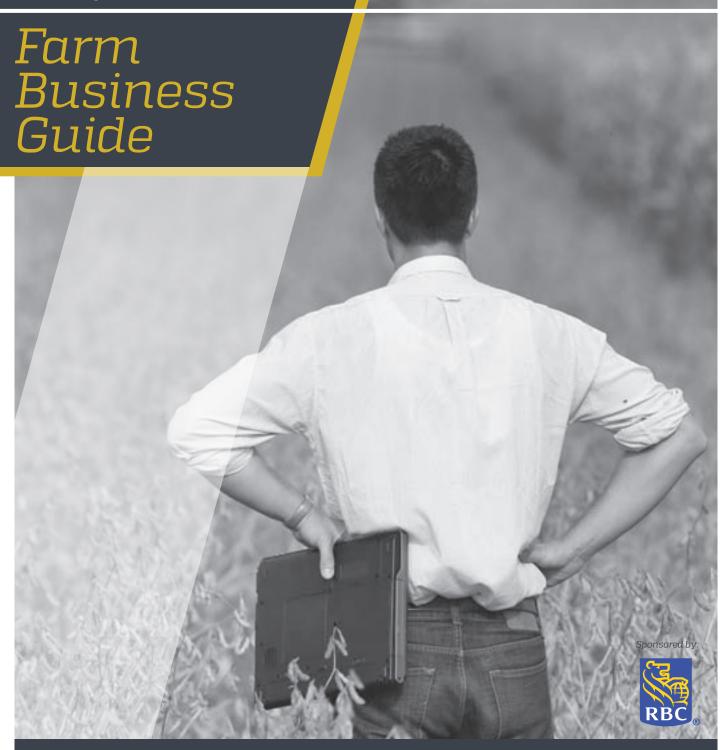
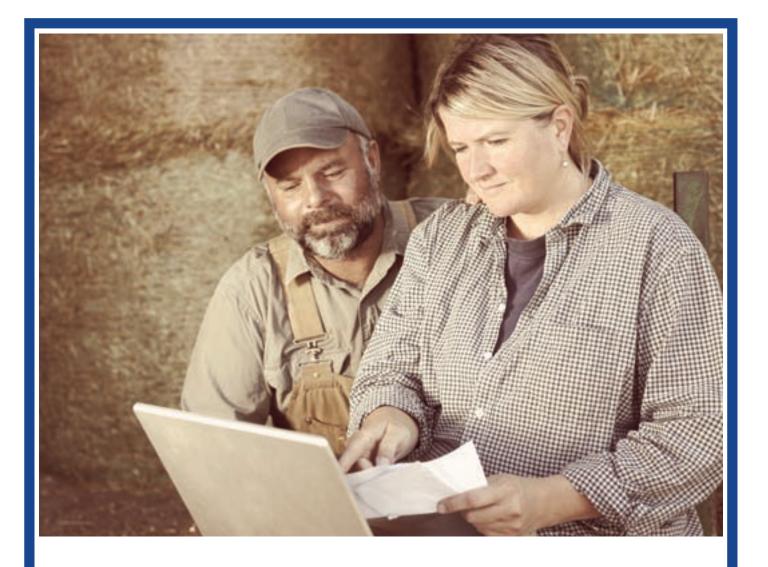
CountryGuide Grainews



FINANCIAL PLANNING



Have you been thinking about your business plan? We have.

It's a fact: farms that have a business plan are more likely to succeed. Today, producers are thinking hard about where they want to go and what moves to make to get there.

RBC Royal Bank® can help. Count on our services and the expertise of our people to help you meet your business goals. So go ahead: dream big and plan confidently.

No matter your next move, we're with you all the way. Talk to one of our agriculture banking specialists today.

Visit rbc.com/chartyourcourse



By the numbers

For the past many decades, farm advisers have been telling farms to operate their farms as businesses without delivering ways to do it. Thankfully, that is changing



TOM BUTTON, EDITOR / COUNTRY GUIDE

n almost any conversation today, you can't be surprised if someone shakes their head and tuttuts that there's a big difference between facts and knowledge.

