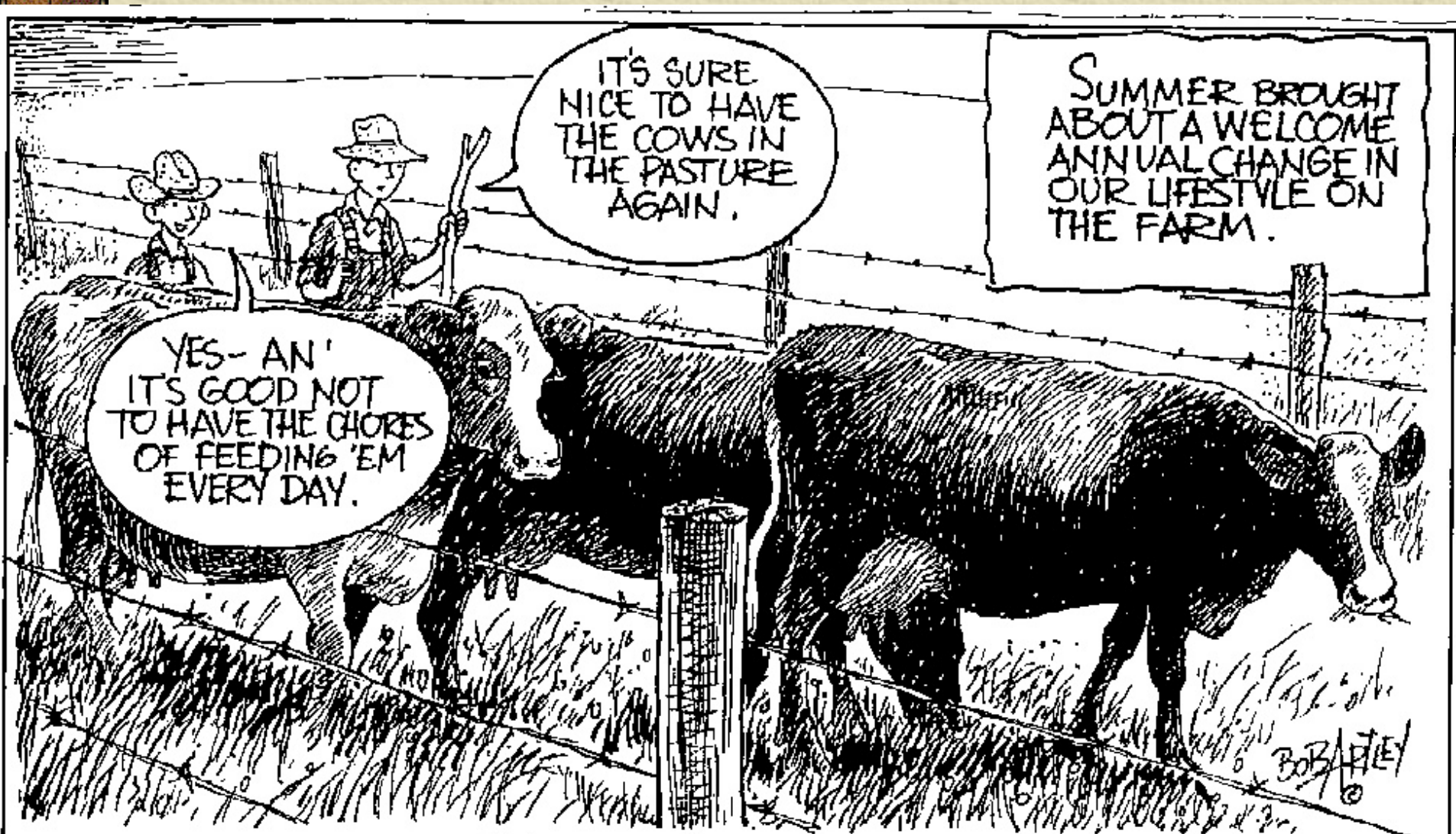




Business Planning/Business Performance for Graziers

Paul Dietmann, Sauk Co. UW-Extension
Agricultural Agent
February, 2004



IT'S SURE
NICE TO HAVE
THE COWS IN
THE PASTURE
AGAIN.

SUMMER BROUGHT
ABOUT A WELCOME
ANNUAL CHANGE IN
OUR LIFESTYLE ON
THE FARM.

YES- AN'
IT'S GOOD NOT
TO HAVE THE CHORES
OF FEEDING 'EM
EVERY DAY.

BOB ARLEY
©


Memories Of A Former Kid.

Distributed by MugWump Marketing



Veteran graziers say they enjoy a *better quality of life* associated with switching to controlled grazing.

