

Women Managing the Farm



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Financial Health Indicators

What we will discuss today

- Financial reports
- Healthy Ratios and benchmarks
- Questions and Answers



How are financial reports useful?

- **As a tool for management**
 - Use in combination with production records to identify strengths & weaknesses
 - Track trends
 - To time cash expenditures & plan for credit needs
 - To provide critical data for ratio analysis & benchmarking



As a tool for use with lenders and other professionals

- Lenders request/require accurate financial statements to accompany a credit request
- A well prepared set of financial statements shows that you have a detailed understanding of your operation and its repayment abilities.
- Attorneys and financial planners use such info for services such as estate planning, organizational establishment, & buy-sell agreements for transition purposes.



As a tool for tax compliance



- A carefully prepared set of financial statement can make life *much* easier when tax time comes around.
- This prevents last minute information collection and provides peace of mind in an IRS audit.



What reports are included

- **Balance Sheet**
- **Income Statement**
- **Cash Flow Projection**
- Others might include a statement of cash flows and a statement of owner equity
- **CREDIT BUREAU REPORT** (accessed by lenders and others)

These reports are interrelated. Therefore, proper timing of the statements is important to gain the most benefit.



BALANCE SHEET

(a/k/a Financial Statement)

- The balance sheet is a statement of financial position at a specific point in time or a financial snapshot of the business.
- The balance sheet reflects the result of all past transactions but not how the current financial position was obtained.



ASSETS

- Assets include anything that is owned or controlled by the operation that has monetary value.
- Assets can be valued at either cost or market value depending upon what is preferred.



Types of assets

- Assets should be divided three categories:
- **Liquid assets** (cash, marketable securities, investment in growing crops, feed & grain inventories, market livestock, accounts receivables, supplies on hand, prepaid expenses.)
- **Intermediate term assets** (Breeding livestock, machinery, vehicles, notes receivables, retirement accounts)
- **Long term or fixed assets** (real estate, including land, buildings and improvements)



LIABILITIES

- Liabilities should include all obligations
- **Current** (accounts payable, CREDIT CARD DEBT, operating loans, accrued interest, accrued income and property taxes, principal portion of term loans due within the next year.)
- **Intermediate** (machinery loans, breeding livestock loans, vehicle loans, STUDENT LOANS)
- **Long term** (mortgages)



OWNER EQUITY

- **Owner equity is the residual amount after liabilities are subtracted from assets.**
- It reflects the owner's investment of their own capital into the business and retained earnings which are generated over time.

Assets = Liabilities + Owner Equity

The total assets of a business belong *partially* to claimholders and *partially* to the owners.



TIMING MATTERS

- Balance sheets are most useful when they consistently coincide with the timing of the income statement – typically at the end of the operating cycle.



INCOME STATEMENT

- A business income statement, also called a profit and loss (P&L) statement is used to measure revenues and expenses over an accounting period – usually one year.
- Income statements can be used to determine tax liabilities, analyze the operation's expansion potential, evaluate it's profitability, and assist in loan repayment analysis.



CASH FLOW PROJECTION

(The farmer's lament!)

- The balance sheet and income statement provide present and historical information. Operators and lenders are often equally, if not more, interested in future performance.
- The cash flow summarizes cash inflows and outflows expected in the coming operating cycle and operating finance activities.



A cash flow helps determine ...

- **The need for operating lines of credit to cover cash flow deficits**
- **Periods of excess cash when funds could be invested**
- **The need for changes in marketing or expenditure plans**
- **The cash flow feasibility of a new investment**
- **The cash flow in a transition year before the operation is fully engaged**
- **Different scenarios to consider price, yield & cost changes (stress analysis)**



Cash flow categories

- Cash inflows – detailed listing of receipts
- Cash outflows – detailed listing of cash expenses AND principal and interest payments on term debt. (Depreciation is excluded since it's not a cash expense).
- Net flows indicate short-term borrowing needs, interest accrued and repayment of the line of credit.

