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PLANNING FOR YOUR AGRIPRENEURSHIP BUSINESS

Creating a basic business plan: Understanding your financials

Introduction:

Welcome to How to Write Your Business Plan 101!
As agricultural entrepreneurs, or "agripreneurs," continue to develop and operate their business differently from the more conventional farming models, business planning becomes even more essential to achieving business sustainability.

Today's hour long workshop will cover the basic outline of what goes into a business plan, and focus specifically on creating the financial sections of the business plan.
The three essential statements are:

- INCOME STATEMENT
- BALANCE SHEET
- CASH FLOW STATEMENT

The examples shown are from Persing Woods, LLC, and have been created using a simple excel program. For more detailed explanations and assistance, please reach out to us at Persing Woods.

Why create a business plan?

Business planning is an important part of owning and managing a farm.
Producers traditionally go through the business planning process to:

- Evaluate production potential and alternatives
- Identify new market opportunities
- Communicate their ideas to lenders, business partners and family members

A business plan helps to demonstrate that the agripreneur has:

- Fully researched their proposed alternative
- Know how to produce their product
- Know how to sell what they produce
- Know how to manage financial risk

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What goes into a business plan?

Example of a Table of Contents: From PERSING WOODS, LLC

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FINANCIAL STATEMENTS

Three basic statements can help to manage the financial health of your business.
Five year projections are standard.
The business plan, especially the financial statements section, is always a work in progress.
Yearly, even quarterly reviews and revisions should be performed.

The basic descriptions of the three financial statements are as follows:

- An income statement shows the profitability or loss of doing business
- The balance sheet determines the value of your business at a point in time (your assets minus your liabilities to determine your net worth)
- Cash is the lifeline of any business. A simple cash flow statement can help track your cash receipts (money coming in) and your cash disbursements (money going out)

Creating an excel worksheet of your financial statements may be tedious at first, but the continued maintenance and updates are quick and simple.

Some of the tabs that can be used to record details are:
Assumptions - includes the price of the products as well as cost of the products
Revenue & Cost Build Up – works to itemize the product sales and cost of goods sold to be summed into the Income Statement
Depreciation Expense – itemizes assets to be included into the depreciation line of the Income Statement
Members Equity Contribution – itemizes specific contribution amounts to be summed into the Balance Sheet

SAMPLES of FINANCIAL STATEMENTS from PERSING WOODS, LLC:

INCOME STATEMENT

Income Statement

	2011				2012			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Revenues	$1,271	$2,268	$2,787	$1,248	$2,862	$3,881	$5,833	$3,195
Cost of Goods Sold	(34)	(58)	(1,523)	(1,484)	(73)	(97)	(3,886)	(3,820)
Gross Margin	**1,237**	**2,210**	**1,264**	**(235)**	**2,789**	**3,783**	**1,947**	**(624)**
Selling & General Administrative Expenses								
Utilities	(155)	(155)	(155)	(155)	(159)	(159)	(159)	(159)
Salaries & Other Labor Expenses	0	0	0	0	0	0	0	0
Repairs, Feed, & Maintenance Expenses	(380)	(780)	(917)	(910)	(1,000)	(1,200)	(1,227)	(1,227)
Property & Other Non-Income Taxes	0	0	0	0	0	0	0	0
Legal & Accounting Expenses	0	0	0	(1,545)	0	0	0	(1,591)
Administrative Expenses	(155)	(155)	(155)	(155)	(159)	(159)	(159)	(159)
Filing Fees	0	0	0	0	0	0	0	0
Fuel and Other Expenses	(618)	(618)	(618)	(618)	(637)	(637)	(637)	(637)
EBITDA	**(70)**	**503**	**(580)**	**(3,618)**	**834**	**1,628**	**(234)**	**(4,397)**
Depreciation	(2,248)	(2,248)	(2,248)	(2,248)	(2,336)	(2,336)	(2,336)	(2,336)
EBIT	**(2,318)**	**(1,745)**	**(2,828)**	**(5,866)**	**(1,501)**	**(707)**	**(2,570)**	**(6,733)**
Interest Income	0	0	0	0	0	0	4	7
Net Earnings	**($2,318)**	**($1,745)**	**($2,828)**	**($5,866)**	**($1,501)**	**($707)**	**($2,566)**	**($6,726)**