- ✓ **The work involves more management, less labor**
- ✓ **A lot less feed, manure, seed, chemicals, bedding, etc., etc., needs to be handled everyday**
- ✓ **Graziers still put in a full day's work, but the work environment is more relaxed and quiet**
- ✓ **A grass-based farm can be a safer place, especially for kids**



Sure, the quality of life on an intensively managed, grass-based farm seems like it could be really nice...but can it be more profitable too???

- ...No practice or system can guarantee profitability
- ...Any benefits with a grazing system won't happen overnight

Many graziers have reduced mechanically harvested feed needs 50% to 80% by increasing the quality and quantity of feed harvested directly by livestock

This means...

- ✓ **Reduced cost of growing, harvesting, and storing crops**
- ✓ **Less use of and need for machinery, livestock feeding and housing facilities**
- ✓ **Livestock spread more manure automatically, reducing the time and expense of manure hauling, and the need for manure storage**
- ✓ **Veterinary and replacement costs are lower as livestock are generally more healthy**

- **Feed costs are the single biggest expense on most livestock farms**
- **Typically, a dairy farmer will spend between \$60 and \$100 per ton of dry matter to grow and harvest forage**
- **A grazer can cut this down to approximately \$30 per ton for at least six months of the year by having the cows do the harvesting**

This is the main reason why grazing systems are competitive.

The Wisconsin Grazing Dairy Analysis confirms that Management-Intensive Rotational Grazing (MIRG) is an economically viable alternative for many Wisconsin farm families.

- MIRG is economically competitive.
- The MIRG system is more economically flexible than the confinement system.
- MIRG is not a reduced management system; it's a different management system.
- A “traditional small Wisconsin dairy farm” with average or better management has a good chance of improving financial performance by judicious adoption of a MIRG system.



Business planning for a grass-based farm should begin with quality of life goals.

Financial goals should move the farm towards the quality of life you want to achieve.

Financial goals should not be allowed to throw quality of life goals out the window.

Three Most Important Financial Goals

Liquidity

Solvency

Profitability

Three financial statements needed for planning and measuring performance

✦ Balance Sheet

✦ Income Statement (also known as a profit and loss statement)

✦ Pro forma cash flow statement

The Balance Sheet

A snapshot of how funds are invested in the farm business (**assets**) and the financing methods used (a combination of **liabilities** and **owner's equity**) at a given point in time.

- **Assets** – Everything that is owned by or payable to the business as of the date the balance sheet is prepared
- **Liabilities** – All obligations owed by the business as of the balance sheet date
- **Owner's Equity or Net Worth** – Total assets minus total liabilities

Useful information provided by a balance sheet

- ✦ Liquidity – The ability of the business to meet its current (short term) obligations with current assets
- ✦ Solvency - The ability of the business to pay off all of its debts if it were to be sold tomorrow

Liquidity

✠ *Current ratio* – All current assets divided by all current liabilities

GOAL: The current ratio should be at least 1.0, preferably 2.0 or more

In other words, current assets should be twice as much as liabilities

Liquidity

✦ *Quick ratio* – Current assets minus inventory, divided by all current liabilities

GOAL: The quick ratio should be at least .5, preferably close to 1.

(The quick ratio eliminates the need to take a physical inventory of product on-hand.)

Liquidity

✦ *Working capital* – All current assets minus all current liabilities

GOAL: Personal comfort level based on average current liabilities

Most Common Liquidity Problems

Poorly structured debt - Paying for long-term assets as if they are current liabilities

High current liabilities forcing sales of inventory at unprofitable prices

Uncollectable accounts receivable continuing to show up as current assets on balance sheet

Solvency

✦ Debt-to-Asset ratio – All farm liabilities divided by all farm assets. It's the banker's share of the farm, so to speak.

GOAL: Should be 30% or less. The higher the debt-to-asset ratio, the greater the level of financial risk.

Solvency (continued)

✦ Equity-to-Asset ratio – All farm assets minus all farm liabilities, divided by all farm assets. It's the farm owner's share of the farm.

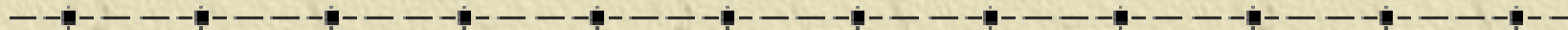
GOAL: Should be 70% or more.

Solvency (continued)

✦ Debt-to-Equity ratio – All farm liabilities divided by owner's equity.

GOAL: Should be 43% or less over the long run. It can be higher in the short-run, especially after a large capital investment in the farm.

Most Common Solvency Problems



Capital investments too high relative to potential income

Assets depreciating faster than the loan balances are being paid off

The Income Statement

A structured way of comparing one year's income and expenses, and determining how much of that revenue was retained by the business.

