

Business Planning for a Successful Farm Start-Up



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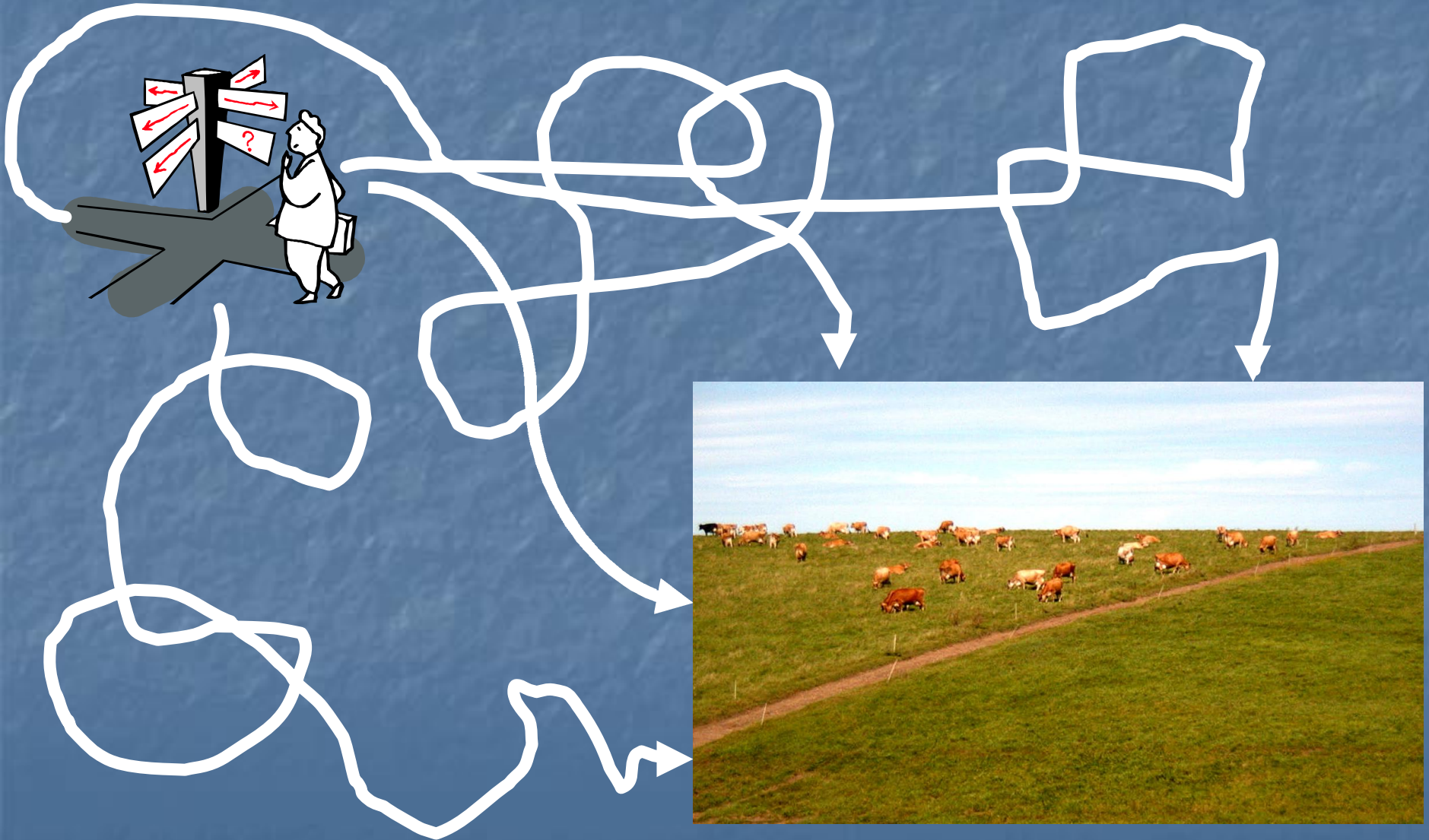
Key Point

It can be done!

Other Key Points

- It will often be difficult
- Starting point will likely be much different than ending point
- Managing risks is critical
 - Some factors increase chance of success
 - Some create a recipe for disaster
- Understanding and using financial statements will put you far ahead of the pack

The Goal



You DON'T Need_____ to Farm

- To own a farm
- Dad, brother, grandma, rich uncle
- A government grant
- A big line of machinery
- A big pile of cash in the bank
- A big pickup truck

You DO Need

- Some cash
- Some financing
 - Bank
 - Self
 - Family
- A good business plan to get the financing when you don't have the cash



You Also Need

- Openness to different ideas
- Patience
- Time to plan, analyze, re-plan
- Ability to swallow your pride occasionally
- Intestinal fortitude during tough times
- To communicate with lender and others when problems are still small

3 Common Types of Beginning Farmers

- Young with limited resources
- Second-career, part-time
- “Retirement” occupation



Most Common Starting Point

- Rent farm—buildings, land, house or combo
- Buy livestock, minimal line of machinery
- Buy supplies, feed
- Custom hire, when necessary & as much as possible
- Drive and determination > Equity

Let's cut rust and rot!



