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Financial Data Driven Decisions

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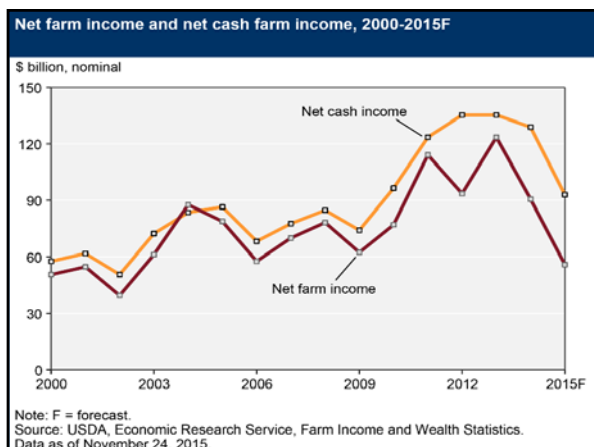


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Session Objectives

Learn how to take the information generated from the farm financial statements and the financial ratios to make business decisions for the farm.

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Formulate Recommendation

Based on these measures, what advice would you give to this operator?

1. Exit farming
2. Find more off-farm income
3. Sell off assets
4. Increase acres
5. Reduce input costs
6. Add an alternative enterprise
7. Something else

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Case Study

The following slides come from the Center for Farm Financial Management's FINPACK training case study

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Liquidity Measures

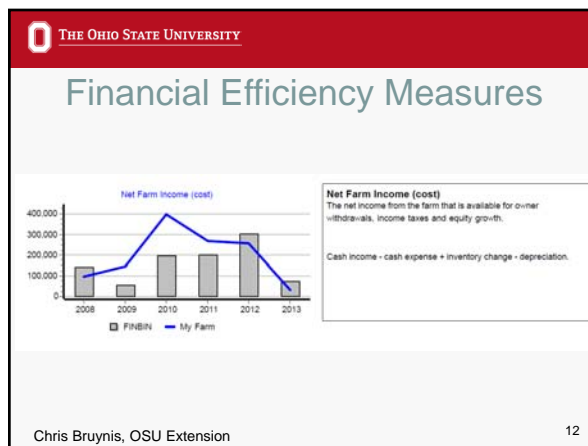
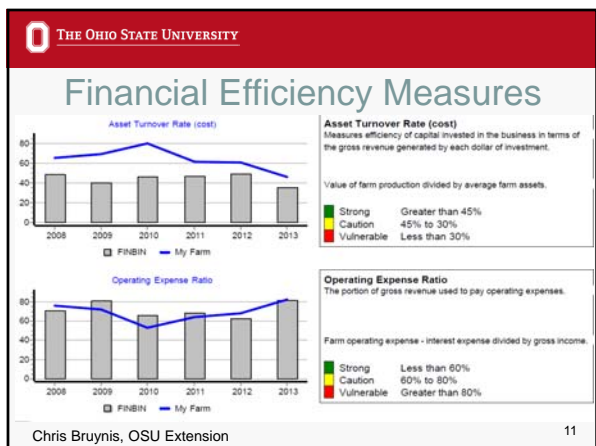
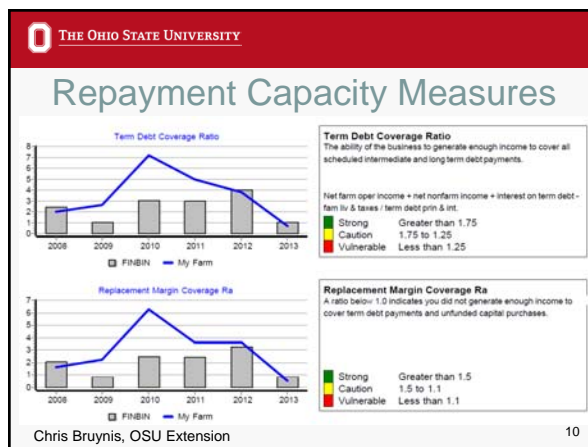
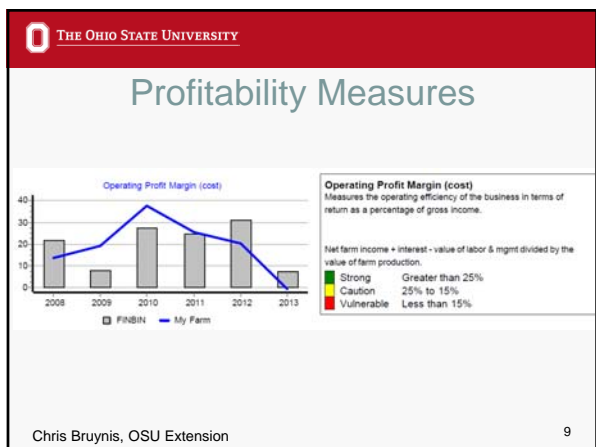
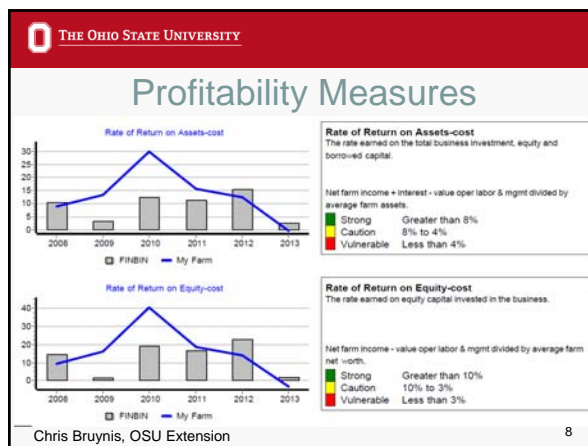
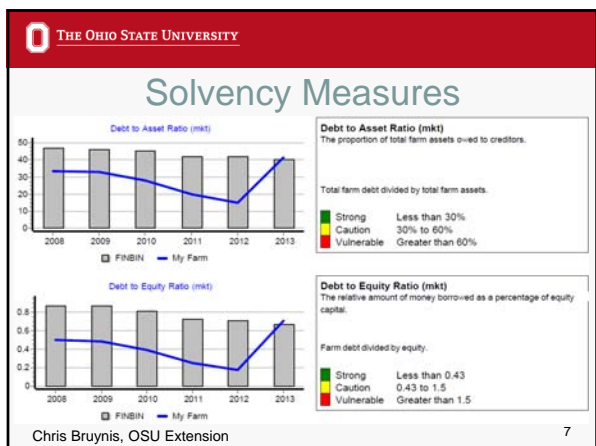
Current Ratio
The extent to which current farm assets, if liquidated, would cover current farm liabilities.
Total current farm assets divided by total current farm liabilities.