Income – Includes cash sales of farm products, government payments, custom work income. Also includes changes in the inventory of feed, crops, and livestock.

Expenses – Includes all cash operating expenses including interest (but not principal) payments. It also includes depreciation.

Useful information provided by the income statement

Profitability measures

- **Net farm income** – The return for your unpaid labor, management, and financial investment in the farm
- **Rate of return on farm assets** – The “interest rate” being earned on all of the investments in the farm
- **Rate of return on farm equity** – The “interest rate” being earned on your investment in the farm
- **Operating profit margin** – The operating efficiency of the business

Useful information provided by the income statement

Profitability measures

- **Net farm income** – GOAL: Personal satisfaction level
- **Rate of return on farm assets** – GOAL: At least the rate of interest on borrowed money.
- **Rate of return on farm equity** – GOAL: Should be higher than the rate of return on farm assets
- **Operating profit margin** – GOAL: Should be at least 20%, but ideally 35% or better

Most Common Profitability Problems on Dairies



Feed costs too high

Overhead costs too high

How do we increase profitability?

-
1. Reduce overhead costs (They aren't really "fixed")
 2. Improve gross margin
 - get more for your milk, cull cows, other farm products
 - cut variable costs
 3. Increase asset turnover
 - (Remember: $\text{Asset turnover ratio} = \frac{\text{Value of farm production}}{\text{Average farm assets}}$)
 - Increased production only improves profitability if variable *and* overhead costs stay the same

