Accounting in agricultural firms

- IAS 41Agriculture - sets out the accounting for agricultural activity.
  - Transforming agricultural assets (living plants and animals) into agricultural produce (harvested product of the entity's biological assets).
  - Biological assets are accounted for mostly at fair value less costs to sell.

	Type of biological asset	Examples
Current Assets	biological assets for consumption	grain for sowing, pigs and young bulls
Fixed Assets	biological assets for production	milk cows, young cows and cows in calf

Financial distress – legal veiw

1. Protect the contractual rights of interested parties.
2. Provide orderly liquidation of unproductive assets.
3. When deemed desirable provide for a moratorium on certain claims in order to give the debtor time to become rehabilitated and emerge from the process as a continuing entity.

Financial Distress

- **PV(CF)> PV(obligations) & cash outflow>cash inflow**
- **Solutions:**
  - **Restructuring of operations** - reducing costs, selling unnecessary assets, change operations etc.
  - **Selling part of the business.**
  - **Liquidation of the company** – company's assets are "worth more dead than alive" i.e. liquidation value of assets > economic going-concern value

Economic distress

- **PV(CF)< PV(obligations) & cash outflow>cash inflow**
- **Types of insolvency:**
  - **Temporary**
    company's intrinsic or economic value > current liquidation value
    Solution – Financial restructuring.
    Aim of financial restructuring - permit the company to relieve the burden of the debtor's liabilities, restructure its assets and capital structure so that financial and operating problems will not recur in the foreseeable future.
  - **Permanent**
    liquidation value of assets > economic going-concern value
    Solution – liquidation, bankruptcy

Company distress

Characteristics	Bankruptcy	Financial restructuring
Objective	Satisfying claims of claimholders	Improving company's solvency
Insolvency	Permanent	Temporary
Company's operations	Will usually end	When possible to be continued
Claims satisfied	With receipts from sale of assets according to the order determined in Bankruptcy Law: firstly claims with a pledge and then other claims	Mainly from company's operating cash flows according to the financial restructuring plan
Claims' reduction	Can be done through the bankruptcy process if company is cured	Allowed, claims (incl. those of banks) can be postponed, reduced, replaced with shares and partitioned
Extent of claims usually satisfied	10-30%	Over 50%
Who remains in control in the process	Trustee	Owners

Introduction (1)

- Time – 1st September 2009.
- Protagonist – consultant Karl Kukk.
- Company – Väätsa Agro AS.
  - Established in 1996 following the privatisation.
  - Activity – dairy farming.
  - Ownership changes:
    - key year 2006;
    - on 1st Sept 2009 94% owned by Hanseatic Capital Estonia OÜ;
    - for summary of changes in ownership structure see Figure 1.

Introduction (2)

- Ownership changes:
  - 2006 Mr Lieberg wants sell his stake.
  - 2006 Windmühle OÜ acquires 65% stake for 4.9 mio EUR. Financing 3 mio EUR loan from Swedbank and 2.3 mio EUR loan from Hanseatic Capital OÜ – see details in the case.
  - 2006 Dec Windmühle OÜ bought by Urbanfors OÜ, merged in March 2007.
    - Urbanfors OÜ owned by Alo Lillepea and GA Fund Management OÜ.

Introduction (3)

- Business activities – see tables and figures under "business activities".
- Industry – EU milk quotas
  - Competitors – see Appendix 2.
  - Milk prices – see Figure 6.
- Financials – Appendices 3 to 5.
  - No cost of good sold – goods and services + change in inventories, signs show their impact on operating profit (+ increase, - decrease).
  - Biological assets:
    - Inventories – grain for sowing, pigs, young bulls.
    - Fixed assets – milk cows, young cows, cows in calf.

Introduction (4)

- Legal considerations – see Table 3.
  - Financial distress PV of CF-s> PV of obligations, however liquidity problems exist.
    - Restructuring of operations, sell the company.
  - Economic distress PV of CF-s< PV of obligations
    - Financial restructuring – going-concern value > liquidation value.
    - Liquidation – liquidation value >going-concern value.
- Task:

1. **What is the financial situation of the company and what caused it?**
2. **What alternative courses of action the company could take to solve it?**

What is LBO?

- The acquisition of a company, division, or subsidiary using highly leveraged financial structure, whereby the cash flows of the acquired business are used to service and repay the borrowed debt.
- If carried out by managers – MBO.

Source: Hunt, P.A. (2009), Structuring Mergers and Acquisitions: A Guide to Creating Shareholder Value, 4th ed., Wolters Kluwer Law & Business.

Why LBO?

1. To acquire stable cash flow operating assets using a limited amount of equity.
2. If the extra debt provides tax deduction which leads to an increase in firm value.
3. If the market does not recognise the value of target's assets.
4. If the target is under takeover threat.
5. If the management believes they can operate more effectively as a private company .
6. To provide an alternative to going public .
7. To provide an alternative to a sale, spin-off, or split-off from a conglomerate.

