



Developing a Business Plan to Take to Your Banker

Paul Dietmann, Sauk Co. UW-Extension Agricultural Agent

Kevin Falk, Columbia County Dairy Grazier

January, 2006

Columbia-Dodge Grazing Network Winter Meeting

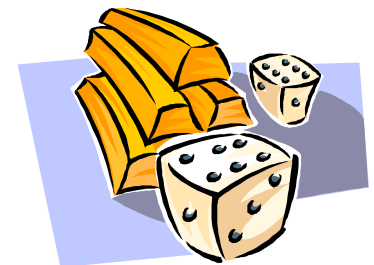
Key Elements of Business Plan

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



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 are better
- Typically three years back

⚡ Pro forma financial statements

- Annual projections three years ahead
- Detailed underlying assumptions





Three 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 Things the Bank Considers

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**) 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

Information From Balance Sheet

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





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

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

One year's income and expenses, and how much 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.



Information From Income Statement

Profitability measures

- **Net farm income** – 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

Common Profitability Problems

Feed costs 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”

Common Cash Flow Problems

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





Profitability and Cash Flow

✦ Related but very different

- Can be profitable with negative cash flow
- Can have strong cash flow and be unprofitable



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



Other Suggestions

- ✦ Use variety of funding sources
 - Milk Volume Production (MVP) loans
 - Dairy Technology grants
 - Utility company programs
 - FSA guarantee or direct loans
 - Possibly Agrability?
- ✦ Banks appreciate added leverage