The comment is usually related to the abundance of information that is so easily accessible on our phones and computers, while we all can't help knowing that if we really want to operate at our best, and if we really want our thinking to be clear, we have to internalize the knowledge before we do any thinking with it.

It turns out there's a similar phenomenon in farm financial management, where a farm can feel almost submerged because it can call up so many dollar-sign data points, yet still not have a pattern of effectively utilizing the information to assist farm management.

Maybe the better example is yield monitors in the field, where again the question is whether we can actually use even a fraction of the numbers we can produce.

Except, there's this big difference. In the office, unlike in the field, there are actually proven techniques for putting the numbers to meaningful work.

Most readers will know that in the pages of Country Guide, we routinely talk to farmers and advisers who excel at this, and my over-arching observation is that, as farmers, they really aren't all that different from any other farmers we know. They just happen to have an extra level of respect for numbers, and to have discovered new ways that their numbers can integrate with their overall approach to farming.

Every farmer I know is somewhere down the same path. In fact, the biggest change I've seen in agriculture in the last 10 years hasn't been the growth in field technology, impressive though that has been, it's been the growth in financial literacy, largely because recent farm incomes have made it practical for farmers to access much better accounting advice.

Still, we thought it would make sense to pull together some of the advice we have been hearing in a brief and concise report, with input from well-regarded advisers, which is what led to what you will read on the following

Our hope is that you will find opportunities to grow your own financial capabilities there. Or perhaps you will find it useful as check list to see whether you have made the progress that you think you've made.

It's always good to compare what you hear from your own advisers with what you can read here, and to go to your next meeting with your accountant with a couple of questions in your pocket. "I've been wondering," you might say, "does it really make sense for me to be carrying this much working capital?"

For all of us, though, a goal is to develop standard decision-making processes on the farm that involve early and routine spreadsheet analysis, actually making use of cost of production and related numbers that until now have been important but limited in their application.

Are we getting it right? Let me know at tom.button@ fbcpublishing.com.

GWEN PADDOCK NATIONAL DIRECTOR, **AGRICULTURE**

ROYAL BANK OF CANADA

is not only a way of life, but also an essential contributor to the Canadian economy, which is

At RBC we know that farming why we're proud to partner with farmers to help you deal with present-day challenges and opportunities

- whether that's volatile commodity markets, the

fluctuating Canadian dollar, the need to establish public

trust or finding new ways to grow your business.

Whether you're looking to expand your farm, pass it to the next generation or you're focused on protecting it against potential risks, we have experienced and knowledgeable agriculture banking specialists and a full lineup of products and services, to help you make your next move.

We're pleased to work with Country Guide/Grainews to highlight the importance of business planning and share some strategies you can use to grow your operation. Should you have any questions, the RBC team of industry experts can help. We look forward to the opportunity to partner with you.

TURN UP your power

Too many farms have let their financial planning slip after years of good cash flows

BY MAGGIE VAN CAMP, SENIOR BUSINESS EDITOR / COUNTRY GUIDE

n golf language, top farms use financial planning to drive their businesses farther down the fairway, while also keeping out of the rough. Also like golf, taking time to analyze the lay of the land and to decide which club to use can make all the difference to your game.

Amanda Hammell, a senior financing specialist in southwestern Ontario for RBC Royal Bank, has mostly crop, hog and beef producers as clients. She also farms with her husband Steve and says the power of financial planning is linking beyond the previous year's net income to know what's happening with cash flow.

Hammell says financial planning isn't just for the larger farms. In fact, she finds younger farmers overall tend to be very good at crunching their numbers.

"It's not the size or scale of the operations that dictate the quality of information," says Hammell.

Nor is Hammell alone. "While bigger can sometimes be better, it's guaranteed that better is always better," agrees Kim Gerencser, from Saskatchewanbased Growing Farm Profits.

For six years Gerencser has been helping Prairie farmers connect their agronomic and operational decisions to their whole farm financial plan through his consulting business. After a career in the financial services industry and a stint farming with his family, he's driven now to help farmers go from good to great in financial planning, or at least to avoid falling into financial trouble.

