Chapter 1:
Understanding the Road to Transition Planning Success

Welcome

Transition planning is the process of planning to transfer the ownership (capital), management, and operations (labour) of an agribusiness to a child(ren), relative or other successor. Transition planning is not a single event and cannot be completed in a handful of meetings with advisors. Rather, it is a process that should be thought of as business continuity planning. Expect to invest six months to a year or more in planning for transition.

Priority one: strategic direction

For transition to be successful, a business must be healthy heading into transition planning, remain healthy throughout the planning process, and emerge at the end of transition as strong as or stronger than when the process started. In order to achieve healthy and effective transition, a transition plan needs to complement the strategic direction of your business. Often, families working on their transition plans overlook this critical piece. Therefore, before you get started, all participants need to have a very clear understanding of:

- What are the agribusiness's goals, values and vision?
- What does each participant in the agribusiness want?
- Where might the agribusiness be in the future (strengths, challenges, opportunities, risks)?
- Where might the family be in the future (strengths, challenges, opportunities, risks, priorities)?

Setting and then frequently referring to a strategic direction will help keep ongoing farm management in sync with the transition, and increases the likelihood that the agribusiness will remain viable and profitable through the transition. Remember, if the planning process does not set the stage for business and family success, the transition plan will fail.

About this guide

If you are thinking about transition planning, this Guide is for you! Whether you are a farm family / agribusiness owner intending to work through transition independently, or a business advisor / consultant hired to assist in the development of a transition plan, this Guide will help you through the necessary steps to successful transition.

This Guide breaks transition planning into three phases: readiness assessment, plan development, and plan implementation.

In order to develop a plan, you will start with an initial planning meeting with family members and others involved in the transition planning process. Then, you will select from the five outlined in this Guide a planning approaches that best suits your business and the priorities and needs of everyone involved in the transition. Once you have identified an approach, you will work step-by-step through a series of topics to create a comprehensive transition plan.

As you work through these topics, your group will identify issues that require follow-up. Staying on top of these tasks and ensuring they get completed is key to a successful transition. When your group identifies issues that require follow-up, it is recommended that you add the task to a master list of follow-up items, and the write a specific action plan for the item. The action plan should:

- clearly identify who should follow-up on the issue and by when;
- list specific steps required to adequately tackle the challenge, including a time line to each of these steps;
- list any specific materials or resources that will be needed to complete the follow-up;
- list how often the action items should be monitored, and who will be responsible for monitoring;
- identify how your group will be able to assess whether progress is being made.

The appendix located at the end of this Guide contains removable forms and worksheets designed to help record information and guide you through each topic.

Icons used in this guide

This guide uses these icons to alert you to useful information.

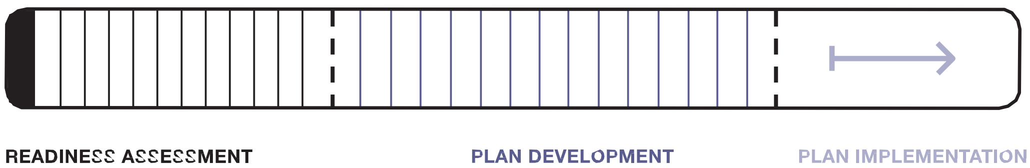
EXAMPLE

KEEP IN MIND

WHAT TO WATCH FOR

EXERCISE

This icon identifies planning progress for those following the *Comprehensive Approach* to transition planning.



Dealing with transition planning conflict and challenges effectively

Transition planning depends on participants working together to create a successful plan. Working towards agreement is not always easy. As you work through the transition planning process, keep in mind the following key considerations:

1. Transition planning often brings up challenging questions, especially when family members are involved. If you have concerns about any of the typical challenges associated with transition planning, such as dealing with entitlement, fairness and equality, compensation, and farming versus non-farming children, you are not alone! Virtually every family undergoing transition struggles with at least some of these concerns. Therefore, before beginning the transition planning process, consider reading Topic 14: ‘Challenges in Transition Planning’, which provides an overview of twenty of the most common challenges families encounter in transition planning.

