Marketing

Create a buy-sell agreement to ease unexpected transition

Family Business
By LANCE WOODBURY

Key Points

- Planning can ease a partner's transition out of the business.
- A buy-sell agreement sets the parameters of an exit strategy.
- A buy-sell agreement forces all parties to be fair in a crisis.

IN a multigenerational or multiple-partner farm or ranch, it is important to consider the ramifications of a partner exiting the business. The death or disability of a partner, a family conflict severe enough to cause a partner to want out, or a retirement can mean significant change for a business. Having a process in place to help smooth the transition can be invaluable, and one of the tools to aid in this is a buy-sell agreement.

A buy-sell agreement is usually a legal document that explains the owners' financial relationship during an exit. For example, if a partner dies unexpectedly, will that partner's spouse or family remain owners in the business? If a partner chooses to leave, can he or she take all of their capital out of the business immediately, regardless of the financial strain it may put on the business? And, what is the value of the exiting partner's ownership stake in the business?

Four questions

Sorting through these questions in the middle of a crisis or at the time of exit puts significant strain on everyone involved. Use these four questions and your key professional advisers to develop a plan.

1. In case of death or disability of a partner, will the exiting partner's spouse or family stay involved in the ownership of the business? This gets particularly tricky in multigenerational businesses where sons or daughters may end up being partners with cousins, uncles, aunts or even grandparents. And asking questions that begin with "If Joe dies …" is also difficult. However, finding out who will be part of the ownership group in the future is critical to determining the rest of the process.

2. Who buys out the exiting partner — the company, other shareholders or a new partner? The answer depends on how ownership is currently structured, what types of entities (partnerships, corporations) are in place and what they own, and the possibility of returning family members or even key employees joining the ownership group.

3. What is the process to value the business? An annual discussion about the value of the business forces owners to go through a process of determining what it is worth. Then a discussion about the "discount factor" should occur. That is, if the buyout is of a minority (less than 50%) shareholder, how should you account for the fact that many people will not buy a minority share of a closely held business because they cannot control their investment?

4. How will the buyout be funded, and what are the terms if bought out over a period of time? Finally, it is important to discuss the sources of cash that allow for a buyout. Whether one uses bank financing, the earnings of the business or life insurance proceeds, it is important to understand the financing mechanism so proper planning and arrangements can be made prior to the exit. Determining the maximum length of the buyout and the interest rate paid also are key points to consider.

Planning is good strategy

Dealing with an unexpected death or disability is difficult enough without having to negotiate directly with those closest to you. Planning in advance of an exit forces everyone involved to be fair, as they might be on either the "buying" or the "selling" end.

In short, having a good buy-sell agreement in place before a crisis happens can help perpetuate the business and preserve relationships.

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Stocks remain tight until spring

Wheat Outlook
By ARLAN SUDERMAN

Key Points

- Old-crop stocks will be tightest just ahead of spring harvest.
- New-crop prices have little reason to rally.
- USDA releases its winter wheat acreage estimates Jan. 12.

WHEAT futures traded well over $7 per bushel in April 1996, and market analysts touted a new era. But the high prices rationed demand while also stimulating production beyond expectations, sending the market into a tailspin. In fact, prices fell roughly $5 off their highs by December 1999 as the market attempted to rebuild demand while discouraging production around the world.

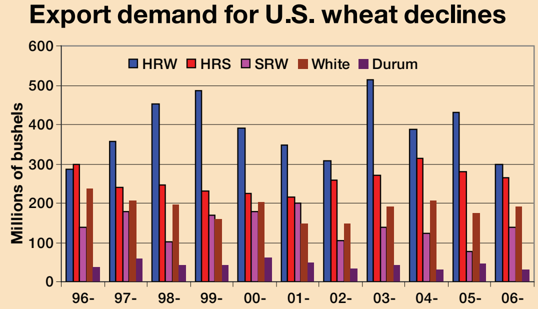
Wheat is a simple crop to grow, which is why farmers everywhere are quick to plant more whenever prices are profitable. As such, wheat bull markets seldom last long and are frequently matched by bearish fundamentals a year or two down the road.

But that doesn't mean this year's bull market is over. Australia's short crop is well documented by now, leaving world stocks of milling wheat squeaky tight.

But those tight stocks must translate into strong demand for U.S. wheat to push our prices higher. The peak export season for U.S. wheat stretches from July to mid-November. That period came and went with U.S. exports falling well below the pace needed to reach USDA's export target for the year. In fact, USDA's export target is the second lowest of the past two decades, and sales are still well off the pace needed to reach it.

Yet, world stocks will be tightest just ahead of the U.S. harvest next spring, as was the case in 1996. That doesn't mean that prices are going to $7, but it does mean we could see considerable volatility in the market as spring approaches and as the market rations remaining supplies of wheat.

Export demand for U.S. wheat declines



SOURCE: USDA & FARM PROGRESS

New-crop outlook

That spring, volatility may or may not provide a boost to prices for the 2007 crop. USDA will release its first estimate of winter wheat acreage Jan. 12, which will indicate the effectiveness of the market at stimulating increased production. Look for planted acreage to be up 7% to 8%, especially in the Plains' hard red winter wheat belt. Unfortunately, acreage is expected to be higher in other areas of the Northern Hemisphere, as well.

The focus will then shift to the condition of that crop, with dry areas raising concerns when the crop entered dormancy in spotty areas of the Plains, southwestern Midwest and Pacific Northwest, with additional concerns over half of China's wheat belt.

Weather concerns exist somewhere every year, but the tightness of world stocks leaves prices particularly sensitive to any threats to next year's production. A favorable spring would result in sinking new-crop prices while old-crop prices remain vulnerable to new highs. Yet, both prices could explode to test the 1996 highs if demand for U.S. wheat surges and adverse weather threatens the 2007 crop.

Don't get caught trying to outguess the volatility. Make incremental sales into rallies and maintain downside price protection on a portion of your 2007 crop with forward sales, put options or hedges, depending on your situation. Unfortunately, new-crop basis bids likely will remain weak until after harvest unless the 2007 crop is legitimately threatened, both here and in other major wheat-producing regions of the Northern Hemisphere.