Gerencser says it's rare for farmers to consistently crunch numbers beyond cost of production. However, the ones who do have a distinct advantage.

"Most farms aren't planning beyond making a crop rotation. But the landscape is changing so much, so fast," he says, words tumbling out of him.

And, he adds after a pause to let his emphasis sink in, the advantage for those who get serious with their financial planning is getting even bigger.

Unfortunately, many farmers have slowly let their financial planning slip during the times of strong cash flow.

Often, looking at the numbers he crunches, gives his clients a clearer pathway, they become more proactive and it helps them see beyond the local markets and recognize the impact of bigger cycles, he says. "Every choice we make has a consequence, and to truly be better, we must evaluate each business decision on its merits, not how it makes us feel."

Here are nine ways Hammell and Gerencser have seen progressive farms use financial planning to take it to the next level

ALWAYS KNOW CASH FLOW.

Once a year Hammell meets with her clients to discuss their plan for the next year and how it fits into their whole-farm plans and finances. Although it seems impossible to find an average price for fluctuating commodity prices, if you look at prices over the last five, seven or 10 years and your farm's average yields, they can be a powerful basis for thinking about the sustainability of changes you want to make.

There's a wide variation in how farmers use their numbers but the progressive ones are able to take basic income and expense information and create budgets and cash-flow projections for the next 12 months, sometimes creating projections and budgets for the coming two to five years, says Hammell. "A cash-flow projection gets the client to think ahead of the day-to-day tasks."

This type of financial planning moves them away from reacting to asking up front how a decision will fit in with the whole operation. It also helps to think about how change can have an impact on cash flow. For example, on her family's dairy farm the price of milk dropped from \$0.87/litre five years ago to \$0.73 in the last year, even though they were allocated more quota. They're carrying more cows to net the same income.

2 DON'T TREAT COSTS AS INVESTMENTS.

Gerencser has found that many farmers he has dealt with don't understand that machinery is not an investment. It's a direct operating cost. Equipment is a depreciable cost, a tool we must have in order to operate, he says. "But it's no better or worse than the hammer we have laying on the shop bench, except it's a way to make money and the government will let us depreciate it over time."

As a cost of operating, equipment needs to be included in cost-of-production calculations, in addition to input costs like seed, fertilizer, and pesticides.

In fact, top farmers include all their costs when calculating cost of product and gross margins.

Planning should be based on accurate comprehensive cost calculations, Gerencser says. And annual cash costs include everything, direct and operating. "Including even the paperclips," he says.

It takes more than knowing your costs to make good financial decisions.

Top farmers connect the dots between production agronomy and gross margins, and know the difference between costs and investments.

3 CREATE CAPITAL EXPENDITURE PLANS.

"A capital expenditure plan is not a Christmas wish list," says Gerencser

It's a strategic framework for what equipment is needed based on the historical results of the business. Although we can't predict production results, if you take your production over the last 10 to 15 years, you're going to have a good idea of a worthwhile pro-



To truly be better, we must evaluate each business decision on its merits," says adviser Kim Gerencser

duction average from which to plan, he says.

Good financial planners don't base ironclad decisions on one good crop year because they know it's a long-term purchase or lease. Instead, lowering cost-per-acre and costper-bushel should drive the decision.

It also has to be practical and not based on habits developed over the last super cycle. "Before that, duct tape and welding were holding a lot of equipment and farms together," says Gerencser.

After 2008, the value of used equipment was high so farmers traded, often flipping tractors or combines every two or three years, enticed by financing at zero per cent and by multi-unit discounts. It became possible because the profits were there. But now, when someone says they need to trade equipment because it's off warranty, Gerencser ask them if they did that in the early 2000s.

Has it become an industry habit to have newer equipment? "All the technology is great, but is it making you more money?" he asks.

Farmers need to look at today's diminished realized profits buying new equipment versus the possibility of cash savings if they keep with the old machinery, and the final decision has to fit into the whole farm, operationally and financially. "Numbers don't lie," says Gerencser.