2. You should expect to have differences of opinion from other people involved in your transition planning process. Differences of opinion are okay and **all families experience them.** To most fairly, calmly and effectively deal with differences of opinion:
    - give all participants the opportunity to voice their opinions;
    - make sure everyone has a good understanding of all of the different opinions;
    - fact-check to ensure opinions are based on valid information;
    - keep conversation focused on opinions and not individuals;
    - give people time to think about what they’ve heard;
    - try ‘parking’ a difference of opinion and agree to discuss it further later;
    - work towards consensus; and
    - if resolution seems challenging or you are worried about the potential for conflict, consider hiring an external facilitator.

Transition Planning Case Study

This case study is based on an actual farming operation in Alberta. To ensure the owners' privacy, this Guide renames them 'Rob and Faye Sample'.

This case study is included in this Guide to provide a real-world example of transition planning. Background information about the Samples' farming operation is provided below. Throughout the rest of this Guide, watch for the Samples Farm to be regularly referenced as an example of a farm tackling various parts of the transition planning process.

Background

Rob and Faye Sample have been farming for 33 years. Both are in their mid-50s. They have two children: an adult, married son and a daughter currently completing university.

The couple bought 800 acres of land for $200,000 from Rob's father in three decades ago, paying it off 15 year later. They also bought an adjoining half section for $128,000 a year after their first purchase, which they managed to pay off 12 years ago.

Five years ago, a neighbour offered to sell 1,440 acres and some outbuildings to the Samples for $1.4 million. The Samples knew the land as they had rented it for some years previous, and they felt they needed it for the success of their entire operation. Though the asking price seemed steep, they opted to make the purchase thinking that if they did not, someone else would.

Three years ago, they added a $350,000 grain handling system to replace/upgrade the older granaries bought from Rob's father. That loan is due two years from now.

Two years ago, they also borrowed $50,000 to renovate their home and buy a recreational vehicle. The loan is due three years from now.

Both Rob and Faye think the nearly 4,200 cultivated acres they are now farming is enough. "We have what we want," says Rob. "We work hard and don't seem to have a lot of time away from the business, even though we have had some excellent help."

The Samples typically employ one full-time employee and several seasonal workers during summer and fall. That staffing situation is not ideal but it is the best they've yet managed.

When they first began farming, Rob and Faye thought they only needed help during seeding and harvest. However, finding qualified, reliable, motivated people for short-term employment proved a constant challenge. Therefore, they decided to hire a full-time employee and bring in additional seasonal help at the busiest times. That said, keeping a full-time worker busy during the winter months proved an issue.

Unfortunately, the Samples' full-time employee decided to leave without much notice just before harvest last year. The Samples have not found someone to replace him. Fortunately, last year was an open fall and their son, John Sample, returned home to help his parents with harvest.

Business Structure

Rob and Faye farm together in a corporate business structure. They each own 50 per cent of the common shares. The first two pieces of land they bought are in both their names and are held personally, outside the family company. The Samples have not created a rental arrangement for the business to farm the personally-held land.

The Samples decided the best way to buy their most recent purchase of land (the previously rented land purchased for $1.4 million) was to buy it through their corporation rather than owning it personally.

Business Challenges

The Samples' farming operations were fairly smooth until two years ago when they faced challenges from wet weather. While markets remained strong that year and the one following, Rob and Faye now have some decisions to make. The loss of their full-time employee just before last fall's harvest meant that, even with their son's help, it was a challenge to get the crops harvested. The entire family faced added stress and longer hours throughout harvest, a burden Rob and Faye want to make sure they don't have to face again.

The Samples would like to consider options to reduce some of their business costs.

The Samples run one combine and one seeding unit, both of which operate at full capacity during the season. Because their equipment is older and slower, they need to hire custom workers to help finish the work on time. Unfortunately, the timing of getting the custom work done is becoming more and more of a problem. Being forced to wait for custom work can delay farming operations, which affects yield and quality. However, they believe it is more efficient to hire custom workers than to invest capital in new equipment because they don't want to take on more debt.

The Samples say their lenders do not appear to be overly concerned, especially because their financial situation has improved over where it was two years ago. That said, their lenders are still cautious about extending additional financing.

In spite of the challenges, the Samples say that farming has given them a good life. At this point, however, the couple want to enjoy more benefits of their hard work and persistence over 33 years. They believe the farm should now be comfortably paying its own way.