Strong	Greater than 2
Caution	2 to 1.3
Vulnerable	Less than 1.3

Working Capital to Gross Revenues
Measures operating capital available against the size of the business.
Working capital divided by gross revenues.

Strong	Greater than 30
Caution	30 to 10
Vulnerable	Less than 10

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Looking Forward

Based on these measures, what advice would you give to this operator?

1. Exit farming
2. Find more off-farm income
3. Sell off assets
4. Increase acres
5. Reduce input costs
6. Add an alternative enterprise
7. Something else

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	Farm A	Farm B	Farm C	Farm D
Gross Cash Farm Income	1,304,598	374,405	669,464	146,793
Total Farm Cash Expenses	1,022,360	264,765	239,430	95,717
Net Cash Income from Operations	282,238	109,640	430,034	51,074
Current Assets	1,099,502	875,962	1,433,052	843,249
Current Liabilities	584,514	514,792	621,001	683,470
Working Capital	514,988	161,170	312,052	159,819
Total Assets (market)	3,461,428	1,613,646	3,445,713	2,489,914
Total Liabilities	1,545,209	1,000,658	1,777,355	1,374,635

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Benchmarking

Calculate the

- Current Ratio = CA/CL
- Working Capital/Gross Revenues
- Debt to Asset Ratio = Debt/Assets (market)

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	Farm A	Farm B	Farm C	Farm D
Current Assets	1,099,502	875,962	1,433,052	843,249
Current Liabilities	584,514	514,792	621,001	683,470
Current Ratio	1.88	1.70	2.31	0.94
Gross Cash Farm Income	1,304,598	374,405	669,464	146,793
Working Capital	514,988	161,170	312,052	159,819
Working Capital/Gross Rev	0.39	0.51	0.45	1.09
Total Assets (market)	3,461,428	1,613,646	3,445,713	2,489,914
Total Liabilities	1,545,209	1,000,658	1,777,355	1,374,635
Debt/Asset Ratio	0.45	0.62	0.52	0.31

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Financial Troubleshooting

Efficiency – the observed relationship between input and outputs.

