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# Mergers and Acquisitions for Farmers

2019 Dairy Summit

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Lancaster Marriott

Lancaster Pennsylvania

# Presenters

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**Don’t Have To Tell You, These Are Challenging Times For Farming.**

- **Under pressure, Amish farmers begin to exit dairy business**

https://www.washingtontimes.com/news/2017/oct/7/under-pressure-amish-farmers-begin-to-exit-dairy-b/

**‘Tough discussions’ ahead for bankers, farmers**

https://www.grandforksherald.com/business/agriculture/4533880-tough-discussions-ahead-bankers-farmers

## Problems of Agriculture – Market Failure

https://www.economicshelp.org/blog/4977/economics/problems-of-agriculture-market-failure/

## U.S. Farm Income Seen Falling for Fourth Straight Year

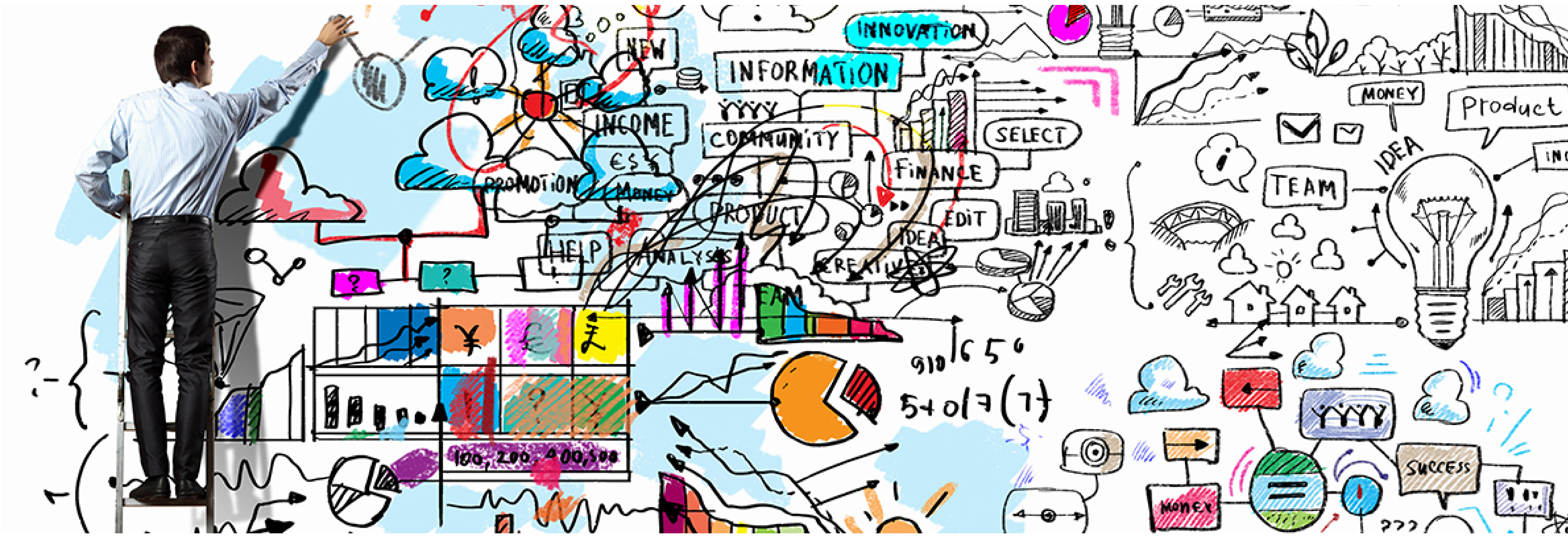
https://www.wsj.com/articles/u-s-farm-income-seen-falling-for-fourth-straight-year-1486486691

# But Maybe You're Thinking:

- Good Time to Acquire Assets, or a Business at a Low Price; or
- It is essential to combine for survival in rapidly consolidating industry. Possible reasons:
  - Synergy:  1 + 1 = 3 – necessary for maintaining competitiveness?
  - Pooling of financial capital to deal with price and industry volatility and compete with the big boys out west?
  - Combine operations to provide marketing leverage
  - Next generation family not interested?
  - Acquire milk base?
  - Acquire facility that is already permitted?  Intangible value?
  - Combine certain systems (e.g. heifer growing, labor recruiting?) with other like-minded producers to extract systems, labor, capital, and performance efficiencies
- How is it done?

# No Single Answer

- Can be complicated, like putting together a puzzle
- Involves the following "pieces", among other factors:
  - Legal
  - Business (for example, owners and employees)
  - Financing
  - Income Tax
  - Estate Tax
  - Personal, family goals
  - Process
  - "Knitting" together multiple objectives
- Legal discovery and due diligence
- Financial and cash flow discovery and due diligence
- Balance "doing the deal" vs "doing the due diligence"
  - Acceptable business risk vs Oh _____! moment!


INNOVATION
INFORMATION
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INCOME
COMMUNITY
SELECT
FINANCE
PROMOTION
MONEY
PRODUCT
EDIT
HELP
ANALYSIS
IDEA
MONEY
Product
TEAM
IDEA
SUCCESS
Money

# Legal

- What structure does this take on?
- Advantages / Disadvantages of each?

