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Planning Partner Exits and Buy/Sell Agreements

DTN Ag Summit
Chicago, IL
December 11, 2012



Kennedy and Coe, LLC

- Top 100 accounting and consulting firm
- Agriculture industry focus
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Outline

- Buy/Sell Agreement Overview
- Buy/Sell Agreements as Part of Comprehensive Planning
- Specific Provisions of a Buy/Sell
- Discussion and Questions



Why Have a Buy/Sell?

- Business Succession
- Protection of continuing operations
- Protection of remaining partners after a triggering event
- Agreed-upon terms for transfer of business or assets
- Maintain family harmony



A Buy/Sell is NOT

- Substitute for good, open communication
- End-all, be-all
 - Terms may be over-ridden
 - All parties must agree
- Again, the buy/sell serves as the mutually agreed-upon terms in the case of a triggering event



Comprehensive Planning

- Buy/Sells should be an element of good comprehensive planning
 - Business succession planning
 - Estate planning
- Most farming operations consist of two distinct types of businesses that should probably be handled differently
 - Farming operations
 - Real estate/Investment holdings



Farming Operation Business Types

- Investment or land-holding entity
 - Farm real estate
 - Ownership may not be impacted by determination of on-farm or off-farm
 - Birthright?



Farming Operation Business Types

- Operating entity
 - Many feel it is best to transfer operating assets to on-farm heirs
 - Skill-set, motivation, long-term vision play a role



Comprehensive Planning for Real Estate/Investments

- Commonly referred to as Estate Planning
- Components of good Estate Planning:
 1. Assets are transferred to heirs in the way and proportion the owner prefers
 2. Minimize the burden of estate taxes on next generation
- Many different options for asset transfer
 - Considerations:
 - Time frame
 - Appreciation of assets during transfer time period



Purpose of Buy/Sells in Real Estate/Investments

- Buy/sell used in the event an heir wants to liquidate
- Specifies triggering events that may force a liquidation
- Determines:
 - Who can purchase
 - Process for setting purchase price
 - Terms of purchase



Comprehensive Planning for Operations

- Commonly referred to as Succession Planning
- Elements of Succession Planning:
 - Identified management and ownership successors
 - Communicated vision and expectations
 - Clear (documented) management roles and responsibilities
 - Regular management meetings – more operationally focused
 - Consideration of business structure and tax implications of ownership transfer
 - Of course, well-specified and agreed-upon buy/sell agreement
 - Regular (at least annual) strategic planning meetings



Purpose of Buy/Sells in Operations

- Buy/Sell mainly used in the occurrence of a triggering event to compensate partners/spouses/heirs
- Qualifies new partners
- Sets process for business valuation
- Lays out terms for buyout
- Includes other more specific provisions



Specific Buy/Sell Provisions

- Specifying triggering events
- Rights of first refusal
- Qualifying partners
- Valuation procedure
- Buyout terms
- Push/pull provision



Triggering Events

- Basis for determining when the buy/sell is executed
- Standard triggering events
 - Death or incapacitation
 - Bankruptcy
 - Divorce
 - Partner withdrawal



Rights of First Refusal

- Spells out the order in which the entity, remaining partners, or immediate family, for example, have the option to purchase
- In a real estate entity, first right of refusal to operate may be incorporated
 - Provides protection for on-farm heirs



Partner Qualifications/Requirements

- Answers the question “Who can be a partner?”
- Used to admit a new partner
 - Buy-in
 - Inheritance
- Examples of qualifications
 - Education
 - Work experience – either in business or another business or industry
 - Subjective attributes – willingness, desire, work ethic
 - Approval of other partners – majority, unanimous



Business Valuation Options

1. Asset valuation upon occurrence of triggering event
 - Greater potential for conflict
 - Who will value?
 - How will values be determined for specific assets?
2. Agreed-upon annual valuation
 - Usually based on beginning-of-year balance sheet
 - All partners agree on a value and sign the balance sheet once a year
 - Upon occurrence of triggering event, the value is already set and agreed to



Buyout Terms

- Buyout option
 - Identify who has option to buy out interest
 - Common that remaining partners have option to purchase interest in proportion to their ownership share
- Structure of payments
 - Initial amount with remainder on installment note
 - All on installment
 - Secured vs. unsecured
- Note term
 - Most likely will differ depending on type of entity, i.e., real estate vs. operation
 - Operation term usually shorter – popular term is 7-10 years
 - Real estate often 15-20 years



Buyout Terms

- Interest Rate
 - Applicable Federal Rate (AFR)
 - Published each month by the IRS
 - Base interest rates used for various purposes such as imputed interest and original issue discount rules
 - Prime interest rate as published by the Wall Street Journal
 - Short-term variable
 - Long-term fixed
- Documentation
 - These buyouts should be documented with purchase agreements and promissory notes with set re-payment schedules



Push/Pull Provision

- Allows for a partner to trigger a buyout
- Partner makes an offer to other partner(s) to either purchase their interest, or have them purchase the offering partner's interest at the offer price
- Provision lays out time period for the offer to be accepted or rejected
- Not a required nor commonly used provision in buy/sells
- **One way or another, a buyout will occur**



Important Considerations and Reminders

- Buy/sell agreements are NOT a substitute for good, clear communication
- Strategic planning is the basis for communicating vision, expectations, wishes
- Buy/sell agreements are tools to be used in Comprehensive business planning



QUESTIONS AND DISCUSSION

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