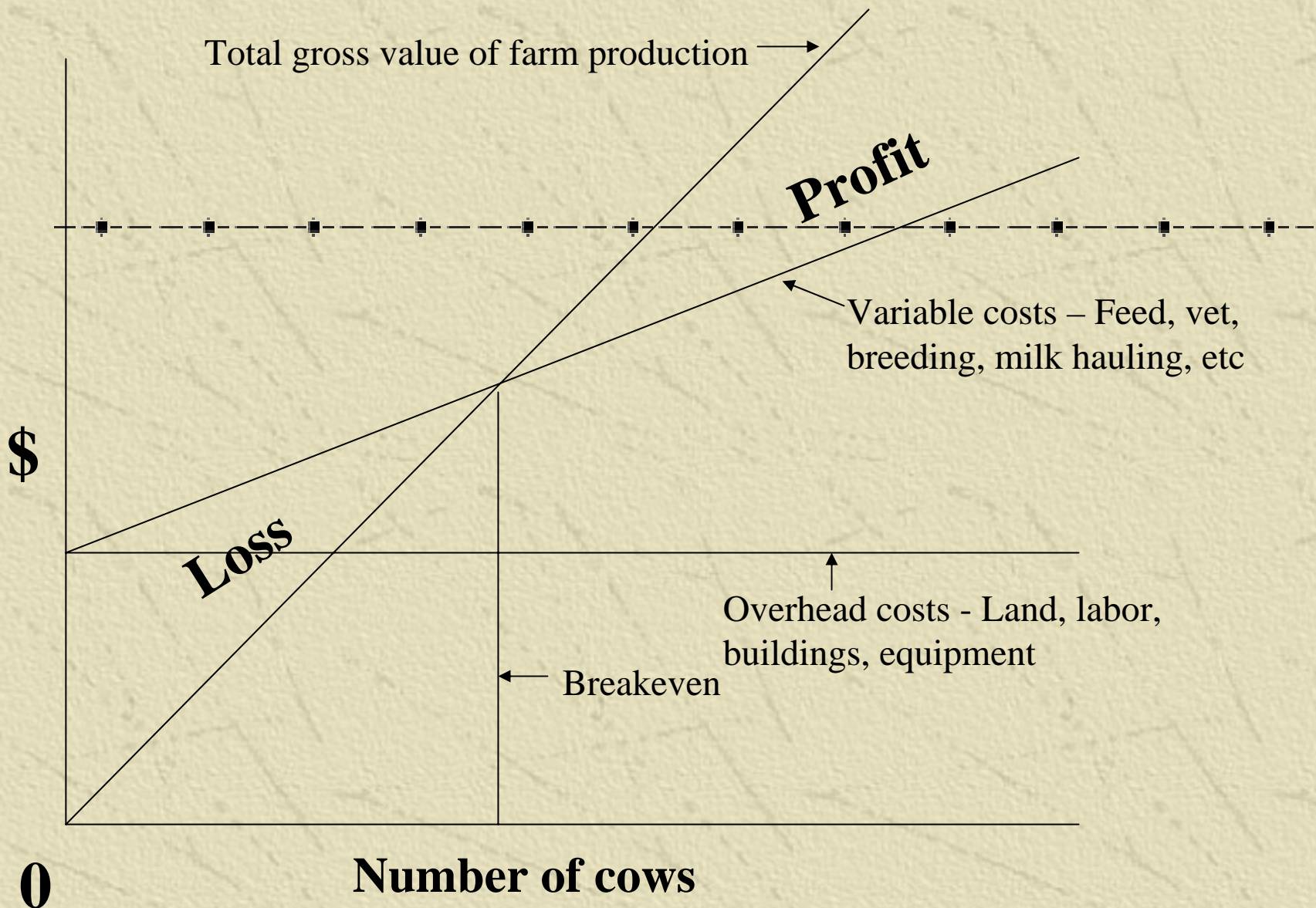
Business Planning- Costs

✠ Overhead Costs

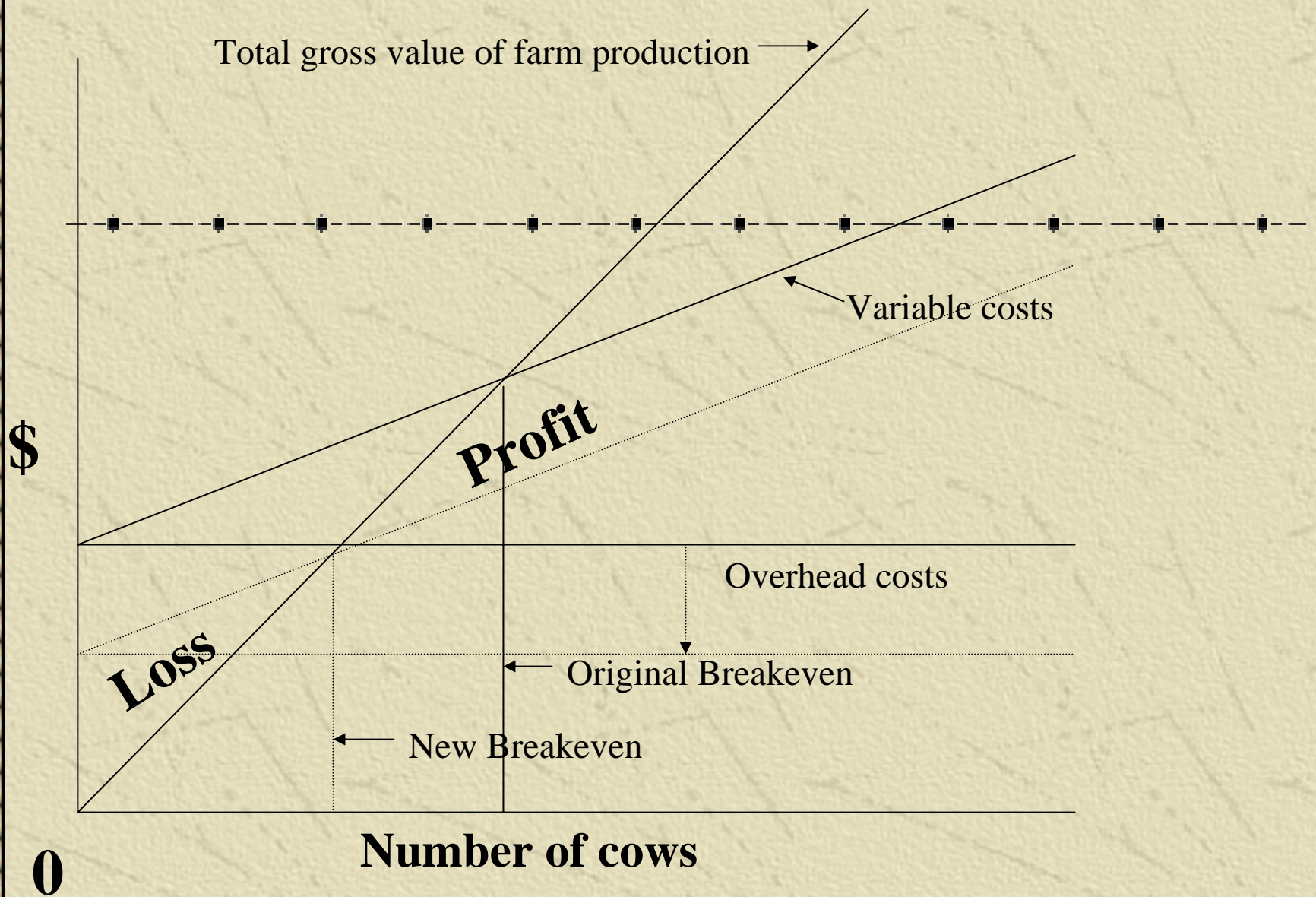
- Costs that exist on the farm whether or not anything is being produced
- Can include mortgage, taxes, depreciation, labor