Factors That ↑ Success

- Family close by
- Good communication skills
- Frugality
- Ability to keep production expenses low
- Paying down principal asap
- Curious mind
- Good record-keeping
- Multiple sources of capital



Some Causes of Train Wrecks

- Not enough cash
- Communication breakdowns
- Vague operating agreements
- Buying toys instead of paying bills
- Equipment, buildings need more work than planned



More Causes of Train Wrecks

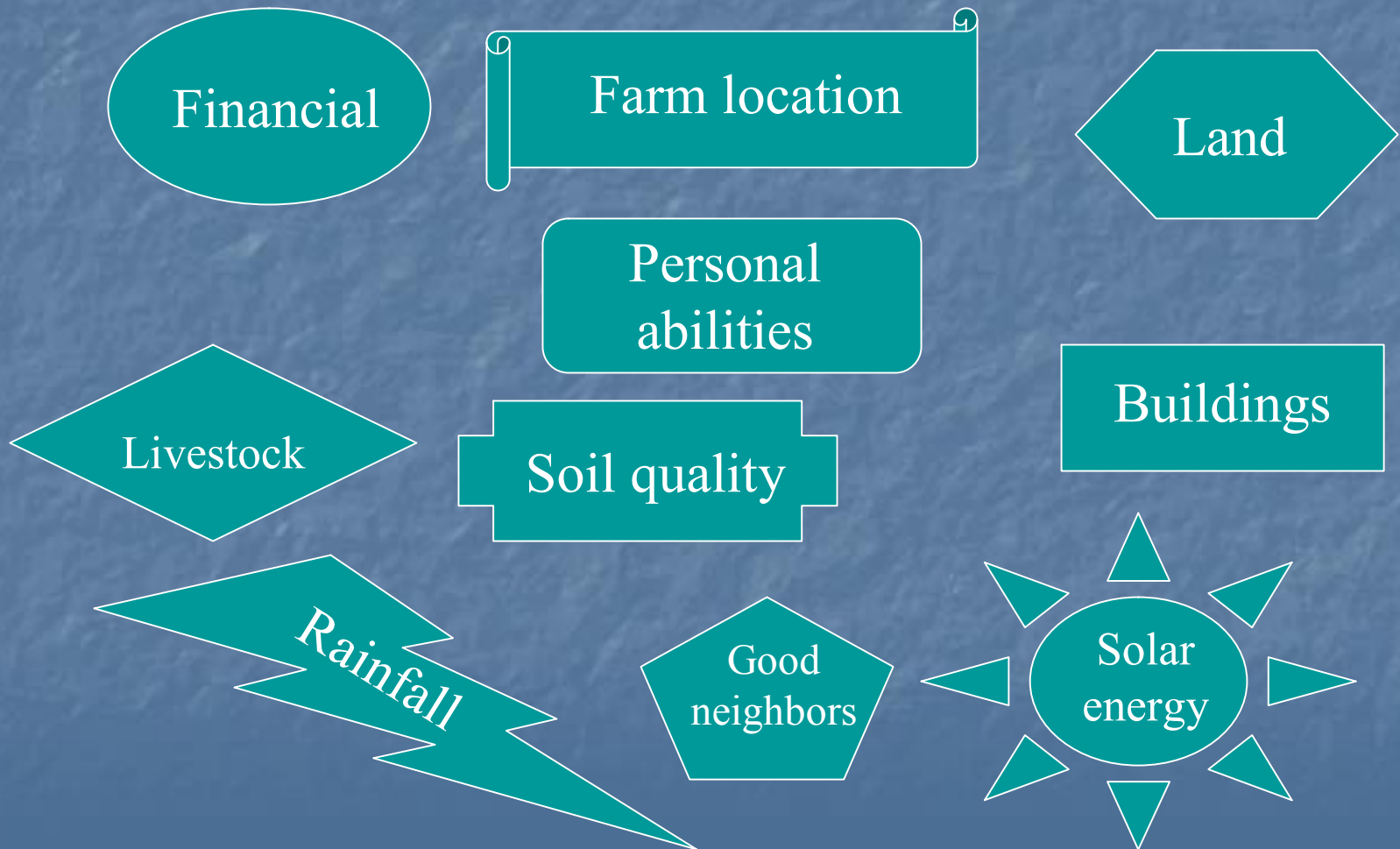
- High livestock illness/death rates
- Lower production than planned
- Sales, prices lower than planned
- Poor record-keeping
- Poor work habits—watching cartoons instead of working
- Not enough cash



Business Planning

- First, set your lifestyle goals
- Business plans need to match the type of lifestyle you want, not vice-versa
- Think broadly about the assets you can use in the farm business to move you towards your lifestyle goals

Business Planning-Lots of Assets!