BALANCE SHEET STATEMENT

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Balance Sheet

	2011				2012			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Assets:								
Cash	$0	$0	$0	$0	$0	$1,671	$2,714	$0
Accounts Receivable	773	748	6	(0)	1,322	1,279	6	(0)
Inventory	67	1,551	1,531	68	80	3,900	3,867	82
Property, Plant, & Equipment								
Equipment & Fixtures	70,533	85,533	165,533	165,533	165,533	165,533	165,533	165,533
Livestock & Bees	1,575	1,606	1,606	1,606	1,606	1,606	1,606	1,606
Land	0	0	0	0	0	0	0	0
Accumulated Depreciation	(12,691)	(14,939)	(17,188)	(19,436)	(21,771)	(24,107)	(26,443)	(28,778)
Total Assets:	**$60,255**	**$74,497**	**$151,488**	**$147,771**	**$146,769**	**$149,882**	**$147,283**	**$138,442**
Liabilities & Members' Equity								
Accounts Payable	$19	$1,503	$1,484	$20	$32	$3,852	$3,820	$34
Revolver Debt	0	0	0	0	0	0	0	0
Members' Equity	60,236	72,994	150,005	147,750	146,736	146,029	143,463	138,408
Total Liabilities & Members' Equity	**$60,255**	**$74,497**	**$151,488**	**$147,771**	**$146,769**	**$149,882**	**$147,283**	**$138,442**

CASH FLOW STATEMENT

Cash Flow Statement

	2011				2012			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Cash Receipts								
Sales Receivables	$499	$2,293	$3,529	$1,255	$1,540	$3,923	$7,106	$3,202
Interest Income	0	0	0	0	0	0	4	7
Cash Infusion from Members	842	14,503	79,839	3,612	487	0	0	1,670
Total Cash Receipts	**$1,341**	**$16,795**	**$83,367**	**$4,866**	**$2,028**	**$3,923**	**$7,110**	**$4,879**
Cash Disbursements								
Cost of Goods Sold	($34)	($58)	($1,523)	($1,484)	($73)	($97)	($3,886)	($3,820)
Selling & General Administrative Expenses								
Utilities	(155)	(155)	(155)	(155)	(159)	(159)	(159)	(159)
Salaries & Other Labor Expenses	0	0	0	0	0	0	0	0
Repairs, Feed, & Maintenance Expenses	(380)	(780)	(917)	(910)	(1,000)	(1,200)	(1,227)	(1,227)
Property & Other Non-Income Taxes	0	0	0	0	0	0	0	0
Legal & Accounting Expenses	0	0	0	(1,545)	0	0	0	(1,591)
Administrative Expenses	(155)	(155)	(155)	(155)	(159)	(159)	(159)	(159)
Filing Fees	0	0	0	0	0	0	0	0
Fuel and Other Expenses	(618)	(618)	(618)	(618)	(637)	(637)	(637)	(637)
Capital Expenditures								
Purchase of Equipment & Fixtures	0	(15,000)	(80,000)	0	0	0	0	0
Purchase of Livestock	0	(31)	0	0	0	0	0	0
Purchase of Land	0	0	0	0	0	0	0	0
Debt								
Financing Fees	0	0	0	0	0	0	0	0
Distributions to Members	0	0	0	0	0	0	0	0
Total Cash Disbursements	**($1,341)**	**($16,795)**	**($83,367)**	**($4,866)**	**($2,028)**	**($2,252)**	**($6,067)**	**($7,593)**

GLOSSARY

The following glossary is a partial listing of terms used in the business plan document. Definitions for the glossary terms were drawn from a number of sources including the *USDA 2000 Fact Book*.