✠ Variable Costs

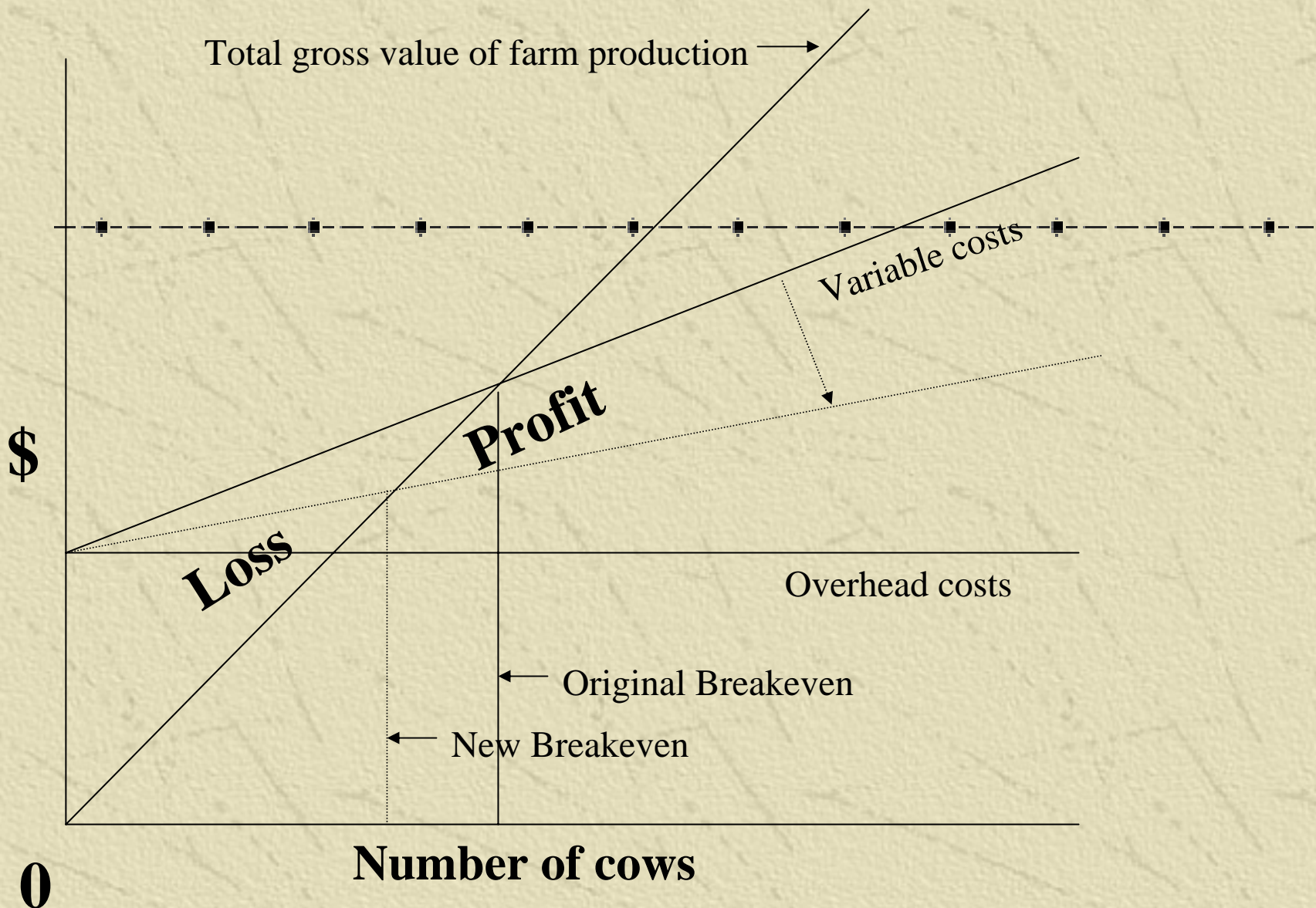
- Costs that increase as farm production increases
- Can includes seed, feed, fertilizer, vet expenses, utilities