● More Thoughts About Business Planning





Increasing Profitability

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

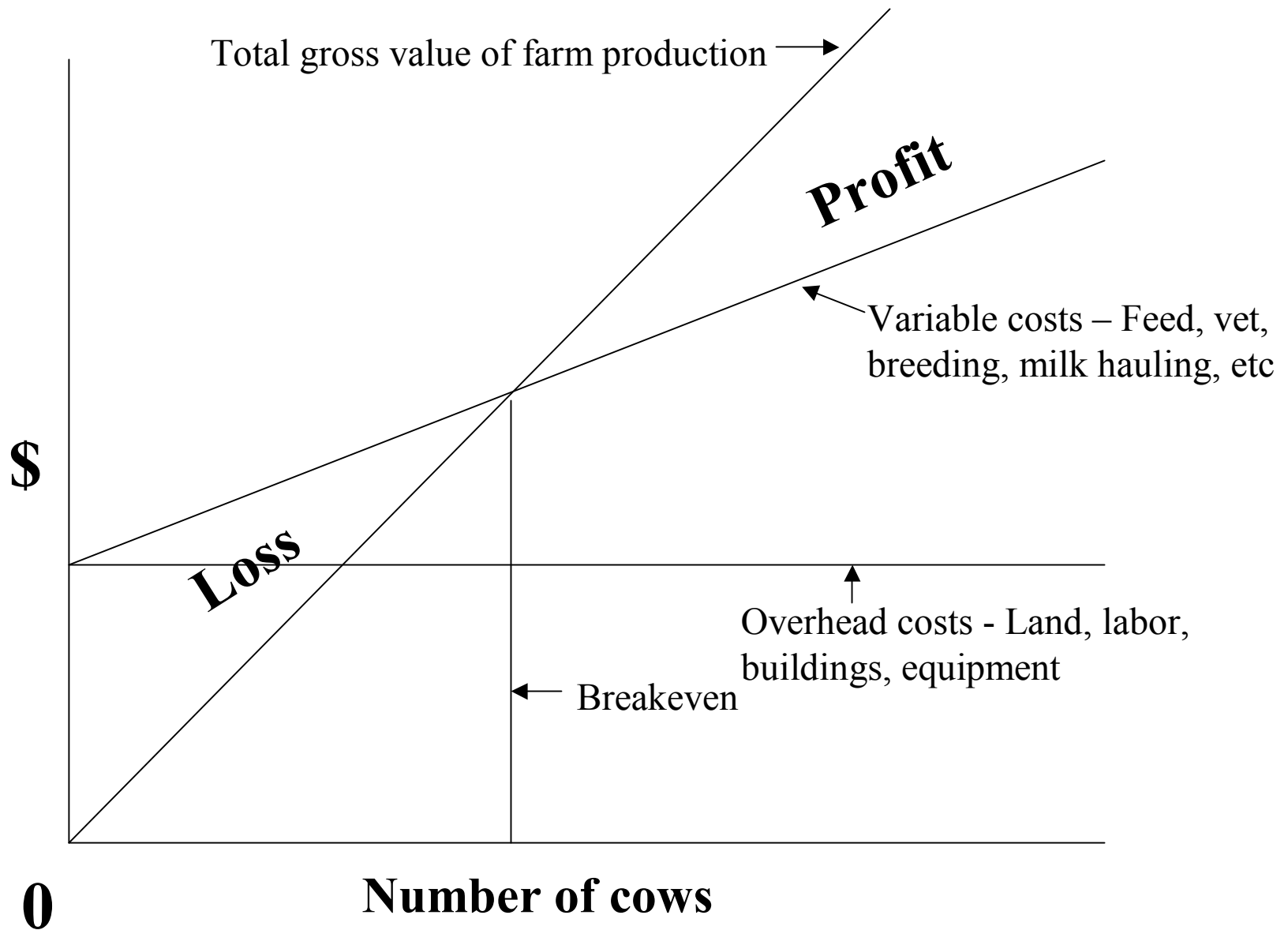
Business Planning- Costs

Overhead Costs