Account receivable: a current asset representing money due for services performed or merchandise sold on credit.
Accrual accounting: revenue and expenses are recorded in the period in which they are earned or incurred regardless of whether cash is received or disbursed in that period. This is the accounting basis that is generally required to be used to conform with generally accepted accounting principles (GAAP) in preparing financial statements for external users.
Asset: anything owned by an individual or a business that has commercial or exchange value.
Balance sheet: an itemized list of assets and liabilities for the business to portray its net worth at a given moment in time—usually at the beginning of each year.
Break-even point: the volume point at which revenues and costs are equal; a combination of sales and costs that will yield a no profit/no loss operation.
Common stock: the most frequently issued class of stock; usually it provides a voting right but is secondary to preferred stock in dividend and liquidation rights.
Corporation: a separate legal entity that is owned by one or more shareholders.
Cost of goods sold (COGS): refers to the inventory costs of those goods a business has sold during a particular period. Costs of goods made by the business include material, labor, and allocated overhead.
Current assets: the cash and other assets that will be received, converted to cash, or consumed in production during the next 12 months. This generally includes cash and checking balances, crops held for sale or feed, livestock held for sale, prepaid expenses and supplies, the value of growing crops, accounts receivable, hedging account balances, and any other assets that can quickly be turned into cash.
Current liabilities: debts due and payable within one year from the date of the balance sheet. In addition to short term operating loans, this usually includes accounts payable, accrued interest and other accrued expenses, and government crop loans.
Depreciation: prorating the cost of a depreciable asset over its projected economic life to account for any decline in the asset's production value over time.
Earned net worth change: represents income that either contributed to or depleted the farm's net worth.
Equity: represents ownership or percentage of ownership in a business or items of value.
Expenses: daily costs incurred in running and maintaining a business.
Farm: As of 1997, the USDA defines a farm as any place from which $1,000 or more of agricultural products were

Net worth: the financial claim by owners on the total assets of a business, calculated as total assets minus total liabilities. Also called equity capital and owner's equity.
Operating expenses: the outlays incurred or paid by a business for all inputs purchased or hired that are used up in production during the accounting period.
Operating loan: a short-term loan (less than one year) to finance crop production, livestock production, inventories, accounts receivable, and other operating or short-term liquidity needs of a business.
Operations structure: pertains to the competitiveness, size, organization, production and resource management of the farm business.
Principal amount: the face-value of a loan that must be repaid at maturity, separate from interest.
Profitability: the relative profit performance of a business, enterprise, or other operating unit. Profitability comparisons occur over time, across peer groups, relative to projections, and relative to norms or standards.
Proprietorship: an unincorporated business owned and operated by a single individual.
Rate of return on assets (ROA): the profitability measure representing the rate-of-return on business assets during an accounting period. ROA is calculated by dividing the dollar return to assets during the accounting period by the value of assets at the beginning of the period or the average value of assets over the period.
Rate of return on equity (ROE): the profitability measure representing the rate-of-return on the equity capital that owners have invested in a business. ROE is calculated by dividing the dollar return to equity capital during an accounting period by the value of equity capital at the beginning of the period or the average value of equity capital over the period.
Partnership: an association of two or more persons to carry on, as co-owners, a business for profit.
Repayment ability: the anticipated ability of a borrower to generate sufficient cash to repay a loan plus interest according to the terms established in the loan contract.
Retailer: a business intermediary, such as a grocery store, that may provide storage, logistical support, and advertising.
Retained earnings: the portion of net income that is retained within a business and added to net worth.
S-Corporation: a type of corporation in which the owner holds 100 percent of the shares.
Sole proprietorship: a business that is owned and controlled by one individual.
Solvency: the business condition of financial viability in

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produced and sold, or normally would have been sold during the year.
Financial feasibility: the ability of a business plan or investment to satisfy the financing terms and performance criteria agreed to by a borrower and a lender.
Financial risk: the risk associated with the use of borrowing and leasing; uncertainties about the ability to meet financial obligations.
Fiscal year: an accounting period of 12 months.
Fixed costs: operating expenses that generally do not vary with business volume. Examples include rent, property taxes, and interest expense.
General partnership: one or more partners are jointly responsible or liable for the debts of the partnership.
Growth potential: the increased amount of money, expansion, activity and other developments that are likely for a business based on product marketing, management skill, industry growth and other factors.
Intermediate assets: assets with a useful life of ten years or less, such as breeding livestock, machinery and equipment.
Intermediate liabilities: intermediate (five to seven years) debt obligations for loans on equipment, machinery, and breeding livestock.
Liability: a loan, expense or any other form of claim on the assets of a business that must be paid or otherwise honored by the business.
Liquidity: a business' ability to meet current obligations with cash or other assets that can be quickly converted to cash.
Long-term assets: assets with a useful life of more than ten years, such as farm land and buildings.
Long-term liabilities: long-term (eight years or more) debt obligations for buildings and equipment.
Net farm income: represents the returns to labor, management and equity capital invested in the business; what the farm will contribute to net worth growth over time.

which net worth is positive; value of total assets exceeds debts
Statement of cash flows: a financial statement presenting the cash receipts and cash payments over a specified period of time. The cash receipts and payments are separated into operating, investing, and financing activities.
Wholesaler: a business intermediary who either buys products or takes possession and acts as a commission merchant.