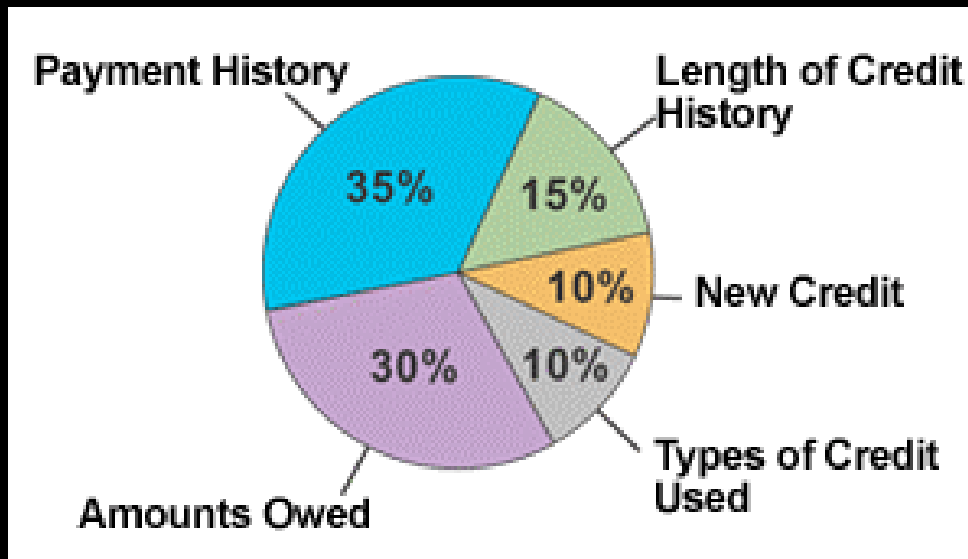


CREDIT BUREAU REPORTS

- Check your credit history (Experian or Trans Union)
- Report Discrepancies
- Manage your credit well....especially the plastic kind!



Your Credit Score



What's in Your Score

Low Risk

>725

Moderate Risk

650-725

High Risk

< 650



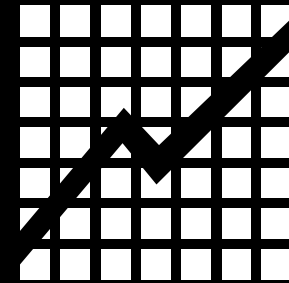
Improve Your Credit Score

- Pay your bills on time
- If you missed a payment, catch up and stay that way.
- Paid collections (even medical) stay on your report.
- Keep low balances on credit cards and other revolving accounts.
- Don't open many new accounts at once.
- Do rate shopping within a focused period of time.
- Payoff debt – don't move it around.



How does my farm business measure up?

- Liquidity Analysis
- Solvency Analysis
- Profitability Analysis
- Repayment Capacity (Coverage Ratios)
- Operating Ratios



Measures of Liquidity

- Current Ratio
- Quick Ratio
- Working Capital



Current Ratio

Total current assets / total current liabilities

- If current assets were sold, could all current debt be paid off.
- *The higher the ratio, the greater the liquidity.*
- *Industry average 1.2-1.8 (120-180%)*



Quick ratio

This ratio is a refinement of the current ratio and is a more conservative measure of liquidity. Generally a ratio less than 1 to 1 implies a dependency on inventory to pay off short term debt.

$$\frac{\text{(Current Assets – Inventory)}}{\text{Total current liabilities}}$$



Working Capital

Current Assets
- Current Liabilities
Working Capital

Indicates the funds available in the short term to purchase inputs and inventory items after the sale of current assets and paying current liabilities.



SOLVENCY

Total Owner Equity / Total Assets

- *This ratio measures the proportion of total assets financed by the owner's equity capital.*
- *The higher the value of the ratio, the more total capital has been supplied by the owner(s) and less by the creditors.*
- *Industry average 40-60%*



PROFITABILITY

Rate of Return on Farm Assets =

$$\frac{(\text{Net farm income from operations} + \text{interest expense})}{((\text{Beginning total farm assets} + \text{Ending total farm assets})/2)}$$

This ratio measures the rate of return on assets and is often used as an overall measure of profitability. This ratio is most meaningful for comparisons across businesses when assets are valued at market value. However, due to the impact of frequent fluctuations in market values of farm assets, it is most meaningful for comparisons between accounting periods for an individual farm operation when using a cost basis balance sheet. The higher the value, the more profitable the business.



Repayment Capacity (Capital Debt Coverage Ratio)

This ratio provides a measure of the ability of the borrower to cover all the term debt payments and capital asset replacement. Industry average 115-140%.

Net Farm Income
+/- Misc. income & expense
+ Non-farm income & expense
+ Depreciation
+ Term debt interest
- Income taxes
- Withdrawals (living)

Principal & Interest Payments
and
Capital Asset Replacement



Interest Expense Ratio

$$\frac{\text{Total Farm Interest Expense}}{\text{Gross Farm Income}}$$

Indicates how much gross farm income is used to pay for borrowed capital. Industry average 10-15%.



Expense/Income Ratio

$$\frac{\text{Farm Operating Expenses}}{\text{Gross Farm Income}}$$

(Excluding interest and depreciation)

This ratio reflects the relationship of expense to gross revenues. The ratio expresses total farm expenses per dollar of gross revenue. The lower the ratio the more efficient the operation. Industry average 65-75%.



Collateral Margin

Indicates the margin a lender has in the collateral used to secure a loan.

$$\frac{\text{Total Collateral Margin}}{\text{Total Collateral Value}}$$

Industry Average
20-40%



**Get a financial check-up
and stay healthy!**