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

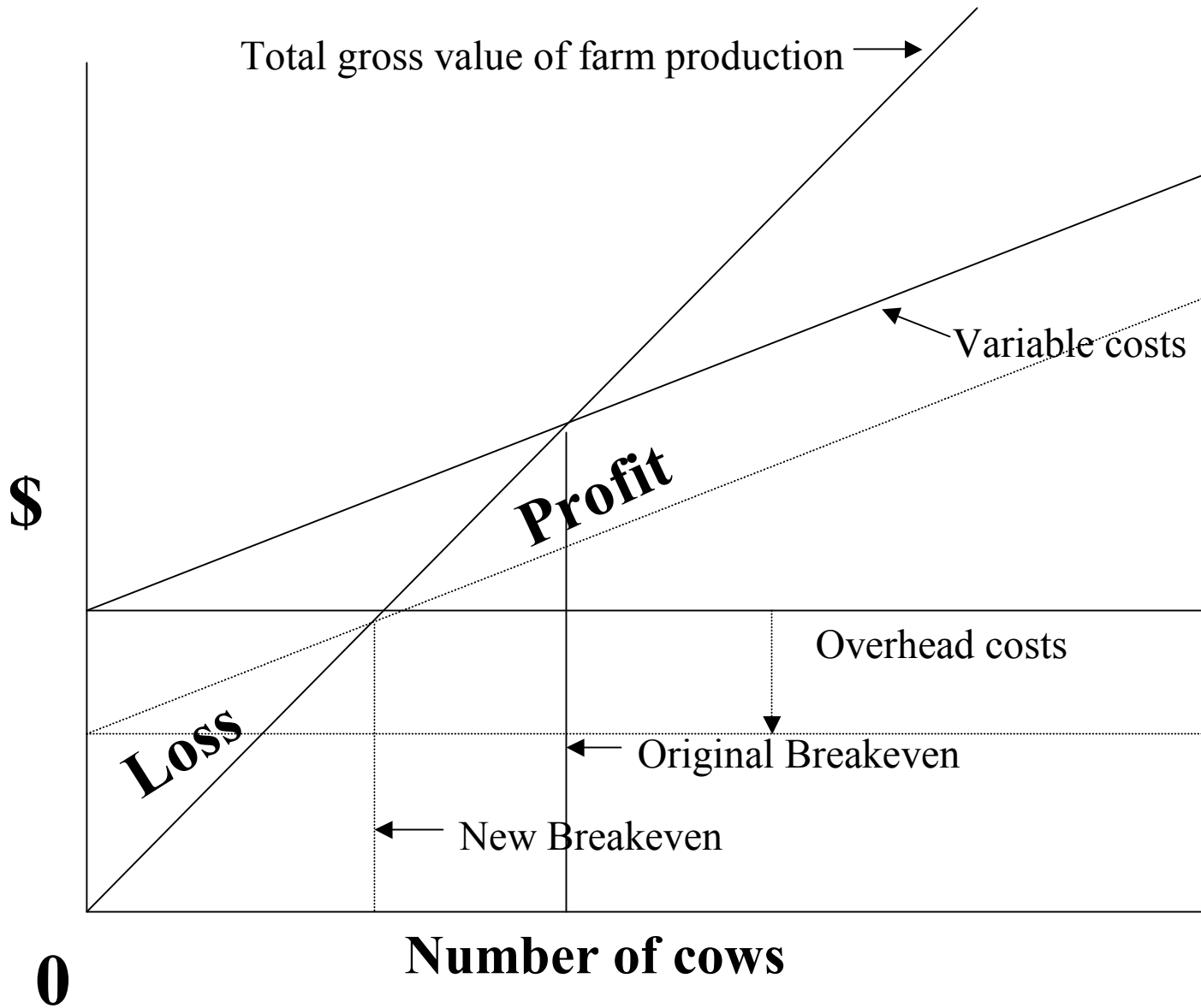
Variable Costs

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

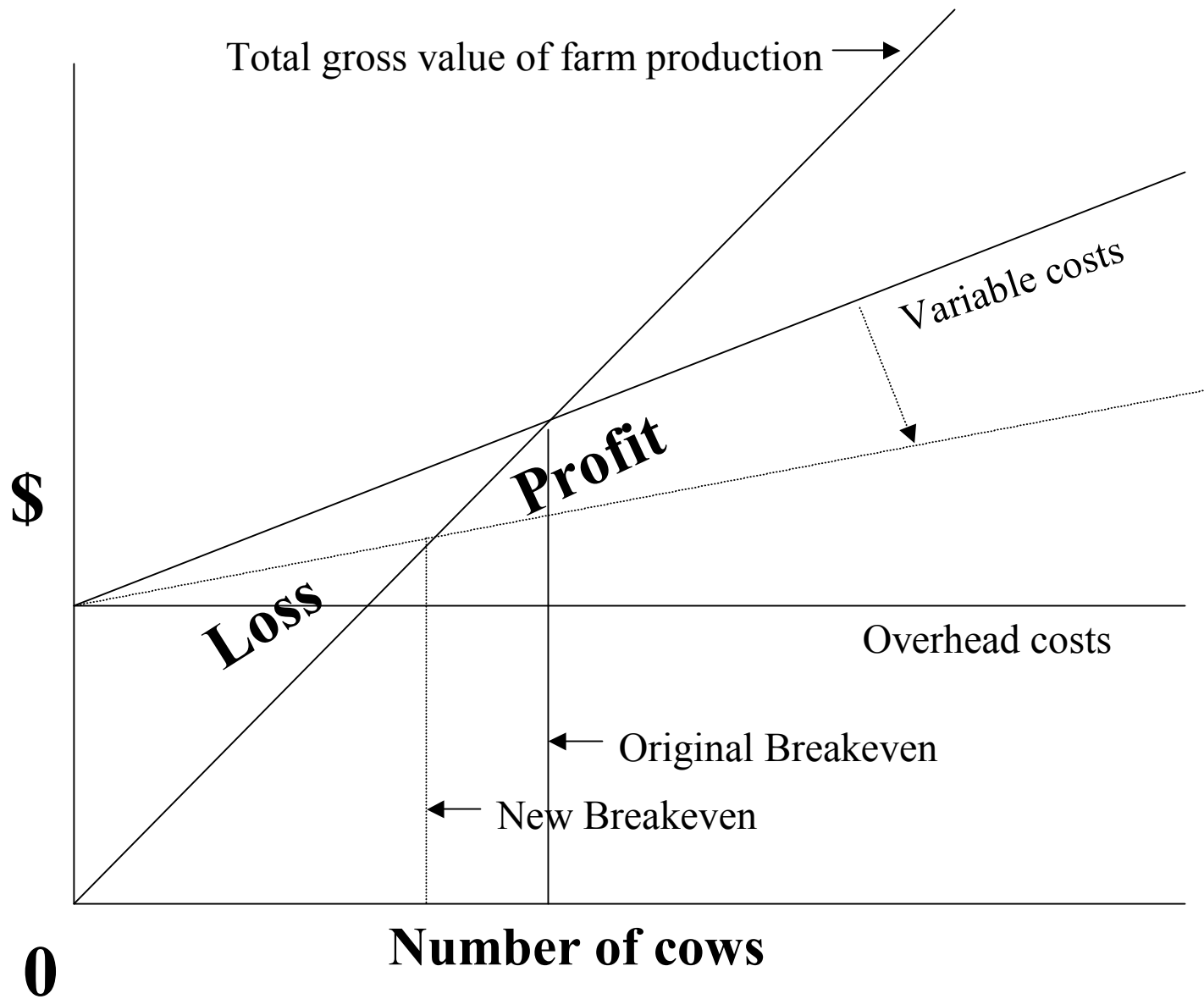


How overhead and variable costs relate to profit on dairy farms