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Farm Financial Standards

The following calculations and descriptions were adapted from the 2000 Farm Business Management Report for Central and West Central Minnesota

Liquidity

Current Ratio: Calculated as (total current farm assets) / (total current farm liabilities). This measure of liquidity reflects the extent to which current farm assets, if sold tomorrow, would pay off current farm liabilities.
Working Capital: Calculated as (total current farm assets) – (total current farm liabilities). This measure represents the short-term operating capital available from within the business.

Solvency

Debt-to-Asset Ratio: Calculated as (total farm liabilities) / (total farm assets). This represents the bank's share of your business. A higher ratio is an indicator of greater financial risk and lower borrowing capacity.
Equity-to-Asset Ratio: Calculated as (farm net worth) / (total farm assets). This measure of solvency compares farm equity to total farm assets.
Debt-to-Equity Ratio: Calculated as (total farm liabilities) / (farm net worth). This measure compares the bank's ownership to your ownership of the business.

Profitability

Rate of Return on Assets: Calculated as [(net farm income) + (farm interest) – (value of operator labor and management)] / (average value of farm assets). This measure represents the average "interest" rate being earned on all investments in the business (your investment and that of your creditors).
Rate of Return on Equity: Calculated as [(net farm income) – (value of operator labor and management)] / (average farm net worth). This measure represents the "interest" rate being earned by your investment in the farm. This return can be compared to the return on your investments if equity were invested somewhere else, outside the business.
Operating Profit Margin: Calculated as (return on farm assets) / (value of farm production), where return on farm assets equals (net farm income from operation) + (farm interest expense) – (opportunity return to labor and management). This measure of profitability shows the operating efficiency of the business. Low expenses relative to the value of farm production result in a healthy operating profit margin.
Net Farm Income: Calculated as (gross cash farm revenue) – (total cash farm expense) + (inventory changes) + (depreciation and other capital adjustments, including gains/losses from the sale of capital assets). This measure represents profitability or the farm's return to labor, management and equity.

Repayment capacity

Term Debt Coverage Ratio: Calculated as [(net farm operating income) + (net nonfarm income) + (depreciation) + (scheduled interest on term debt and capital leases) – (family

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living and taxes paid)] / (scheduled principal and interest payments on term debt and capital leases). This measure of repayment capacity tells whether the business produced enough cash to cover all intermediate and long-term debt payments.
Capital Replacement Margin: Calculated as the value of (net farm income) + (net nonfarm income) + depreciation – (family living expenses, taxes paid, scheduled payments on term debt). This measure describes the amount of money left over after all operating expenses, taxes, family living costs, and scheduled debt payments have been made.

Efficiency

Asset Turnover Rate: Calculated as the (gross farm revenue) / (average farm assets). This measures the efficiency of using capital. A high level of production in proportion to the level of capital investment yields a high (or efficient) asset turnover rate.
Operating Expense Ratio: Calculated as the value of [(total farm operating expenses)– (depreciation) – (farm interest)] / (gross farm revenue). This measure reflects the proportion of farm revenues used to pay operating expenses, not including principal or interest.
Interest Expense Ratio: Calculated as (farm interest) / (gross farm revenue). This measure of financial efficiency shows how much of gross farm revenue is used to pay for borrowed capital.
Depreciation Expense Ratio: Calculated as (depreciation and other capital adjustments) / (gross farm revenue). This measure indicates what proportion of farm revenue is needed to maintain the capital used by your business.
Net Farm Income from Operations Ratio: Calculated as (net farm income from operations) / (gross farm revenue). This measure of financial efficiency compares profit to gross farm revenue. It shows how much is left after all farm expenses, except for the return to unpaid operator and family labor, management and capital, are paid.