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

Key Elements of Business Plan

- Who are you? Background, education, experience
- What are you planning to do? Project description, goals



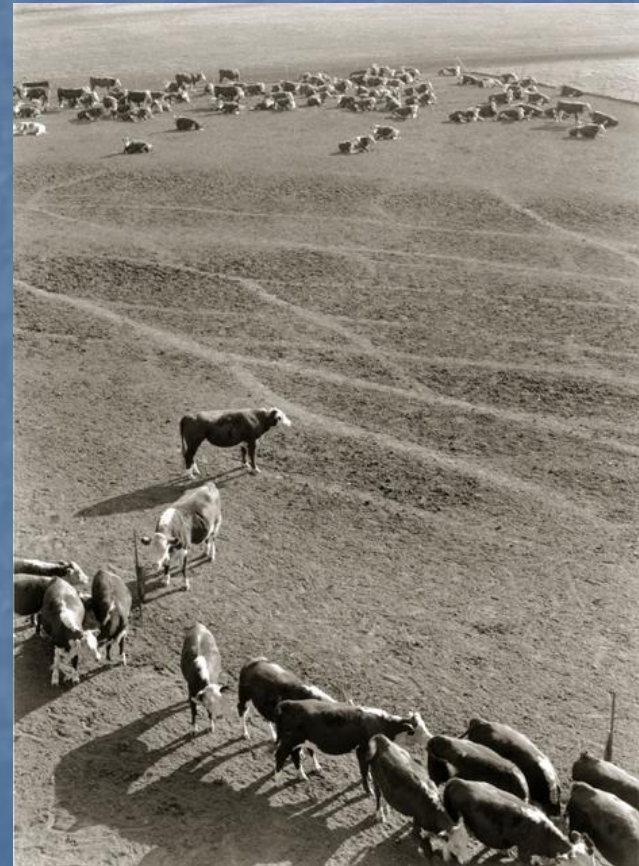
Key Elements of Business Plan

- What are the risks? Honest opinion of potential problems
- What is your track record? Historical financials
- How successful are you likely to be? Pro-forma financial statements



The banker wants to see...

- Character
- Capacity
- Capital
- Collateral
- Conditions
- You lose money before they do



Business Plan—Narrative Sections

- Executive summary. Appears first, written last
- Your farm. History, current description, vision, goals, business strategy
- The project. Detailed outline, \$ needed, how it will be used
- Management. Who you are & why you will succeed
- Critical risks. What could go wrong



Business Plan—Financial Sections

- Historical financials
 - Tax records okay, financial statements better
 - Typically three years back
- Pro forma financial statements
 - Annual projections three years ahead
 - Detailed underlying assumptions



Understanding, Using 3 Financial Statements

- Balance sheet—What the farm is worth, how it's financed
- Income statement—How effectively the farm generates profits
- Statement of cash flows—Where \$\$ come from, where they go, how many stick around

Four Measures to Consider

Liquidity

Solvency

Profitability

Repayment capacity

Balance sheet

Income statement

Statement of cash flows



The Balance Sheet

A snapshot of the investment in the farm business (**assets**) and the financing methods used (a combination of **liabilities** and **owner's equity**).



The Balance Sheet

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

Current Assets

Cash \$100

Checking \$2,000

Accounts Rec. \$500

Feed inventory \$10,000

TOTAL \$12,600

Current Liabilities

Coop bill \$1,000

Principal due \$3,162

TOTAL \$4,162

Intermediate Assets

Breeding livestock \$40,000

Machinery \$75,000

TOTAL \$115,000

Intermediate Liabilities

TOTAL \$0

Long Term Assets

Farm \$350,000

TOTAL \$350,000

Long Term Liabilities

Farm loan bal. \$246,838

TOTAL \$246,838

Total Assets \$477,600

**Total Liabilities
\$251,000**

Net worth \$226,600

Information From Balance Sheet

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



**8 more
buckets of
liquid assets!**

Common Liquidity Problems

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

High current liabilities forcing sales at unprofitable prices

Large, unplanned expenses



Common Solvency Problems

Capital investments too high relative to potential income

Assets depreciating faster than the loan balances are being paid off—Fancy vehicle syndrome



The Income Statement

One year's income and expenses, and how much revenue was retained by the business.

It's not a cash flow statement...it includes non-cash items.



The Income Statement

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.



Income

Calf sales \$28,000

Custom work \$1,000

Change in feed inventory \$2,000

GROSS FARM INCOME \$33,000

Expenses

Feed \$3,000

Vet \$2,000

Supplies \$1,000

Interest on farm loan \$15,000

RE taxes \$4,000

Misc. \$500

TOTAL CASH FARM EXPENSE \$26,250

Net CASH Farm Income \$6,500

Depreciation \$5,000

NET FARM INCOME \$1,500

Information From Income Statement

Profitability measures

- **Net farm income** –Return for your unpaid labor, management, and financial investment in the farm



Information From Income Statement

Profitability ratios

- **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

Common Profitability Problems

Operating expenses too high

Overhead costs too high

Preaching to
the choir here



Statement of Cash Flows

All cash flowing into the operation (including loan proceeds) and all cash flowing out (including family living expenses, taxes, principal and interest payments.