Current Financial Status

The Samples have accumulated just over $1.7 million in owner's equity (or about $3.6 million in equity – net worth), calculated using market value for assets and excluding outstanding shareholder loans. They have three term loans, an operating loan and some accounts payable. The operating loan has not revolved in the past two or three years. The following chart shows the Samples' existing term loans:

Original Date	Original Amount	Principal and Interest Annualized	Principal Outstanding as at December 31 last year	Principal Due this Year
Five years ago	*$1,400,000*	*$127,058*	*$1,244,561*	*$49,885*
Three years ago	*$ 350,000*	*$70,000 (equal principal)*	*$210,000*	*$70,000*
Two years ago	*$50,000*	*$11,548*	*$40,962*	*$9,495*

The large $1.4 million loan used to buy more land was a risk. It was financed over 20 years and matures 15 years from now. Because their other land was already paid off, they used it as security for the large loan and didn't need a down payment. However, the loan did equal about 60 per cent of the farm's total land value.

Due to the wet weather four years ago, the Samples needed to take out a $350,000 loan to access more operating capital. When things started to turn around two years ago, the couple took out a $50,000 loan to pay for much-needed home renovations and to buy a recreational trailer (fifth wheel) so they could enjoy breaks from the farm. They financed both loans over five years.

In the past, Rob bought smaller capital items using operating cash rather than taking out a loan and setting a repayment schedule. However, he feels cash flow can be tight at times.

Business Management

The management structure of Sample Farms is similar to the vast majority of mid-sized farms in Alberta. Faye does the bookkeeping and manages the office functions such as payroll and GST reporting. Rob's passion is farming. While he assumes responsibility for all other management functions, he'd rather be outside working. Though he knows some changes are needed, he thought things were working fine until their hired man left. Now, big questions about how the work is going to get done are setting in.

The Family Options

Rob and Faye are in their mid-50s. Their son John is 29 and married to Rebecca. Their daughter Carol is 27 and is currently finishing a degree at university.

John has an agricultural business degree and works for the provincial government, making about $55,000 annually. John likes his job but is interested in other options. He has always enjoyed helping his family with harvest in the fall. Last year was the first year that his help was critical, due to the hired man's unexpected departure.

Rebecca is a trained health professional who enjoys many job options in any urban centre. However, she would have few job opportunities if they opt to move to the Sample farm. That said, John and Rebecca have discussed moving to the farm and having John work with his father or take the farm over completely from his parents. Rebecca and John currently have no children. If they opt to move to the farm, Rebecca thinks the timing would be good to start a family since her career options would be limited.

Carol is in a long term relationship with an apprentice carpenter and lives in another province. Their future plans hinge on where Carol can find work after she finishes her degree. Carol did help on the farm when she was younger but has not talked about any interest in farming as a career.

Rob and Faye take a fixed management salary of $60,000 per year plus an allowance for their daughter's university costs. Every month, Rob takes money from the farm account and transfers it to a separate account for family living expenses. Faye thinks they should be focusing on savings and security right now in order to be prepared for retirement. Both Rob and Faye think the equity they have built in the farm will ensure protection for their family and provide for their own retirement.

Faye's parents ran a successful business. She and Rob may inherit from them in the distant future. Rob's parents have both passed away. Rob and Faye's term loans are life insured. Rob has no disability insurance. There are no other life insurance policies.

Faye's biggest concern is the fact that Rob is under constant stress. She has a hard time getting him to talk about their financial situation. Compounding the situation is the possibility that John and Rebecca may want to move to the farm but there has not yet been any real discussion about it.

The Future

The loss of the hired man significantly influenced the couple's future plans. They are certain that they do not want to do another harvest without a full-time person to help. They are currently asking themselves a lot of important questions:

- How can they avoid hiring someone who may leave at any time?
- Should they talk to John and Rebecca about taking over the farm? Will that put too much pressure on the young couple?
- What would happen if John and Rebecca move home to farm? How would the business be set up?
- If John and Rebecca take over the farm, what does that mean for Carol and her partner?
- Can Rob and Faye continue to manage with just seasonal help?

All these questions and more are integral to transition planning for this family.

