We had another meeting to discuss USDA inspected slaughter and processing in the Placer/Nevada County area on November 4th. There have been two previous meetings and a tour of two USDA inspected facilities in Northern California. There are several outstanding issues that I want to highlight to give people some things to think about. There is a Mendocino Meat Plant Feasibility Study that was recently completed. Parts of this article are drawn heavily from this study. You can find the complete paper here: http://cemendocino.ucanr.edu/files/171140.pdf.

Business Structure - This seems to be the number one issue that needs further emphasis for discussion. Business structure examples would include: Partnerships, Limited Liability Companies, S-Corporations, B-Corporations, Cooperatives, and New Generation Cooperatives.

a. Partnership - This involves two or more parties as owners. At least one of the partner’s complete assets would be liable if there ever was a legal action that resulted in needing to pay for damages. This potential exposure makes partnerships an unlikely choice.

b. Limited Liability Companies (LLC) - The owners are called members and they have limited liability. Members may pull out at any time without triggering capital gains tax penalties. Income is distributed to members in

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proportion to their ownership. Income is taxed at the member level. While LLC’s resemble partnerships, they share the corporate characteristic of limited liability, and may have an unlimited number of members. LLC’s can have varying investment levels. LLC’s pay an annual minimum franchise tax of $800 in California if gross revenue is less than $250,000. This rises to $900 for revenues between $250,000 and less than $500,000. It rises again to $2,500 if revenues are between $500,000 and less than $1,000,000. This would be the fee paid when the plant we’ve been discussing operates at full capacity.

Grasslands Livestock Alliance is an example of an LLC that is comprised of a husband and wife team. The company provides a consistent supply to Whole Foods markets in Texas. Cattle are raised to meet American Grass-fed Association grass-fed beef standards. They provide grass-fed beef to Whole Foods stores without investing in any facilities or trucks (Farm Credit Council). They collect a management fee from the 15-20 producer members. Producer members make annual commitments 6-12 months in advance. Quarterly meetings are held to discuss coordination, quality, marketing, and other issues.

An LLC may be a more flexible business structure to consider as it can have non-farmer members. This allows the LLC to have access to investors representing a broad range of investment capacities.

c. **S-Corporations** - This offers a blend of partnership and corporate characteristics. Income is taxed at the owner (shareholder level). Outside investors may have to pay capital gains taxes. Shareholders have limited liability. An S-Corporation can have up to 100 shareholders. They can have varying investment levels. Only US citizens can be members of an S-Corporation.

High Sierra Beef formed as a S-Corporation as a business in 2004 to market grass-fed beef. The board of directors did not hire professional management due to lack of funds and the business floundered. It was sold in 2006 to a board member who still operates the business today. **A lesson learned is that producers who already have full-time jobs can not run another business on a volunteer basis.**

d. **B-Corporations** - The "benefit corporation" became a recognized business structure in California on January 1, 2012. B-Corporations must have an explicit social or environmental mission, and binding fiduciary responsibility to take into account the interests of workers, community, and the environment as well as shareholders. This would not be a good fit for the USDA-inspected facility.
e. **Cooperatives** - Jointly owned business that: distributes control equally (either as one vote or proportionate to use); provides equitably distributed capitalization responsibilities, also on the basis of use. Cooperatives usually have employees who operate the cooperative on a daily basis. Cooperatives resemble partnerships and LLCs in that income may be taxed only at the individual (member) level if profits are distributed properly as “patronage refunds.” Cooperatives share the corporate characteristic of limited liability and involve similar capital gains tax advantages.

The cooperative model has had mixed agricultural success. Country Natural Beef would be the most successful example. It is a marketing cooperative and does not own any processing facilities. It contracts with a feedlot and processing plant to end up with packaged product to sell to stores, restaurants, and industrial customers. Producers are paid according to meeting carcass criteria.

The best recent example of a processing cooperative is the Livestock Processors Cooperative Association (LPCA) that was created by Cattle Producers of Washington. The plant is located in Odessa, Washington. The USDA-inspected plant provides the service of harvest and processing and works with a marketing company that sells product or works with ranchers to provide meat to specific customers. The plant has the capacity to harvest 40 head of cattle or animal equivalents in a day. This would translate to 8,000 head per year. The cost to build the plant was $3 million.