Anything left over is considered “capital replacement margin”

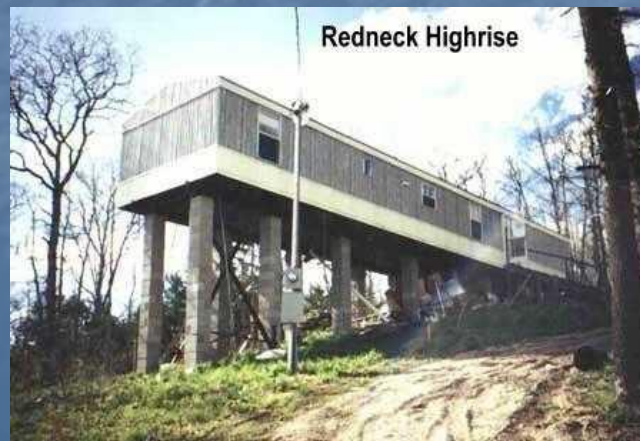


Cash Flow Statement

Net cash farm income	\$6,500
Nonfarm income	<u>\$30,000</u>
<u>Net cash available</u>	\$36,500
Family living draw	\$15,000
Income taxes & SS	<u>\$5,000</u>
Cash avail for principal paymtns	\$16,500
+ Farm interest paid	<u>\$15,000</u>
Cash available for P & I	\$31,500
Scheduled P & I payments	<u>\$18,162</u>
Cash surplus or deficit	\$13,338

Common Cash Flow Problems

- Poorly structured debt
- Too much debt relative to income
- Rarely is family living expense the problem!



Completing the Financials

- Detailed notes of assumptions used in pro formas
 - Expected changes in production level, product prices, operating expenses
 - Schedule of additional investments, borrowing
 - Other rationale used in developing projections

Completing the Financials

- The assumptions should be positive but realistic
- Assumptions establish credibility of the whole plan



Profitability and Cash Flow

- Related but very different
 - Can be profitable with negative cash flow
 - Can have strong cash flow and be unprofitable
- A number of ways to improve cash flow
- Three ways to improve profitability

