3		$	44,220		22%		
Shareholder 4		$	22,110		11%		
		$	**201,000**		**100%**		

It will be necessary to prepare cashflow projections to determine timing of dividend distributions. It is not uncommon for no dividends to be paid until end of second season.

Investment Considerations

1. What are my investment needs?
    - What are the projected returns?
    - Does the investment need to be cashflow positive, do I need a regular dividend stream?
    - Will this investment deliver capital growth?
    - How long am I committed to investing?
    - How Liquid is the investment and what are the options for exit?
    - Are there other investment options / opportunities that will better meet my needs?

2. Who am I investing with?
    - Who are the other shareholders / investors / directors?
    - What is their track record?
    - What skills can they bring to the partnership?
    - Do all the investors have a common goal or vision for the investment / partnership?

3. What are the risks?
    - What type of industry does the investment involve and what are the risks associated with that particular industry?
    - Do the returns match the associated risk?
    - What is the appropriate level of risk for the equity partnership to assume?

Important Criteria For Establishing Successful Equity Partnerships

1. People
    - All investors need to have clear and common goals for the investment.
    - Open and honest communication. It is important to get the people chemistry right.
    - What do the investors want to achieve from the investment?
    - What time frame are investors committed to?

2. A robust and detailed Business Plan, as planning is the blueprint for success.
    - What are the production objectives and how will they be achieved?
    - What capital expenditure is required and how will it be funded? We believe that developing properties to a very high standard at the outset is essential. This is done by capitalising all the costs at the beginning to ensure target production is achieved, thus enhancing cashflows and dividends to shareholders, while also maximising capital growth.

- It should include detailed cashflows / forecasts, capital budgets and capital growth projections.

3. Shareholders Agreement – This is the key agreement for binding all the shareholders together and should include details on the following:

   - Shareholding – who are the shareholders and how many shares are held (numbers and classes of shares).
   - Governance - who are the directors and what is the voting procedure, how are decisions made with regard to running of the company?
   - Exit, entry and transfer procedures for shareholders.
   - Clear valuation procedures for shareholders wishing to complete any of the above.
   - Dividend distribution policy – there should be a clear policy around how any surpluses are paid out as dividends and the timing of such payments.
   - Banking arrangements – who are the financing arrangements with and what are the appropriate facilities?
   - Meeting and reporting standards – How often will the board and shareholders meet, what information will be provided to shareholders on a regular basis (i.e. farm reports, budget vs actual and annual accounts).

4. Positive cashflows and returns

   - Positive cashflows deliver reliable and regular dividends to shareholders, while keeping financiers supportive.
   - Positive cashflows also provide expansion and growth opportunities for the partnership.

5. Seek sound professional advice

   - Seek both sound legal and accountancy advice prior to entering into any contractual arrangements, to ensure any tax implications and structural issues are sorted at the outset.
   - The right advice at the beginning will save time, and produce a desired and successful outcome well into the future.

6. Communication

   - Clear concise reporting to all shareholders (monthly farm reports from the farm manager and financial updates)
   - Who will the farm manager report to, liaise with?
   - What are the appropriate timeframes / agenda for director meetings?

7. Governance

   - Clear description of roles through Shareholder Agreement and Employment Agreement.
   - Clear understanding of the respective roles of the parties involved (Shareholders, Directors and Equity Manager).
   - Sound leadership ensuring the effective management of the roles.

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Formation of an Equity Partnership, the Process

Investment Considerations
Investors need to have identified their own investment needs / criteria / expectations, from the outset.

Investment Capital
If an equity partnership investment meets your criteria, how much can I invest? What can I comfortably leverage against my existing business / assets?

You may wish to involve your accountant and banker for guidance.

Equity Partners
Find like minded equity partners / investors, with the same goals / expectations for investment.

Find an equity manger if required?

This could be facilitated with help of friends, your financier, your accountant, real estate agent and other trusted professionals.

Property
Start searching for a property that will meet the investors objectives / needs.

There may need to be some compromises between investors around size, locality and price.

Business Plan
Formulate a detailed Business Plan including;
Production objectives, capital requirements, budgets, and detailed cashflows / forecasts.

Sale & Purchase Agreement
Complete signing of the Sale & Purchase Agreement for the appropriate property.
Ensure appropriate legal and accounting advice is obtained.

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Due Diligence
Complete due diligence on any potential property;

What Consents are required for Water, Effluent disposal etc...
What Dairy Company can I supply?
Prepare an Environmental Management Plan.
Seek professional guidance.

Finance
Seek finance for the proposal based on the Business Plan.

Company Formation
Formation of Company - complete registration at the 'Companies Office' and confirm Directors and Shareholders.

Shareholders Agreement
Formulate a Shareholders Agreement covering all the issues relevant and specific to your Equity Partnership.

Seek professional guidance to complete.

Deposit
Agreement unconditional, pay deposit.

Confirm Finance Structure
Confirm Finance Structure / Interest rates / Risk Management tools / Mandates etc.

Settle
Settle on property purchased.

Limitations of Equity Partnerships

Issue	Direct Ownership	Equity Partnerships
Timeframes	Quick turn around and instantaneous decisions as required. Generally no need to involve other people / decision makers. However decisions can be less informed or bias, due to no one else being involved. Easier to purchase property at auction.	Equity Partnerships take more time for decisions to be made for the following reasons; 1. Generally more people are involved. 2. In addition there can be the formation of a new company / shareholders agreement and the election of directors. The time involved in forming an equity partnership in most cases will prevent the purchase of property at auction. However even though decisions can be slower the outcome can be better due to more heads sitting around the table
Compromise	No compromises when it comes to investment / farm purchase. For example, farm size, location, price, management, decision making.	May have to compromise with other investors regarding; farm size, location, price, management, decision making.
Control	100% control of all decisions, plans, goals and objectives. No need to rely on others.	No direct control over decisions, plans, goals and objectives, Rely on consensus of Directors.
Exit	Easy exit at any time, subject to market conditions.	Slower exit as it generally affects more people and the equity partnership may need to source more equity or another investor to replace the equity being removed. Exit process needs to be followed as per 'shareholders agreement'.
Leveraging	Leveraging opportunities available for surplus equity / capital.	No leveraging opportunities with shareholders capital, as the company has already done the leveraging.

Summary:

Equity Partnerships represent an innovative and popular means of combining investment capital to achieve a desired investment objective. While this report identifies a range of issues relevant to equity partnerships, it is not exhaustive.

Professional advice should be obtained to ensure the individual investors' needs are met with regard to investment requirements, legal obligations and taxation planning.

It is hoped that informed investment choices can be undertaken and clear understanding of the requirements and operation of an Equity Partnership will assist with the choice.

Should any more specific advice or detail be required we would be happy to assist.