Sample Farms Ltd. Financial Performance

Ratio Analysis

		2008	2009	2010	2011	2012
Liquidity						
Current ratio	current assets / current liabilities	**2.3**	**1.4**	**1.4**	**2.1**	**2.7**
		$1,743,077	$1,346,246	$902,137	$2,106,650	$2,591,404
		$ 756,705	$980,005	$631,263	$1,004,929	$965,588
Working capital percentage of total operating expenses	current assets - current liabilities / cash operating expenses	**74.1%**	**29.9%**	**23.0%**	**78.5%**	**120.1%**
		$ 986,372	$ 366,121	$ 270,874	$1,101,721	$1,625,816
		$1,330,637	$1,226,399	$1,176,975	$1,403,805	$1,353,326
Debt structure ratio	current liabilities / total liabilities	**35.68%**	**42.51%**	**28.75%**	**40.25%**	**41.41%**
		$ 756,705	$ 980,005	$ 631,263	$1,004,929	$ 965,588
		$2,120,646	$2,305,543	$2,195,902	$2,496,962	$2,331,731
Solvency						
Equity ratio	total equity / total assets	**54.8%**	**48.3%**	**47.4%**	**54.0%**	**60.8%**
		$2,574,515	$2,155,864	$1,982,625	$2,926,306	$3,609,359
		$4,695,161	$4,461,407	$4,178,527	$5,423,268	$5,941,090
Debt to equity ratio	total liabilities / total equity	**0.82**	**1.07**	**1.11**	**0.46**	**0.65**
		$2,120,646	$2,305,543	$2,195,902	$2,496,306	$2,331,731
		$2,574,515	$2,155,864	$1,982,625	$5,423,268	$3,609,359
Debt servicing ratio	debt servicing capacity / principal and interest	**2.06**	**-1.92**	**-0.44**	**4.55**	**3.27**
Debt servicing capacity	net income (before tax) *plus* interest on term	$ 365,683	$ (372,111)	$ (96,660)	$1,020,651	$ 756,689
Net income	debt *plus* amortization *minus* owner	$ 175,340	$ (546,751)	$ (301,339)	$ 815,581	$ 554,953
Amortization	withdrawals *minus* income tax paid	$ 99,037	$ 91,976	$ 107,625	$ 106,816	$ 99,652
Interest		$ 91,216	$ 82,664	$ 97,054	$ 98,254	$ 102,084
Principal		$ 86,059	$ 110,899	$ 122,606	$ 125,890	$ 129,380
Interest		$ 91,216	$ 82,664	$ 97,054	$ 98,254	$ 102,084
Payments		$ 177,275	$ 193,563	$ 219,660	$ 224,144	$ 231,464

Financial Efficiency

		2008	2009	2010	2011	2012
Gross margin ratio	gross margin / gross revenue	**48.3%**	**22.6%**	**4.7%**	**62.7%**	**63.0%**
		$ 639,963	$ 171,527	$ 31,319	$1,256,449	$1,166,975
		$1,324,340	$ 759,509	$ 670,053	$2,004,093	$1,851,116
Contribution margin ratio	contrribution margin / gross revenue	**28.4%**	**-13.8%**	**-18.8%**	**48.9%**	**45.9%**
		$ 375,813	$ (105,164)	$ (125,862)	$ 979,471	$ 849,964
		$1,324,340	$ 759,509	$ 670,053	$2,004,093	$1,851,116
Net operating profit margin ratio	net operating profit margin / gross revenue	**-8.0%**	**-73.6%**	**-91.7%**	**24.6%**	**21.5%**
		$ (105,334)	$ (558,866)	$ (614,547)	$ 493,472	$ 398,138
		$1,324,340	$ 759,509	$ 670,053	$2,004,093	$1,851,116
Interest expense ratio	total interest / gross revenue	**8.1%**	**13.5%**	**18.8%**	**6.0%**	**6.3%**
		$ 107,893	$ 102,551	$ 125,986	$ 120,808	$ 116,722
		$1,324,340	$ 759,509	$ 670,053	$2,004,093	$1,851,116
Amortization expense ratio	amortization / gross revenue	**7.5%**	**12.1%**	**16.1%**	**5.3%**	**5.4%**
		$ 99,037	$ 91,976	$ 107,625	$ 106,816	$ 99,652
Profitability		$1,324,340	$ 759,509	$ 670,053	$2,004,093	$1,851,116
Return on equity ratio	net income / total equity	**6.8%**	**-25.4%**	**-15.2%**	**27.9%**	**15.4%**
		$ 175,340	$ (546,751)	$ (301,339)	$ 815,581	$ 554,953
		$2,574,515	$2,155,864	$1,982,625	$2,926,306	$3,609,359
Return on assets ratio	net income + long term debt interest / total assets	**5.7%**	**-10.4%**	**-4.9%**	**16.9%**	**11.1%**
		$ 266,646	$ (464,087)	$ (204,285)	$ 913,835	$ 657,037
		$4,695,161	$4,461,407	$4,178,527	$5,423,268	$5,941,090
Asset turnover ratio	gross revenue / total assets	**28.2%**	**17.0%**	**16.0%**	**37.0%**	**31.2%**
		$1,324,340	$ 759,509	$ 670,053	$2,004,093	$1,851,116
		$4,695,161	$4,461,407	$4,178,527	$5,423,268	$5,941,090