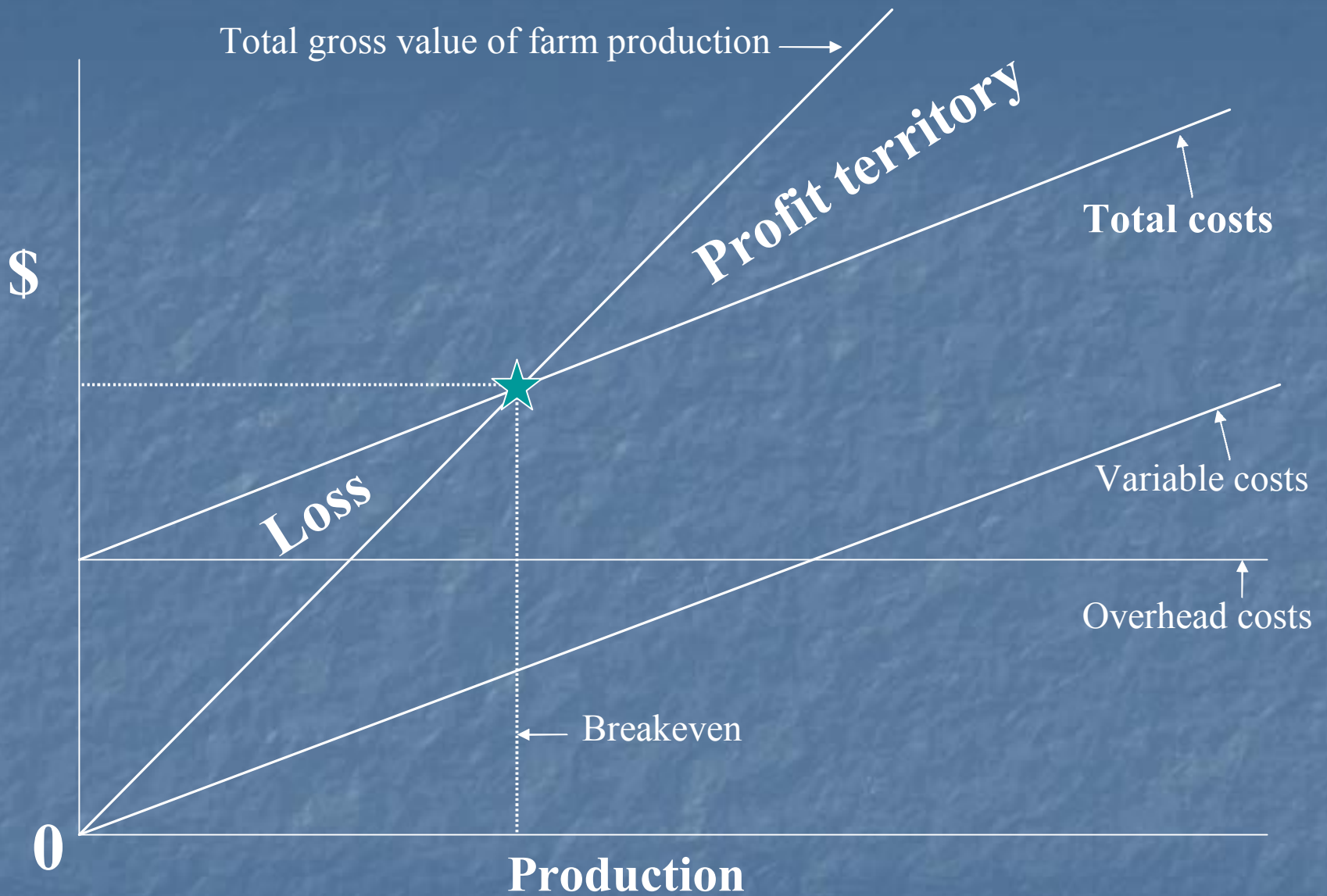
Business Planning- Costs

■ Overhead Costs

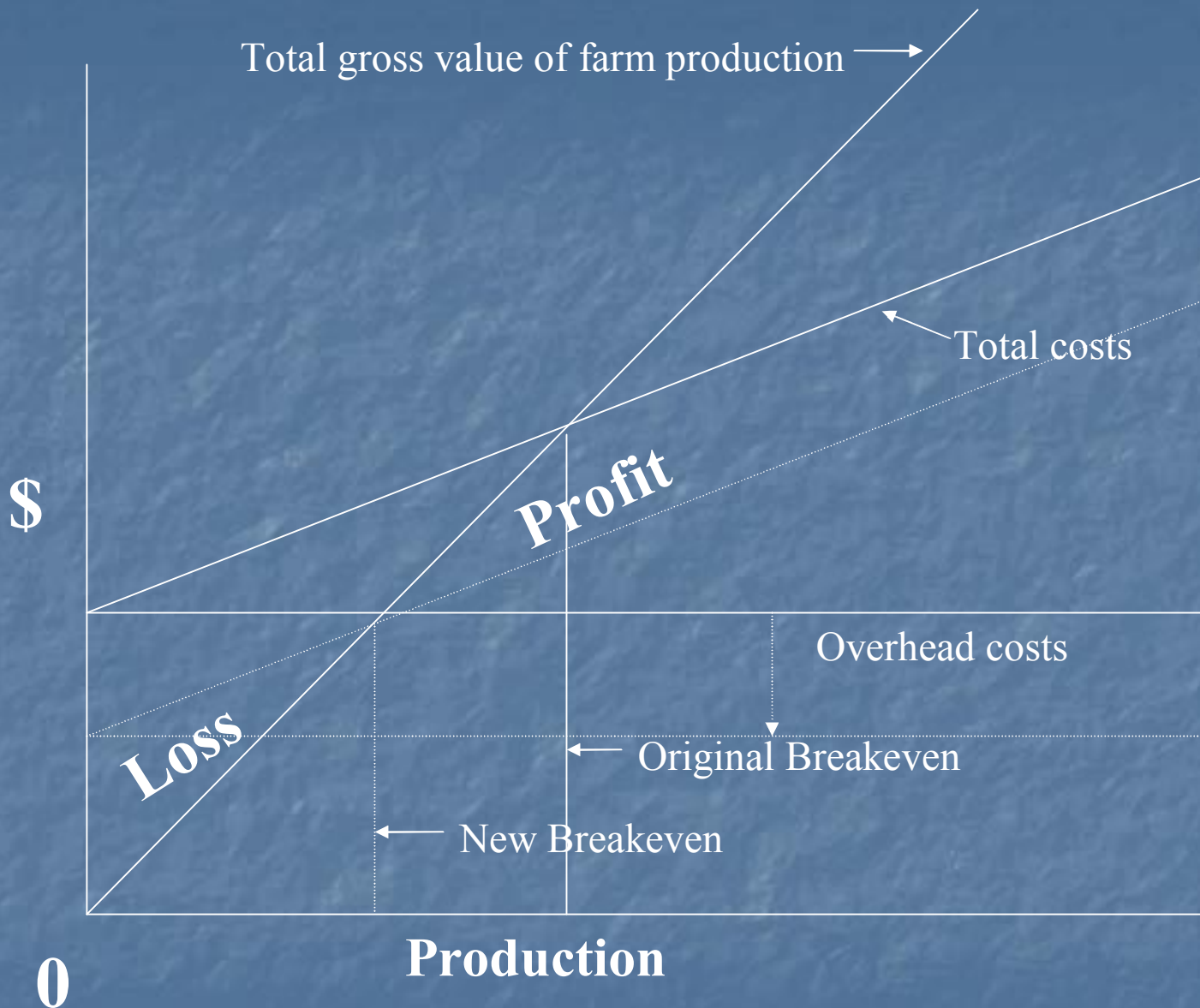
- Costs that exist on the farm whether or not anything is being produced
- Can include mortgage, taxes, depreciation, maybe labor