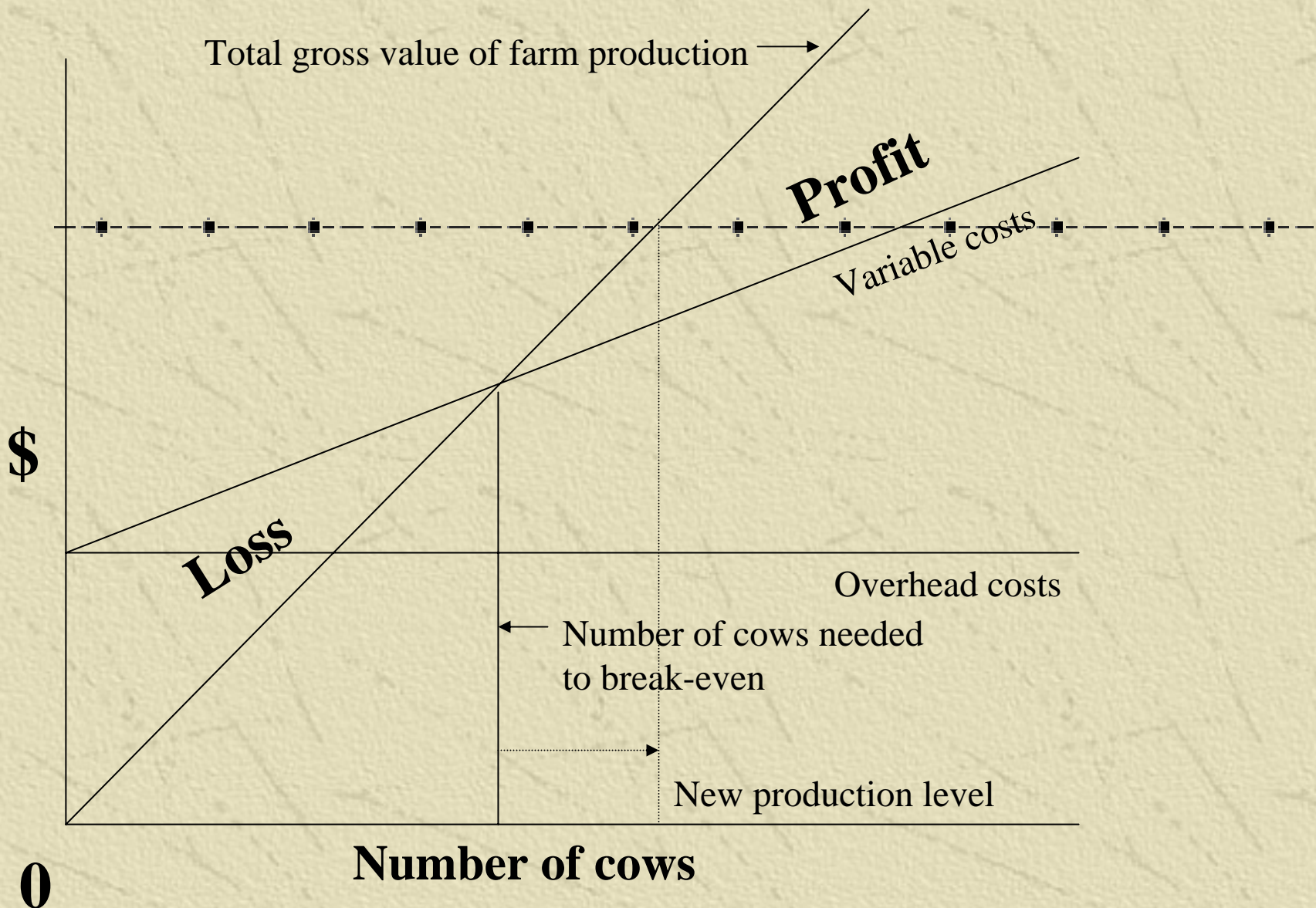
How overhead and variable costs relate to profit on dairy farms



One way to increase profitability: Reduce overhead costs



Another way to increase profitability: Reduce variable costs



A third way to increase profitability: Increase production, keep all costs the same

Business Planning

- ✦ First, set your lifestyle goals
- ✦ Business plans need to match the type of lifestyle you want, not vice-versa
- ✦ Put your goals and plans in writing
 - ✦ Write it for yourself, not for your banker
 - ✦ Think broadly about the assets you can use in the farm business to move you towards your lifestyle goals

Business Planning-Lots of Assets!

Financial

Farm location

Land

Personal
abilities

Buildings

Livestock

Soil quality

Rainfall

Good
neighbors

Solar
energy

Business Planning- Liabilities

✠ Mortgage

✠ Taxes

✠ Other bills

✠ A variety of risks

- Price decreases for production
- Price increases for inputs
- Loss of production
- Drought
- Personal injury
- Problems with livestock health
- Machinery breakdowns
- Fire

Business Planning

- ✦ Most graziers are trying to take full advantage of all of the assets at their disposal...
- ✦ ...And, are trying to reduce their liabilities as much as possible

Thinking About Assets and Liabilities



Our textbook definitions:

Assets - Everything that is owned by or payable to the business as of the balance sheet date