Sample Farms Ltd. Balance Sheet

	2008	2009	2010	2011	2012
Assets					
Current					
Accounts Receivable	$ 55,885	$ 207,624	$ 170,384	$ 169,881	$ 274,665
Inventory	$1,591,159	$1,043,327	$ 656,833	$1,800,868	$2,195,199
Prepaid Expenses	$ 96,033	$ 95,175	$ 74,920	$ 135,901	$ 121,540
Total	$1,743,077	$1,346,126	$ 902,137	$2,106,650	$2,591,404
Long Term					
Patronage Dividends	$ 17,667	$ 18,931	$ 21,551	$ 23,101	$ 26,983
Land	$1,728,000	$1,728,000	$1,728,000	$1,728,000	$1,728,000
Property and Equipment	$ 630,417	$ 664,350	$ 694,839	$ 605,517	$ 506,703
Total	$2,376,084	$2,411,281	$2,444,390	$2,356,618	$2,261,686
Total Assets	$4,119,161	$3,757,407	$3,346,527	$4,463,268	$4,853,090
Liabilities					
Current					
Bank Indebtedness	$ 429,577	$ 507,092	$ 491,199	$ 631,620	$ 611,606
Accounts Payable	$ 241,069	$ 361,134	$ 17,458	$ 247,419	$ 224,602
Current Portion Term Debt	$ 86,059	$ 110,899	$ 122,606	$ 125,890	$ 129,380
Total	$ 756,705	$ 979,125	$ 631,263	$1,004,929	$ 965,588
Long Term Debt	$1,363,941	$1,325,538	$1,564,639	$1,492,033	$1,366,143
Shareholder Loan	$ 805,190	$ 805,190	$ 805,190	$ 805,190	$ 805,190
Total Liabilities	$2,925,836	$3,109,853	$3,001,092	$3,302,152	$3,136,921
Retained Earnings					
Share Capital	$ 100	$ 100	$ 100	$ 100	$ 100
Net Earnings (Loss) Current Year	$ 175,430	$ (546,751)	$ (301,339)	$ 815,581	$ 554,953
Retained Earnings Prior Year	$1,017,795	$1,193,325	$ 646,674	$ 345,435	$1,161,116
Retained Earnings	$1,193,325	$ 646,674	$ 345,435	$1,161,116	$1,716,169
Liabilities and Retained Earnings	$4,119,161	$3,756,527	$3,346,527	$4,463,268	$4,853,090
Normalizing Adjustments					
Balance Sheet					
Market Value Adjustment to Land					
Acres	2560	2560	2560	2560	2560
Market value	$ 900	$ 950	$ 1,000	$ 1,050	$ 1,100
	$2,304,000	$2,432,000	$2,560,000	$2,688,000	$2,816,000
Original cost	$1,728,000	$1,728,000	$1,728,000	$1,728,000	$1,728,000
Net worth adjustment	$ 576,000	$ 704,000	$ 832,000	$ 960,000	$1,088,000
(note: no adjustment to market value for equipment)					
Shareholder Loan Adjustment	$ 805,190	$ 805,190	$ 805,190	$ 805,190	$ 805,190
Total Adjusted Assets	$4,695,161	$4,461,407	$4,178,527	$5,423,268	$5,941,090
Total Adjusted Net Worth	$2,574,515	$2,156,744	$1,982,625	$2,926,306	$3,609,359