■ Variable Costs

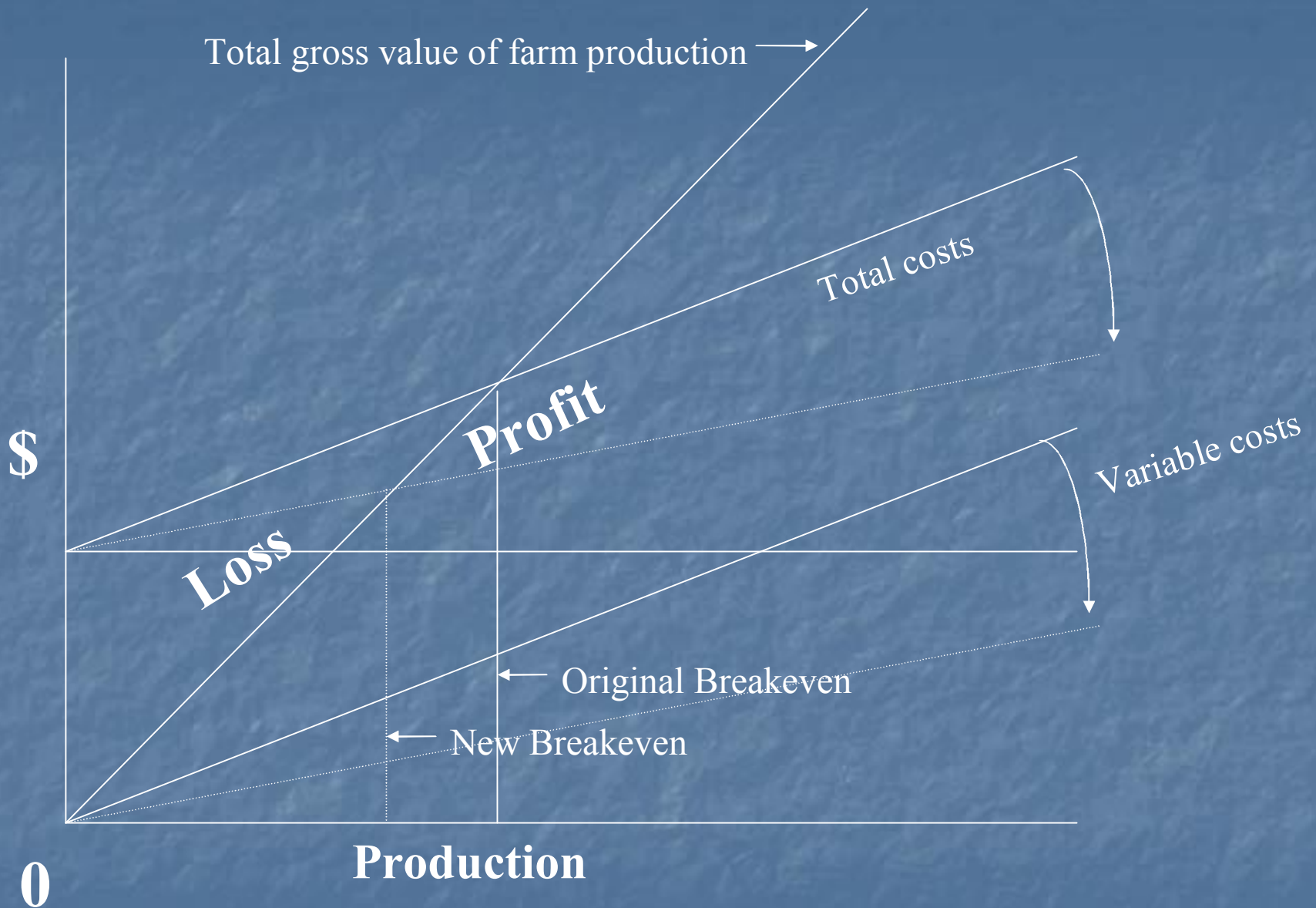
- Costs that increase as farm production increases
- Can includes seed, plants, feed, fertilizer, vet expenses, utilities, labor



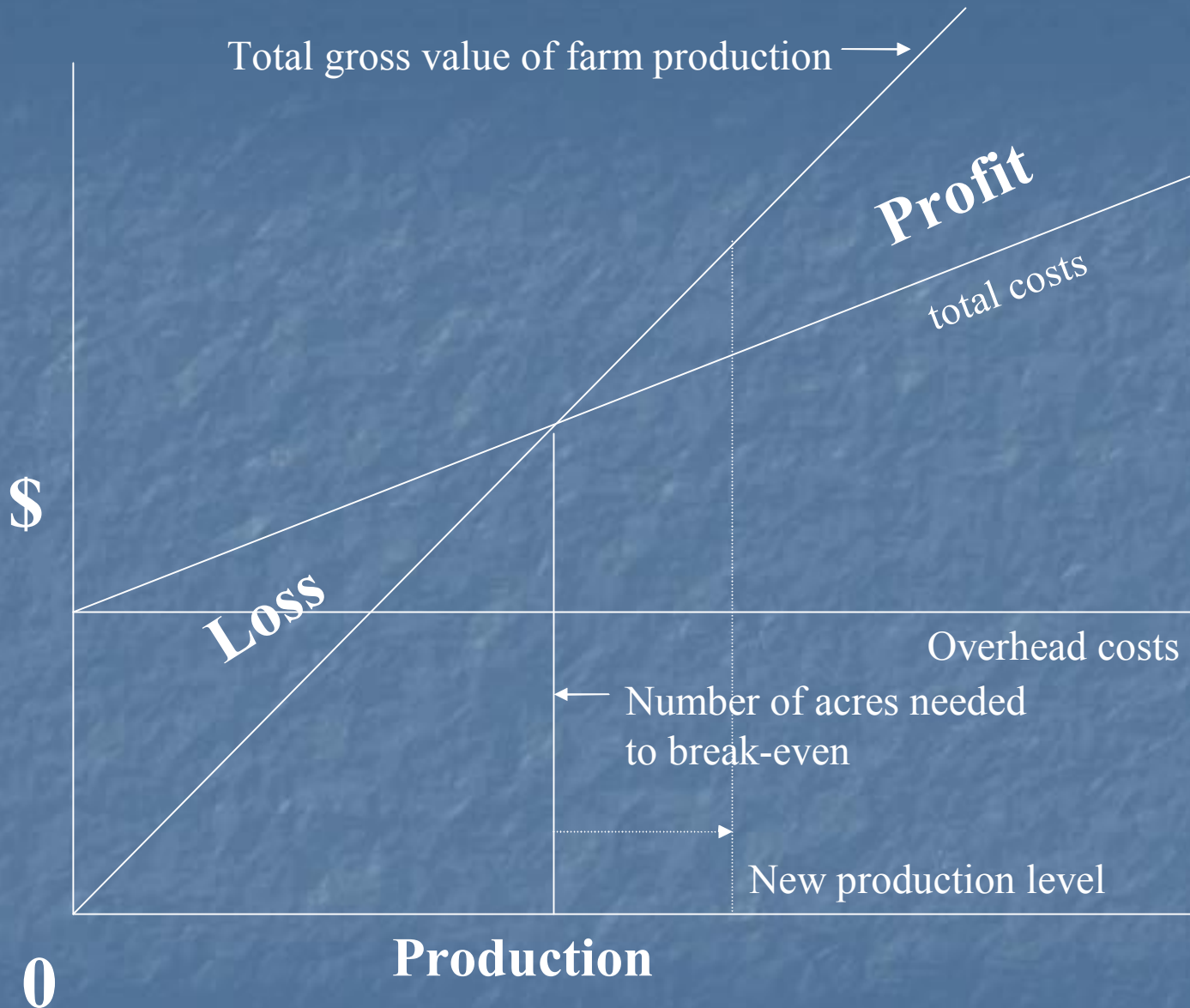
How overhead and variable costs relate to breakeven point