BUY ASSETS WITH HIGHER ROA.

Top farmers understand that return on assets and not total equity value should drive debt position, says Hammell.

"Equity is not cash flow," she says. "Appreciated asset value doesn't mean the farm can sustain higher spending."

Adding debt should drive revenues, she says, and spreading out payments to make it work still adds to total debt. On

their own farm, Hammell has found equipment sales people know how tempting it is to amortize new equipment over far longer terms rather than keeping equipment longer.

Understanding the difference between the revenuegenerating capacities of different farm assets helps with deciding about expansion and purchases, says Hammell. However, when they look at buying new equipment such as buying a new skid steer, it doesn't generate any increased income. Their farm only owns a tractor and a mixer and hires custom work so they can focus on managing for higher returns per litre of milk while only carrying overhead that contributes to that goal.

Top farms actively plan for change. They see the impact of purchases on the total farm operation and how it might limit other needed spending.

Often strong, financially high-performing farms look at options other than buying more new assets. Hammell sees swapping of services between farms, with one mowing the other baling, for instance, while on other farms the farmers may trade two tractors to buy one bigger one.

PREPARE FOR CYCLES AND MANAGE ACCORDINGLY.

In agriculture, having a big picture perspective is really important for financial planning, says Gerencser. Reality is that we can't control the weather or international markets but what we can do is recognize the ups and downs and resulting risks and opportunities.

"Every business is cyclical, including farming," says Gerencser. "Ignoring that is dangerous."

The trick is to recognize where you are in the cycle, and that it could change at anytime. "The great farmers know where they are in the cycle and make adjustments," he says.

Working capital is calculated as current assets minus current liabilities, so it includes grain inventory and cash as assets. Gerencser says on grain and oilseed farms working capital should be at least 50 per cent of cash costs, and that he prefers 100 per cent.

Lenders, supply companies or financial institutions are generally comfortable with 25 to 30 per cent working capital. However, working capital becomes more important in cyclical industries, agrees Hammell. If a farm has strong working capital, then it won't have to revise their plans if prices change.

Operating lines are only for short-term expenses that should be turned over in less than 12 months. Also, top farmers make sure all their lines of credit are on the balance sheet, not just the one at the bank. People can get into trouble when they start using their operating lines for capital purchases.

CREATE SPREADSHEETS OF CHANGE.

"The best is when a client creates their own Excel spreadsheets," says Hammell. "They really know how to interpret the data, can rebuild it to accommodate change, and it's specifically for their own farm."

With some accounting programs you can load your budgets right into the program and see monthly how you are doing right after reconciling.

"Great farmers connect the

CONTINUED ON PAGE 6

dots between the production decisions and financial decisions," adds Gerencser. "That connection is often found in a decision spreadsheet".

Great financial analysis has multiple layers, but most people don't get beyond knowing COP, even though the value of those COP numbers increases when they are crunched into a spreadsheet analyzing the costs and benefits of changes.

Then the next layer of thinking involves adding in the long-term effects of the change, and estimating whether the change will generate higher return on investment to the bottom line

For example, cutting crop input costs tends to be a reaction to lower margins, but this may affect your production, which will lower profits for the year and may be the worst thing you can do. "Cutting direct costs can mean shooting yourself in the foot," says Gerencser.

Next, for expansion or improvements, you need to add in the cost of efficiency gains on the operation and structures of the business. For example, if you expand, do you need to buy another tractor?

Now you have a better number that you crunch back into a projected new gross margin. Does it still make sense?

7 SEEK OUTSIDE HELP.

The best, most progressive farmers grow slowly, steadily and consistently, and they plan ahead. They use their trusted ag accountant to help create projections; they talk to their bankers who have seen many ideas, all the time.

"They go to people who have helped them get where they are today," says Hammell.

"Reality is that change will happen, it's always is happening," says Gerencser. The problem is we tend not to adjust to change until we feel pain and it's too late by then.

Having an external adviser can really help.