Sample Farms Ltd. Income Statement

	2008	2009	2010	2011	2012
INCOME					
Crop Sales	$1,265,882	$1,307,341	$1,056,547	$ 860,058	$1,456,785
Inventory Change	$ 58,458	$ (547,832)	$ (386,494)	$1,144,035	$ 394,331
GROSS REVENUE	$1,324,340	$ 759,509	$ 670,053	$2,004,093	$1,851,116
DIRECT EXPENSES					
Fertilizer	$ 291,717	$ 241,624	$ 279,728	$ 381,991	$ 240,996
Chemical	$ 147,110	$ 150,966	$ 154,134	$ 223,288	$ 240,577
Seed/grain purchases	$ 226,939	$ 179,022	$ 204,872	$ 114,958	$ 164,351
Crop Insurance	$ 18,611	$ 16,370	$ -	$ 27,407	$ 38,217
Total	$ 684,377	$ 587,982	$ 638,734	$ 747,644	$ 684,141
GROSS MARGIN	$ 639,963	$ 171,527	$ 31,319	$1,256,449	$1,166,975
VARIABLE EXPENSES					
Custom Work	$ 67,355	$ 76,637	$ 17,990	$ 82,229	$ 84,101
Fuel and oil	$ 42,186	$ 54,447	$ 44,441	$ 72,140	$ 65,821
Wages (direct)	$ 63,106	$ 59,670	$ 61,212	$ 73,374	$ 97,864
Repairs & Maintenance - Machinery	$ 91,503	$ 85,937	$ 33,538	$ 49,235	$ 69,225
Total Operating Expenses	$ 264,150	$ 276,691	$ 157,181	$ 276,978	$ 317,011
CONTRIBUTION MARGIN	$ 375,813	$ (105,164)	$ (125,862)	$ 979,471	$ 849,964
FIXED EXPENSES					
Utilities	$ 13,273	$ 11,431	$ 14,953	$ 12,143	$ 14,898
Rent	$ 64,659	$ 56,969	$ 61,201	$ 60,304	$ 66,652
Repairs & Maintenance - Building	$ 26,333	$ 20,286	$ 11,473	$ 28,179	$ 8,230
Insurance	$ 34,731	$ 39,195	$ 39,532	$ 30,876	$ 30,646
Interest & Bank charges	$ 16,677	$ 19,887	$ 28,932	$ 22,554	$ 14,638
Interest on Long Term Debt	$ 91,216	$ 82,664	$ 97,054	$ 98,254	$ 102,084
Office	$ 34,020	$ 24,577	$ 25,530	$ 31,860	$ 20,529
Professional Fees	$ 10,468	$ 7,134	$ 7,475	$ 9,050	$ 8,240
Property Taxes	$ 23,521	$ 26,284	$ 22,743	$ 11,687	$ 12,998
Salaries & Benefits	$ 67,212	$ 73,299	$ 72,167	$ 74,276	$ 73,259
Amortization	$ 99,037	$ 91,976	$ 107,625	$ 106,816	$ 99,652
Total Overhead & Administration Expenses	$ 481,147	$ 453,702	$ 488,685	$ 485,999	$ 451,826
NET OPERATING PROFIT	$ (105,334)	$ (558,866)	$ (614,547)	$ 493,472	$ 398,138
OTHER REVENUE (EXPENSE)					
Programs (Government)	$ 231,382	$ 18,988	$ 290,477	$ 291,058	$ 117,295
Rebates	$ 17,667	$ 16,384	$ 25,226	$ 17,194	$ 22,437
Custom work	$ 18,326	$ 3,255	$ 11,903	$ 13,857	$ 17,083
Gain / (Loss) on capital assets	$ 13,389	$ (26,512)	$ (14,398)	$ -	$ -
Total Other	$ 280,764	$ 12,115	$ 313,208	$ 322,109	$ 156,815
NET INCOME	$ 175,430	$ (546,751)	$ (301,339)	$ 815,581	$ 554,953