Source: Hunt, P.A. (2009), Structuring Mergers and Acquisitions: A Guide to Creating Shareholder Value, 4th ed., Wolters Kluwer Law & Business. Ross, S.A., Westerfield, R.W. and Jaffe, J. (2008) Corporate Finance, 8th ed., McGraw-Hill Irwin.

Main risk of LBO

- **High leverage!!!**

Good candidates for LBO

- Capable, experienced and committed management team.
- Industry leader with defensive market position.
- Stable business with little cyclicality.
- Little existing debt.
- Strong historical and projected cash flows with a reasonable degree of predictability.
- Minimal on-going capital expenditure needs.
- Reasonable future working capital needs.
- Assets that can be sold to repay or used as collateral to support debt.
- Assets that can be written up and depreciated in order to reduce taxes.
- Attractive valuation.

Source: Hunt, P.A. (2009), Structuring Mergers and Acquisitions: A Guide to Creating Shareholder Value, 4th ed., Wolters Kluwer Law & Business.

What happened? (1)

- 14 September 2009 – initiation of financial restructuring.
- 20 November 2009 – approval of 1st restructuring plan:
  - 30% of Swedbank AS pledged claim to be satisfied from cash flow, remaining part replaced with 43% holding in Väätsa Agro AS.
  - Maaelu Edendamise Sihtasutus claim not reduced.
  - Hanseatic Capital Estonia OÜ claims fully replaced with a holding in Väätsa Agro AS.
  - Other claims reduced 20-35%.
- Swedbank AS votes against the plan, initiates court proceedings – 1st VA - 2nd Sw - 3rd VA - 2nd VA.
- 23 December 2010 1st financial restructuring plan remains in force.

What happened? (2)

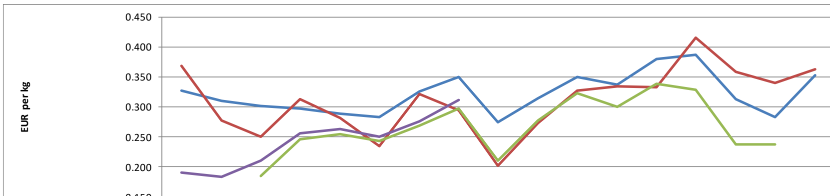
- 7 January 2011 Swedbank AS and Swedbank Liising AS appeal to the Estonian Supreme Court claiming:
  - Replacement of a claim with a holding in a company violates their constitutional rights.
  - Financial restructuring period (till the end of 2024) too long.
  - Väätsa Agro AS permanently insolvent.
- 11 May 2011 the 1st restructuring plan is cancelled.
- 11 Nov 2011 the 2nd financial restructuring plan is approved.
- April 2012 Trigon Dairy Farming purchases Väätsa Agro AS for 7.3 mio EUR.
- Dec 2012 the restructuring plan is fulfilled.

What happened? (3)

- Steps under Trigon Dairy Farming:
  - Sept 2013 construction of Lõõla farm begins:
    - Phase 1 2 new farms + renovation of 2 old ones for 2200 cows – 11 mio EUR, construction was finished in September 2014. The biggest in Estonia and Baltics.
    - Phase 2 + 1130 cows- when????

What happened? (4)

- 2017 ended for Väätsa Agro with a profit of 2.4 mio EUR.
- Recent milk price developments.



	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
EU average	0.327	0.310	0.301	0.297	0.289	0.283	0.325	0.350	0.274	0.315	0.350	0.337	0.380	0.386	0.313	0.283	0.352
USA Class III	0.369	0.277	0.250	0.313	0.282	0.235	0.321	0.294	0.202	0.272	0.327	0.334	0.333	0.415	0.358	0.340	0.362
Estonia average			0.184	0.245	0.254	0.243	0.269	0.296	0.210	0.277	0.323	0.300	0.338	0.328	0.237	0.237	
Väätsa Agro AS average	0.190	0.183	0.211	0.256	0.263	0.251	0.275	0.311									

Source: EU average and US Class III: LTO International Milk Price Comparison (http://www.milkprices.nl); Estonian average from Statistics Estonia (http://www.stat.ee/) and Väätsa Agro AS average (annual reports 2002-2009)

Conclusion

- LBO is always risky, but even riskier when economic situation is very good and when the persons initiating the LBO have short-term interests in mind.
- Company's capital structure should be set in a way that it is able to service its loans.
- Company's loan financing should generally support the company's main activity.
- If the company is temporarily insolvent, financial restructuring could help the company to continue its activities without the need of declaring bankruptcy and selling all its assets.
- As an owner or manager of a company you should
  - Avoid selling your (shareholder's) stake to speculators.
  - Not be afraid to dispute with banks or other claimholders, fight for your rights if you think that the truth is on your side.

Notes for the future

- **Experience of successful financial restructurings:**
  - Use if needed and creditors are ready to believe that saving the company is possible.
  - Do not feel ashamed of the situation.
  - Move quickly and do not postpone the decision if company's financial situation is weak.
  - Select the right people to run the company (during the process of restructuring) and right legal counsellors for the restructuring process.