Each rancher bought one membership of the facility for a one-time fee of $600 and is approved by the association board. Each member gets one vote. According to their website, they have 80 members. Member benefits include receiving a discount over non-members in the harvesting fee and priority over non-members in scheduling. The plant is located in an industrial park. Here is the website address:

[http://www.livestockprocessors.com/home.html](http://www.livestockprocessors.com/home.html)

This is a start-up business that can hopefully succeed in the future. Time will tell.

f. **New Generation Cooperatives (NGC)** - These emerged during the 1990’s in the Midwest and have a processing focus. They were associated with niche products such as bison, tilapia, specialty wheat varieties, and edible beans. They differ from traditional cooperatives in two ways: members must have delivery shares to use the NGC; and membership in the NGC is closed. This means the total amount of delivery shares sold to all members equals the product volume at which the plant operates at the most efficient processing level. Unlike a cooperative, the NGC member’s shares are usually transferable and they can appreciate or depreciate in value. The NGC can sell more delivery shares to current or new members if it wishes to expand.
Business Structure Options

<table>
<thead>
<tr>
<th>Structure</th>
<th>Big Considerations</th>
<th>Potential Option for USDA Inspected facility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partnership</td>
<td>Owners fully liable for business debt.</td>
<td>No</td>
</tr>
<tr>
<td>LLC</td>
<td>Liability limited to business only. Unlimited number of partners. Income taxed only at member level.</td>
<td>Yes</td>
</tr>
<tr>
<td>S-Corporation</td>
<td>Income taxed only at shareholder level. Limited to 100 shareholders.</td>
<td>No</td>
</tr>
<tr>
<td>B-Corporation</td>
<td>Need explicit social or environmental mission.</td>
<td>No</td>
</tr>
<tr>
<td>Cooperative</td>
<td>Income taxed only at member level. Liability limited to business only. One member, one vote</td>
<td>Yes</td>
</tr>
<tr>
<td>New Generation Cooperative</td>
<td>Member must have delivery shares. Membership closed (tied to plant capacity) Shares Transferable.</td>
<td>Maybe</td>
</tr>
</tbody>
</table>

Financing

The Mendocino County Plant Feasibility Study identified three alternative financing options: equity capital, debt capital, and grants. Grants are not an option for the Placer/Nevada USDA inspected processing. Grants for the sake of grants create an enabled organization that will not do anything unless they have a grant. The result is a passive organization with little accountability for getting things done. Grants can be a useful tool for planning assistance and funding some specific start-up costs (not equipment). They only work if used as a tool. They do not work if used as a crutch. The government is not going to build a USDA inspected facility.

Equity Capital - Invested money that is not repaid to investors in the normal course of business. It represents the risk capital staked by the owners through purchase of the company’s common stock. An outside investor (with no need for use of the processing facility) would be interested in the rate of return on the investment and how quickly that return would be realized. A processing facility would not be a good fit for an investor looking for a short and high return on their investment (a common interest in someone with venture capital).

There were 11 producers in Mendocino County who indicated an interest in becoming an investor in a harvest and processing facility. In our region, I feel there would be a high likelihood of producer interest in investing in a plant through the purchase of memberships or shares.
a. **Crowd funding organizations such as Kickstarter** have become popular to directly raise small sums of money from many people for consumer products or creative efforts. Another type of organization is Kiva that is focused more on helping people. Kiva's mission is to connect people through lending to alleviate poverty. *Neither of these types of organizations would be a potential source of equity capital or a processing facility.*

A potential source of outside funding might be investors interested in a longer-term return on investment (at least 7-10 years) who are interested in their community and local food. An example would be Slow Money, which focuses on investing in farming and food ventures looking to serve local and regional markets. This might have potential for some source of equity capital, although not in large amounts. Bringing in outside investors will translate to increasing the business administrative costs.

b. **Investor’s Circle** - This includes investment funds and companies and seeks to fund businesses looking to undergo an assessment of social and environmental impacts. While not food-focused, they have invested money in Niman Ranch, New Day Farms, and other food-oriented companies that market to consumers.

c. **LION (Local Investment Opportunity Network)** - Member are motivated by a desire to promote economic development in their community. It is an informal network of individuals who meet to hear business plans. The individual makes investment decisions. They currently only have a group in Madison, Wisconsin.

d. **Stock Offering** - Investors would buy shares with the expectation of sharing in the firm's returns. This would require dealing with the Securities and Exchange Commission, which would be complicated. A processing facility would not create a lot of interest in a stock offering.

There probably would be minimal interest from impact investors (like those just listed) in a processing facility. Potential investment would need to come from producers and people or businesses interested in local food.