- Crop yields, pigs per litter, rate of gain
- Largely determined by a farmer's managerial and technical skills

Scale – refers to the size of the business

- Problems usually occur when business is too small
- Determined by assessing the labor utilization

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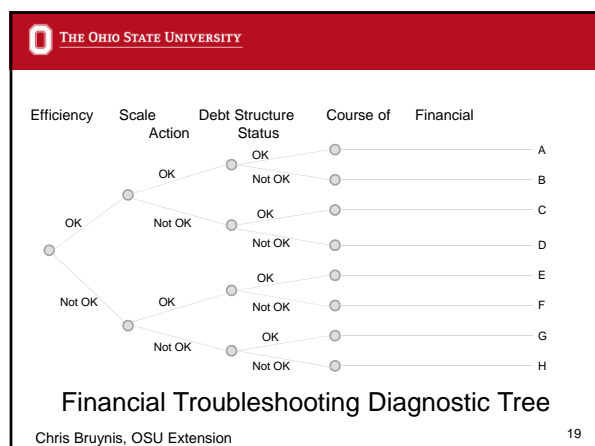
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Financial Troubleshooting

Debt Structure – refers to the amount of outstanding debt, its term, and costs.

- Too much debt forces untimely asset liquidation
- Too little debt can limit size, efficiency, growth and earning capacity

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Financial Troubleshooting Diagnostics

A) Efficiency OK, Scale OK, Debt OK

- 1) Review financial performance annually
- 2) Keep current on new technology
- 3) Tell them they are doing a good job
- 4) Potential for expansion
- 5) Also look at off-farm investments

B) Efficiency OK, Scale OK, Debt **Not OK**

- 1) Restructure debt—lengthen term or reduce interest rate to improve cash-flow
- 2) Sell assets to reduce debt
- 3) Reduce debt through “shelving” or write-off
- 4) Chapter 12 bankruptcy

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Financial Troubleshooting Diagnostics

C) Efficiency OK, Scale **Not OK**, Debt OK

- 1) Cash flow problems will develop unless scale problem is addressed
- 2) Expand by adding an enterprise or expanding existing enterprises—use records to make expansion decision
- 3) Custom crop farming, Custom livestock feeding
- 4) Are they using their resources fully—machinery, labor?
- 5) Do they have the management ability and emotional stability to handle the additional stress of expansion?
- 6) Off-farm income—will this affect their efficiency in farming?
- 7) Retire

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Financial Troubleshooting Diagnostics

D) Efficiency OK, Scale **Not OK**, Debt **Not OK**

- 1) Often a young farm family
- 2) Tell them they are doing a good management job
- 3) Least cost way of expansion—rent additional land or facilities or custom feed livestock—crop-share rent vs. cash rent, custom crop farming
- 4) Off-farm income—will this reduce their efficiency?
- 5) Scale back and obtain off-farm income

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Financial Troubleshooting Diagnostics

E) Efficiency **Not OK**, Scale OK, Debt OK

- 1) Enterprise analysis—enterprise record keeping
- 2) Re-orient priorities—spend more time on management
- 3) Difficult to make a permanent improvement in management—may increase efficiency for short time
- 4) Use advisory services
- 5) Improve marketing
- 6) Is poor efficiency due to uncontrolled family living expenditures or due to high operation costs?
- 7) Do they like farming—should they quit while they still have good equity—are they afraid to make a change?
- 8) Establish a point where bank will not extend credit

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Financial Troubleshooting Diagnostics


F) Efficiency **Not OK**, Scale OK, Debt **Not OK**

- 1) Must change two major factors to be successful—rather unlikely
- 2) Are the debt problems due to poor efficiency—will debt problem develop again if solved now?
- 3) Poor efficiency leads to other problems
- 4) Should they quit farming?

G) Efficiency **Not OK**, Scale **Not OK**, Debt OK

- 1) Hobby farming
- 2) Should they leave before their equity is gone?
- 3) Can resources be employed better elsewhere?
- 4) Off-farm employment is vital

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Financial Troubleshooting Diagnostics

H) Efficiency **Not OK**, Scale **Not OK**, Debt **Not OK**

- 1) Is it worth the hassle?
- 2) What else is at risk—marriage, family, retirement?
- 3) Get out while you can!

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Summary

Even if every thing is OK, there are still courses of action to take!

Troubleshooting a farm business requires an orderly approach, good data, and occasional intuitive leaps of faith.

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Questions?

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