That outside person can be your banker, accountant, or financial adviser, but it needs to be someone with your best interest having an impact on his or her success. Since they aren't emotionally tied to keeping things the same, external advisers can often

see to the heart of the matter, and focus on the financial interests, says Gerencser.

"We all have hit a wall of too many choices," says Gerencser. "It helps for someone who is independent and yet very familiar with the financial and operational aspects of your business to have a look at those choices. They tend to be able to see the pathway through the problem more clearly."

Top farm managers also recognize their weaknesses, with a strong focus on thingsthey're not strong or passionate about, yet the farm can't afford to let lapse. They hire this done, whether it's marketing or scouting or doing the books.

"Do what you do best and hire the rest," Gerencser says.

DRILL DOWN EARNINGS TO A PER UNIT.

Hammell says the banks love knowing the EBITDA — earnings before interest, taxes, depreciation and amortization — because it's a way to compare between companies and it takes away the effects of financing and accounting decisions.

What she likes about calculating EBITDA is that it gets her clients thinking about what they're spending to generate cash. For example, one of Hammell's farm clients had a top EBITDA until the draws for the farm were included, then the EBITDA was average.

Another level of thinking occurs when gross margins are looked at over a single unit. Then it becomes very powerful when the farmer starts trying to maximize the returns on their asset base on a per unit basis, she says. Then they really start seeing the impact an investment or change might make on the gross margins.

For example, Hammell recently read a dairy rule of thumb stating wages for one full-time person should generate 430,000 litres per year. It's an efficiency benchmark that sometimes gets stretched during succession when an additional family draw is added to the books.

9 OFF-FARM INVESTING.

Progressive farmers tend to take money out of their businesses, says Hammell. That's because they tend to be more forward thinking and numbers-oriented.



Equity is not cash flow.

Appreciated asset value doesn't mean the farm can sustain higher spending," says RBC adviser

Amanda Hammell

Also, succession planning and managing employees are part of their business so they are always thinking about the human part of financial planning.

"They do a good job planning for nonfarming children," says Hammell. "Some set up their non-farming children in other businesses or help them with their homes using the equity they have in their farms instead of waiting for the inheritance."

This way of thinking often comes from baby-boomer farmers who want their kids to enjoy life because they want to enjoy life. Hammell estimates about five per cent of her clients have investments other than their farms, and maybe 30 or 40 per cent have some kind of trading accounts, but it varies greatly and often depends on the stage of business.

Watch your working capital

A low current ratio can sap the energy from your operation

BY JOHN GREIG, FIELD EDITOR / COUNTRY GUIDE

lack of working capital can be fatal to a farming operation, but even just flirting with insufficient working capital can hamstring your farm's ability to make sales when prices are most profitable, and interfere with other decisions too.

"If you don't have enough working capital, what I find is that it doesn't let you make the management decisions you need to make," says Nevon Faucher, senior account manager in commercial banking and agribusiness with RBC in Regina.

"You just can't operate without it," agrees Wayne Ryan, CEO of Allied Associates LLP, a London, Ont.-based agriculture accounting firm.

Working capital, for all its wide-ranging implications for farms, is a simple calculation. Take current assets — anything that can be liquidated or turned into cash in the next 12 months — and subtract current liabilities — anything that is due for payment in the next 12 months. That gives you a concrete number that can then be evaluated and monitored.

Dividing current assets by current liabilities yields the current ratio, a measure of the health of working capital on the farm that can be benchmarked against other businesses. It is also helpful for lenders and business partners.

Faucher says that having less working capital means having to rely on lines of credit,

or other lending products with less favourable terms, which in turn affects the farm's ability to make the best decisions for its financial health.

For grain operations, this is especially critical because of the advantages of being able to market grain when the market

"It's been proven time and time again that the lowest price is off the combine. If you can hold and price strategically, you hit higher profit markets," says Faucher.

If your working capital reserves are tight, then marketing decisions aren't based on profitability, but on what bills are due to be paid.

A lack of working capital can also mean an inability to make agronomic decisions that are needed, such as an in-season insecticide application.