# Struggling Dairy Example

- Might be nearby/down street
- Might be farther
- Perhaps another state

# What does it have that we like?

- “Fit”
- Size
- Geography/location
- Philosophy

# Big initial decision: Asset acquisition or business purchase?

- Easier answer (for Buyer): Asset acquisition
- Buying assets unaccompanied by “baggage”

# Possible assets:

- Real estate
- Land
- Buildings
- Livestock
- Equipment
- Inventory
- All of above, “as a going concern.”

# Key point. You're not buying liabilities attached to these.

- Mortgage debt
- Other real estate liens
- As to livestock and equipment, UCC liens
- Seller contracts:
  - Employment contracts
  - Guaranteed payments
  - Feed supply
  - Milk sale

# All that “left” with the Seller

- You know, when you buy, these things are free and clear
- Perhaps eases integration into your operation (200 acres nearby)

# Not that easy:

- Seller must be able to sell (their own banker)
- Family vote?
- Transition issues
- You must be able to buy:
  - Your banker
  - Employees:  Leap of faith
  - Transition period – rumors.  Dealing with unknown

# Alternative:  True Merger

- Merger
- Stock purchase
- Purchase of LLC and LP Interests
- Point:  Two become one
- EIN number:  one survives (usually one with more assets / buyer)

# Why more challenging legally?

- Liabilities, known and unknown
- Rather than having certainty, you have uncertainty
- Hopefully reflected in price being paid (lower for purchaser)


Title
sale
real
estate
Association
Ownership
seller
Insurance
Attorney
buyer
Short
property
information
Time
Attorneys
transaction
legal
specific
Part
home
timely
selling
relocation
good
Ordinance
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agent
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companies
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buy

# What kinds of liabilities are we talking about?

- Known:
  - Things on books
  - Feed bills
  - Wages
  - Employment contracts
  - Guaranteed payments

# Other Liabilities

- Unknown
  - Unasserted third party claims
  - Bad milk
  - Overtime / wages
  - Worker’s Comp / Unemployment Comp
  - Inaccurate Books
  - Fraudulent Books

# Unknown Liabilities

- Unknown Creditors (machinery repair, veterinarian)
- Environmental

# Any other options?

- Joint Venture
- Two entities create a third entity to operate a business line or asset
- Blackacre for sale / 200 acres
  - Farm A:  Needs land to grow crops for feed
  - Farm B:  Needs land for manure management

- Both farms want to avoid integration with current books
- Separate EIN
- Not seen too often, because alternatives are usually “better”
- 50 /50 purchase, followed by a “management agreement.”
- Creation of another entity is avoided

But might do:

A. If family member wants that part of business for another family member.

B. If there is a new facet of farm business that one can't do alone, but can do together

- Farm A has land
- Farm B needs land

# A Simpler Way to Think About It (maybe)
# The EIN — Your "Federal" Identity.

Asset Acquisition:  You don't care about Seller EIN.

Entity Purchase:  You care a lot about Seller EIN.

Merger:  One EIN will survive.

Joint Venture:  Creating a new EIN

# Other Common Issues in Mergers and Acquisitions (Non Tax and Non Legal)

- Securing leases to secure an adequate land base
- Neighbor relationships – who can help with this?
  - Who do neighbors trust that can speak to your credibility with them?
  - Professionalism
  - Commitment and follow through
  - They are waiting and watching
- Secure raised feed and crop suppliers (relationships)
- Secure a market
- Deferred maintenance on facilities and equipment; buyer beware – it will always take more $$ than you think to get things up to your standards

# Tax Issues Common in Mergers and Acquisitions

- Asset Price Allocation – important to buyer and seller
  - Land
  - Buildings/Facilities
  - Equipment
  - Livestock
    - Mature cows
    - Replacements
- Asset deal or stock deal
  - Very different tax results for buyer and seller
- Know the tax cost/savings BEFORE finalizing deal price

# Hot Button Tax Traps for the Seller – Tread Carefully in the Minefield!

- Long-Term Capital gain rates are 0%, 15% or 20% (maximum)
- Maximum ordinary income rate is 37%
- Equipment gain = depreciation recapture
- Dairy facilities (free stall barn, milking parlor, etc.) gain = depreciation recapture
- Depreciation recapture = ordinary income = top federal rate of 37%
- Depreciation recapture is NOT capital gain income!
- Livestock
  - Raised mature (2 year old) dairy cows are capital gain assets
  - Replacements are ordinary income
- Land = capital gain
- Tax is paid on ordinary gain (equipment/facilities/replacements, etc.) in year of sale even if seller financing

# Hot Button Tax Traps for the Seller – Tread Carefully in the Minefield!

- Hot Assets (Partnerships and LLCs) – subject to ordinary income and self-employment tax
  - Accounts receivable
  - Prepaid expenses
  - Crop inventories
  - Supply inventories

- LLC's vs S Corporations
  - LLC's taxed as partnerships – tax law deems you are selling the underlying assets, not the LLC itself (bulk of assets are ordinary gain treatment)
  - S Corporations – tax law deems you are selling the stock (ie. capital gain treatment)

- Negative tax basis capital

# Tax Planning Opportunities

- In true merger – Section 368 Re-organization
  - Complicated and messy but planning opportunity exists
- Purchase price allocation
- If seller's personal residence situated on farm being sold, opportunity to create tax-exempt income
- Which entity purchases real estate vs equipment to optimize depreciation write-off options
- Stock vs asset deal
- Depending on deal timing, spread transaction components across 2 tax years
- Depending on deal, defer sale of replacements until they mature to shift income from ordinary gain to capital gain

# Questions ?????