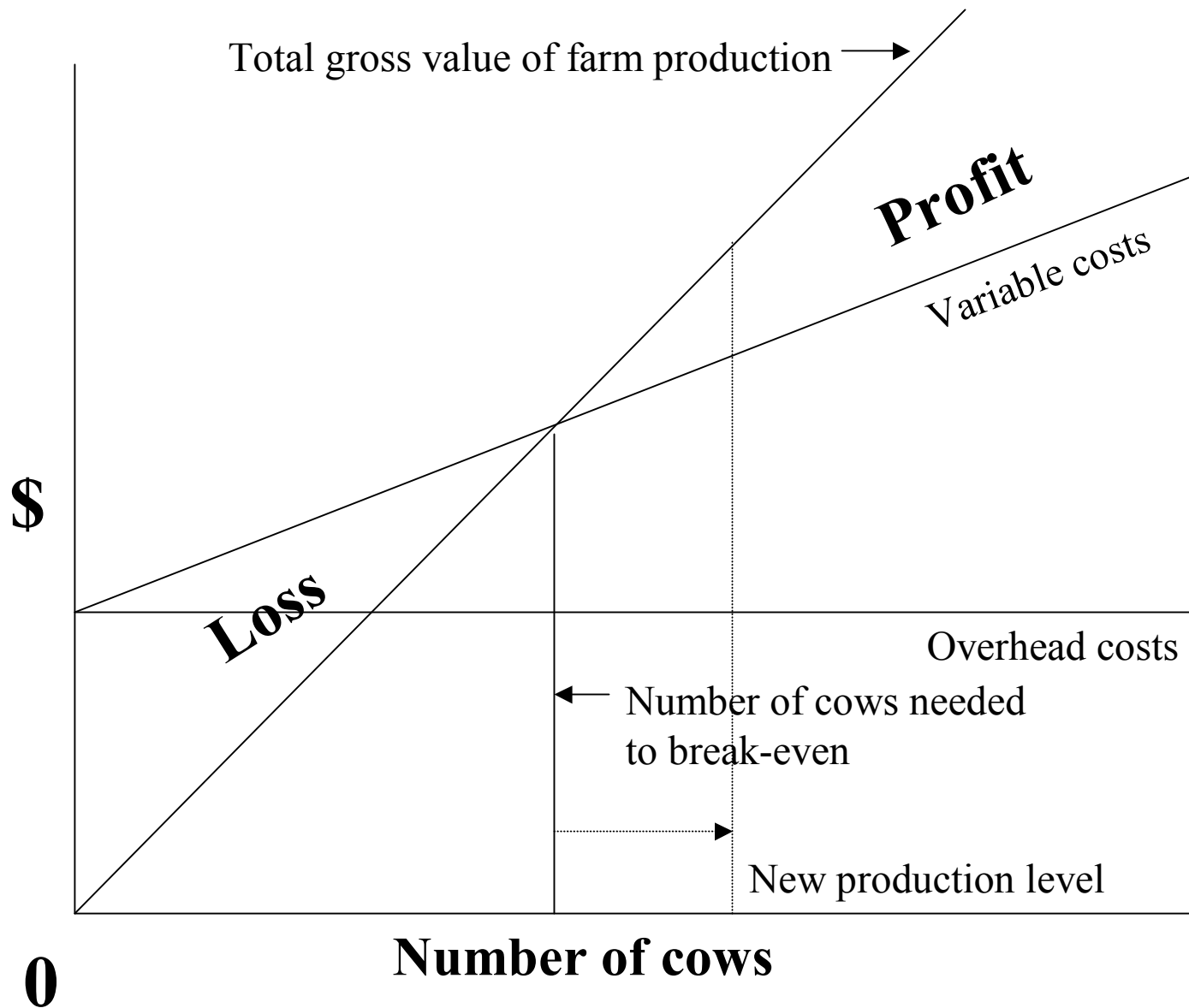
Adapted from the work of Dave Pratt, Ranch Management Consultants, Inc.



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

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