Monitoring working capital is the key to understanding how much is needed and its status on the farm. Being able to monitor working capital is especially important during the production season, as that's when expenses are incurred and income is earned for many farmers.

Most farms will be comfortable operating with a ratio of 1.5:1 of current assets to current liabilities, says Ryan. "At 1.25 you are cutting it close," he says, but adds that when a farm is scaling up, getting to 1.5:1 can be "a huge number."

Operations that run 2:1 are the very successful, well-run businesses, and their working capital position helps them cash-flow strategic decisions.

Some farms may be able to manage with a lower ratio. Supply-managed farms and others that turn over their inventory more frequently might be able to manage at closer to 1.25:1, says Ryan, but because of their price volatility, cash crop farms "might want to have more of a cushion because you just don't know."

Many bankers, including Faucher, like to have a postharvest review in the autumn. It's a time to look at how working capital functioned on the farm, and it could be a time to sort through whether everything bought via working capital made sense. Did a tractor die and was it replaced using a line of credit? That purchase could be moved to longer-term financing and that could free up more working capital.

"It's much easier to fix a problem in October and November than in March or April, 30 days before seeding," says Faucher. That's also the time when Faucher says he "arm-wrestles" with some farmers over their levels of working capital. If the farm has managed to get to 3:1 or 4:1, as can happen especially in a good year on a well-managed farm, then that's the time to look at paying down longerterm debt and reducing working capital.

So, what if your numbers say you're short of working capital?



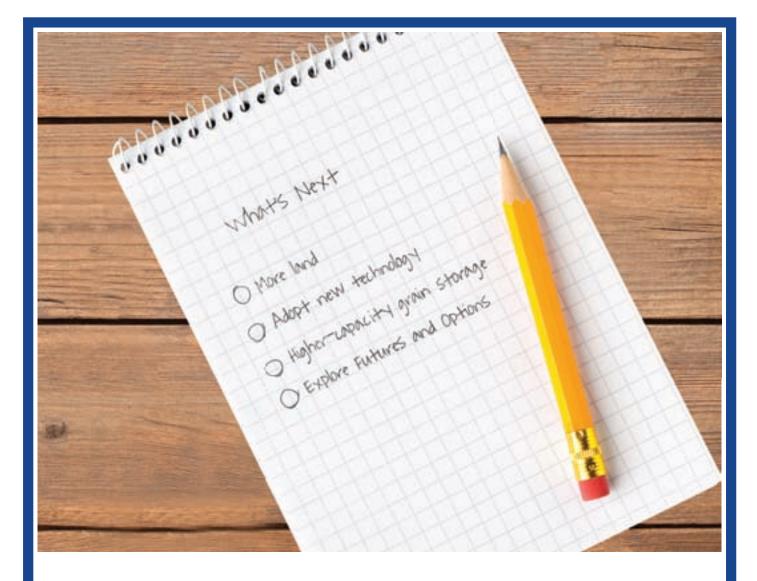
POST-HARVEST IS A SOLID TIME TO EVALUATE YOUR WORKING CAPITAL, SAYS RBC'S NEVON FAUCHER.



MANAGE YOUR WORKING CAPITAL, WARNS ALLIED'S WAYNE RYAN, OR YOU CAN GET TOO BOXED IN.

There are ways to free up cash, says Faucher. Land can be remortgaged to create more cash, for instance, or assets can be financed longer term. Cash may also be raised from other business partners or from other farm or non-farming businesses.

There are ways out of cashflow challenges, Faucher and Ryan say. But making the decision to deal with them, and to get advice, is key.



It's your farm now. Let's go.

You've waited, worked, saved, worried and planned. Now, the family farm is almost yours. What's your next move? At RBC®, we can help. Our people have the expertise to help you put your plans into motion, and the credit and risk management products to do it right. Your family farm has a past to be proud of. Today, the future's every bit as bright.

Talk to your RBC® agriculture banking specialist about your plans for the future and how we can help.

Visit rbc.com/itsmyfarm