One way to increase profitability: Reduce overhead costs



A second way to increase profitability: Reduce variable costs



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

Re-thinking 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

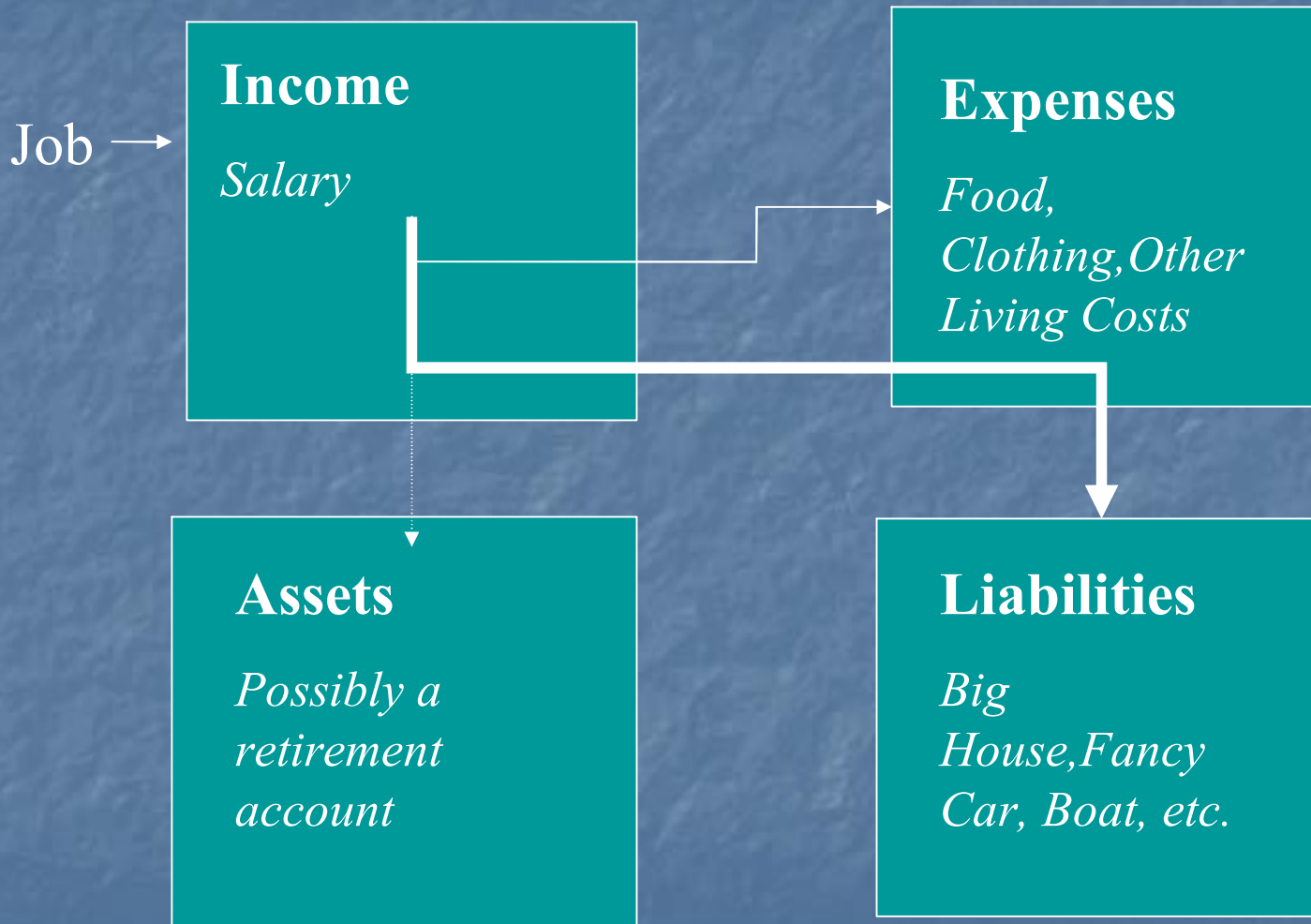
An Alternative Way of Thinking About Assets and Liabilities