Liabilities - All obligations owed by the business as of the balance sheet date

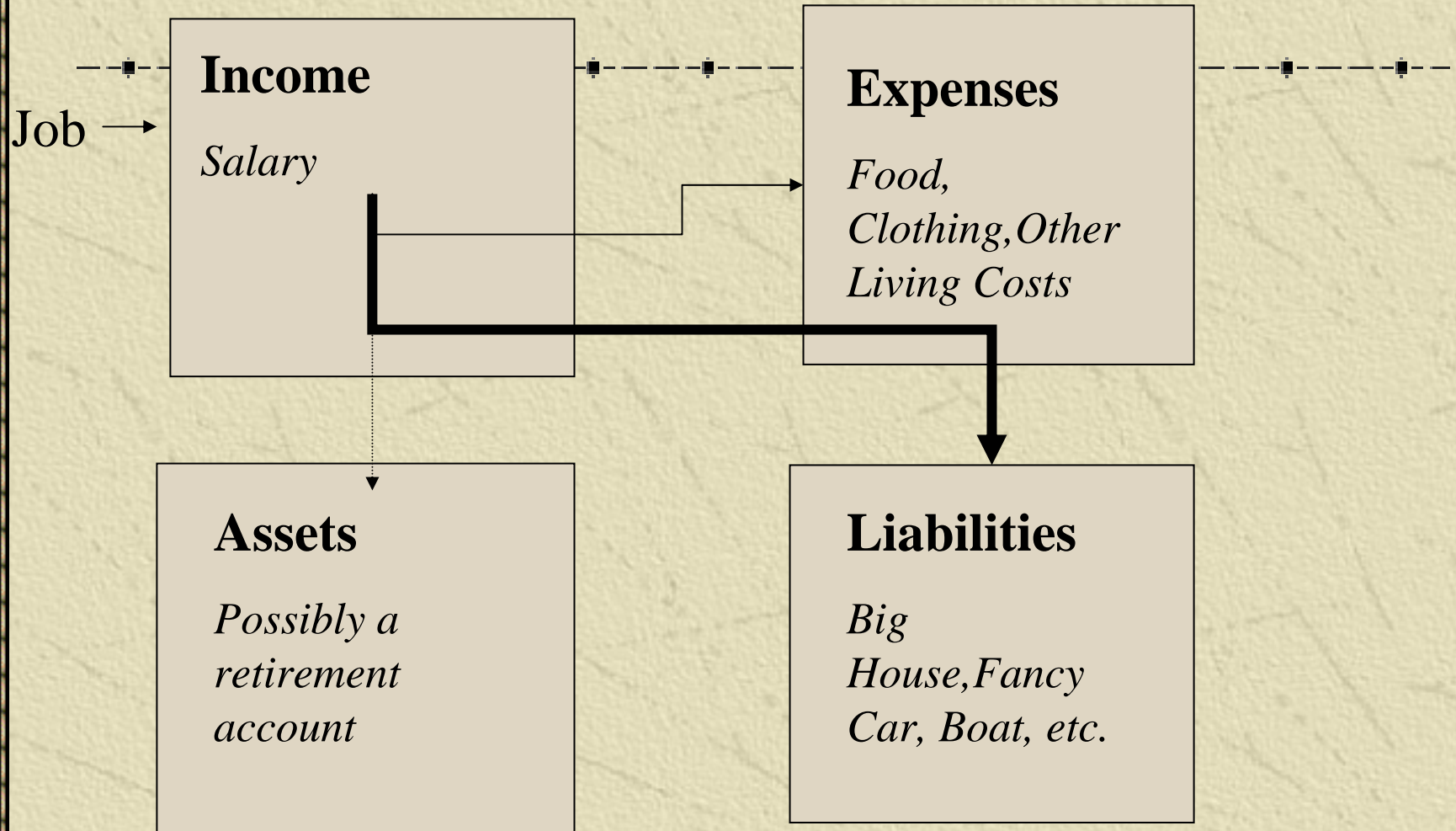
A Different Way of Thinking About Assets and Liabilities

Definition from Robert Kiyosaki, author of Rich Dad, Poor Dad:

