

# New Generation Partnerships – Lease Back

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## ■ The Challenge – How to access financing to grow hogs

Hog production facilities are capital intensive. Total capital costs for farrow to market operations are typically \$6000 per sow place.

A typical budget for a 5000 sow multi-site operation would be:

Item	Cost
Land and site preparation \$	2,100,000
Building construction	13,800,000
Equipment	8,900,000
Pre-commissioning costs	3,900,000
Breeding stock	1,300,000
<b>Total cost</b>	<b>\$30,000,000</b>

Traditional bank financing can be placed for 60% of total cost depending on risk appetite. Therefore, \$18M can be borrowed from the banking system. **\$12M must therefore be shareholder equity, secondary debt or retained earnings.**

## ■ The Problem – Where do we find \$12M?

**Shareholder equity** – Venture capitalists often look for returns in excess of 30% when investing in common stock. Public offerings have limited track record in agricultural investments. Community offerings are successful for amounts up to \$1.5M but fall far short of numbers required for larger units.

**Secondary debt** often carries 5 – 12% preferred returns and can fill gaps but is expensive and is often short term with convertible to common shares optional.

**Retained earnings** – Often operations are trying to grow more quickly than profits will allow. Operations are also getting larger so capital costs are not linear.

### ■ **An Option – Lease Back**

In the Lease Back approach, the projects are reduced into self-financed units that are leased back to the operating company. For example, a 5,000 sow unit will require about 40,000 finishing spaces. If the spaces were put into 4 units of 10,000 spaces each, each unit can be financed separately. Nursery spaces can be treated like-wise.

Banks consider the risk of separate units to be leased back as lower risk and, therefore, will often finance 75% or higher.

Equity investors of leased units should get a preferred return on their investment. Returns of 8 – 12% are higher than many investments in the market place.

Budget for a 10,000 place-finishing unit:

Capital cost @ \$300/place	\$3,000,000
Equity of 25%	750,000
Bank financing of 75%	2,250,000

### ■ **Determining Lease Rates**

Lease Rates should reflect all costs:

- Pay all costs to operate the unit.
- Pay off the bank financing over 15-year period.
- Return investors a suitable return to equity.
- Provide for end of use provisions.

## ■ **Conclusion**

Leasing of buildings and equipment can significantly reduce the capital requirements necessary to expand hog operations. Units of production can be broken down in to “bite” size investments that individual investors (or groups of investors) can handle.