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

Assets – Items that earn income

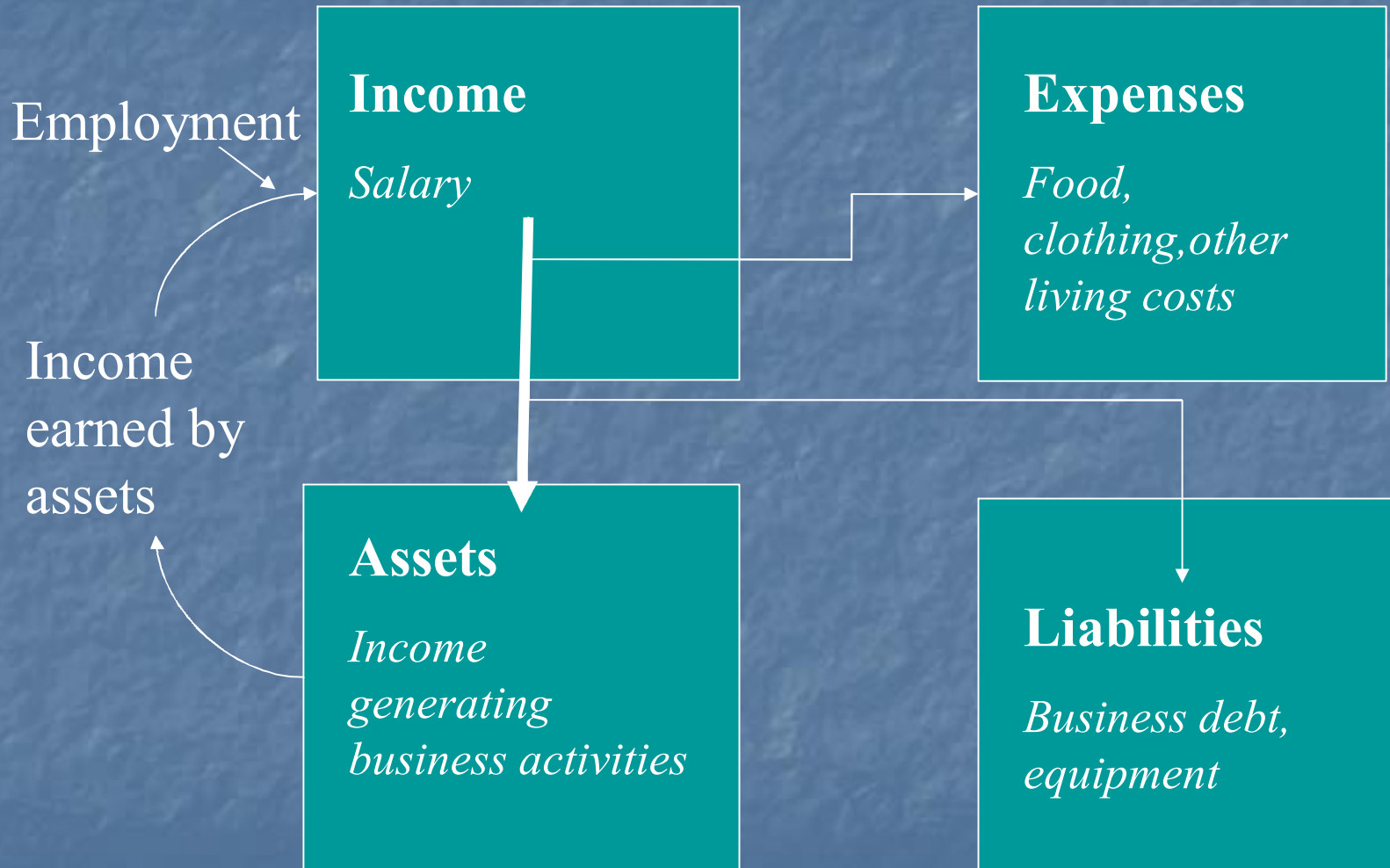
Liabilities – Items that do not earn an income

Kiyosaki's definition illustrated



Typical middle-class person with a non-farm job

Kiyosaki's definition illustrated



Business owner who is building wealth

Some Bottom Lines

- A good business will generate increasing levels of profitability and cash flow going forward
 - Profitability without cash flow is recipe for disaster
 - Cash flow without profitability is a terminal condition
- Doesn't make sense to borrow at 7% to earn 6%
- If a bank won't invest based on your business plan, maybe you shouldn't either

Thank You!

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