Assets - Items that earn income

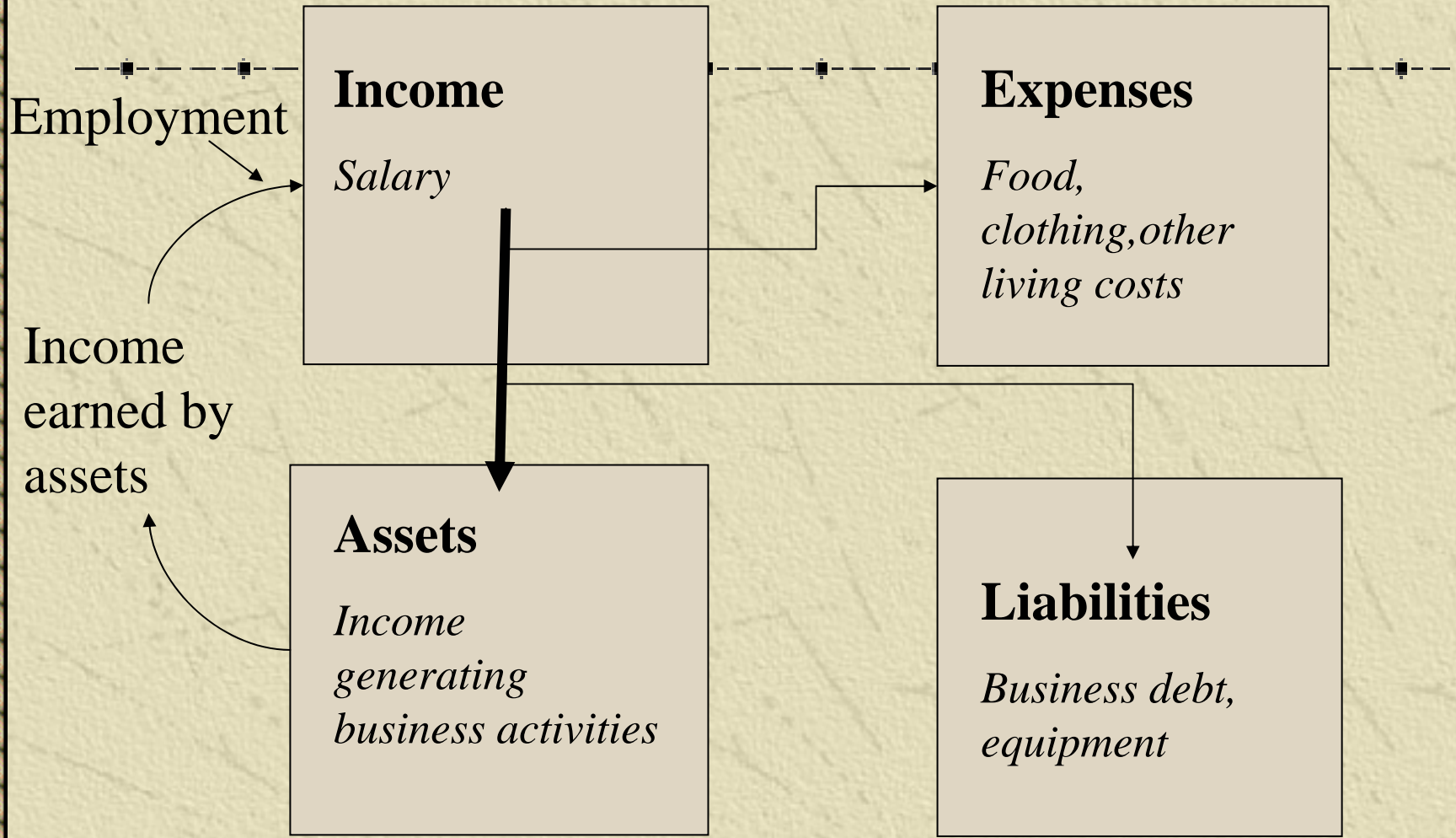
Liabilities - Items that do not earn an income

Kiyosaki's definition illustrated




Typical middle-class person with a non-farm job

Kiyosaki's definition illustrated



Business owner who is building wealth



There is nothing wrong with a farmer building wealth, as long as you are moving towards your quality of life goals!

Who are the Wealthy in the U.S.?

Seven Characteristics of Successful Wealth Builders*:

-
1. They live well below their means
 2. They allocate their time, energy, and money efficiently, in ways conducive to building wealth
 3. They believe that financial independence is more important than displaying high social status
 4. Their parents did not provide economic outpatient care
 5. Their adult children are economically self-sufficient
 6. They are proficient in targeting market opportunities
 7. They chose the right occupation

*From The Millionaire Next Door (1996) by Stanley & Danko

Who are the Wealthy in the U.S.?

More Characteristics of Millionaires (more than \$1 million net worth)*:

- 2/3 are self-employed
- Average annual taxable income is less than 7% of net worth
- 80% are first-generation wealthy
- Wear inexpensive clothes, drive older vehicles
- Most are meticulous budgeters, planners, and investors
- On average, invest 20% of taxable income each year
- Most could live on investments for ten years without working
- Wives are more frugal than husbands

*From The Millionaire Next Door (1996) by Stanley & Danko



**Many of these people didn't amass their wealth
because their goal was to get rich. They
wanted:**

- a) To work for themselves**
- b) To build a successful business**
- c) To be financially self-sufficient**

Sound familiar???