**Debt Capital** - This is the financing needed over and above what can be raised through equity investment and or membership. Most loans would likely require a 30% down payment. Using the Mendocino county study as a starting point, $500,000 would need to be raised in equity capital to get the loan (assuming the lender likes the business plan). Such a facility would also need an operating loan on top of the facility construction loan.
a. **Community Development Financing Institution (CDFI)** - Funding comes from the US Treasury to community development oriented banks, credit unions, venture capital funds, and corporations. They can provide working capital and equipment financing.

b. **Small Business Administration 504 Program** - The purpose of the SBA Section 504 Fixed Asset Loan Program is to provide long-term financing for small businesses for fixed assets. The funds must be used to purchase fixed assets for projects that help create new employment or retain existing jobs. The program does not provide working capital.

The Mendocino County study noted an example where SBA could finance 30% of eligible costs, an affiliated SBA lender would provide 50% and the Mendocino County facility owners would provide the other 20%. Businesses can borrow up to $5,000,000 for building acquisition/construction, machinery, and equipment costs. The current loan rate is 5.23%. The loan term is 20 years for building acquisition/construction and 10 years for machinery and equipment.

c. **USDA Rural Development Business and Industry** - This program can serve to provide a loan guarantee of 80%. Eligible borrowers include cooperatives, corporations, partnerships, and other legal entities organized as either a profit or non-profit. Borrowers can use loan funds for purchasing machinery, equipment, leasehold improvements, and supplies. It offers a 15 year loan for machinery and equipment and 7 years for working capital. It is important to note that they provide a loan guarantee. Borrowers would need to work through a lender. The lender would take the loan application if they were interested in funding and work with this program to get the 80% loan guarantee.

**Ownership**

This is the biggest decision facing the group interested in seeing a local USDA inspected slaughter and processing plant. Who owns the plant? Who signs the loan documents? Who makes sure the loan is paid back? Who makes this effort their primary focus 24 / 7 / 365?

The prevailing attitude is build it, hire a manager and meat cutters and everything will work out. It is much more complicated than that. For example, let's say an LLC was chosen as the preferred business organization.
People would invest in the LLC as members. From there a Board of Directors would be chosen. After that, the next step would be **HIRING** a Chief Executive Officer (CEO). Under that person would be operations (meat cutters), marketing (scheduling, contacting potential clients, promotional programs), and finance (paying bills, bookkeeping, audits, cash flow, profit and loss).

It will not work to hire a butcher to run the business unless they have that inclination and would hire another butcher to handle the main meat cutting tasks. Otherwise that person ends up spread too thin with little time to deal with anything other than meat cutting and paying some bills.

**Final Thoughts**

The time is approaching for people to commit to a business structure and define their level of investment. This needs to be coupled with a decision on the facility size and detailed financials. A business plan would then need to be developed in order to seek financing. The interest must evolve from "wouldn't it be great to have local processing plant" and going on tours to dealing with the grunt work of putting a business in place and supporting it.

**UPCOMING EVENTS**

Contact Roger Ingram at (530) 889-7385 or rsingram@ucanr.edu to register or if you have questions. Check website for updated information at ceplacer.ucdavis.edu

**Low-Stress Livestock Handling Seminar**

Wednesday, January 22, 2014  8:00 AM - 5:00 PM

Eco-Farm Conference, Monterey, CA

Presented by The Whole Picture Consulting, LLC & Sustain Environmental, Inc.

Be on the leading edge of livestock and land management with this introductory workshop of Stockmanship & Low-Stress Livestock Handling Basics. Join instructors Richard McConnell and Tina Williams of Hand ‘n Hand Livestock Solutions; Whit Hibbard, Editor/Publisher of the Stockmanship Journal; Kent Reeves of The Whole Picture Consulting, and a panel of Stockmanship practitioners to learn how to be successful through low-stress livestock management.

Seminar Includes:

- History & The Case for Low-Stress Livestock Handling
- What is the Economic, Social, & Environmental Value of Stockmanship
- What are the Advantages to the Handler and to the Livestock
- Understanding Natural Instincts of Livestock and Communicating with Them
- Predator/Prey Relationships (Our Instincts)
- Herd Training & Management (Sorting, Loading, Receiving & Weaning)
- Our Attitude as We Deal with Livestock and Why Animals are Never Wrong
- Panel Discussion with Instructors and Practitioners

For more information, go here: http://ecofarm2014.org/schedule/pre-conference-events/

**Farm and Ranch Business Planning Short Course**

February 6 - March 13, 2014  6:00 PM - 9:00 PM

7 sessions including one Saturday, February 8

UCCE Extension Office - Auburn

11477 E Avenue, Auburn

- **Getting Started with Sheep** Spring 2014
- **Getting Started with Cattle** Spring 2014
- **California Grazing Academy** Late April 2014

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