

# The Financial Plan

The financial plan will help you (and any potential lender) estimate how much cash will be needed and when, in order to start and/or maintain a profitable business. You'll also be able to estimate how much profit you can generate, given the level of capital you are able (or willing) to invest.

The process of creating financial projections for your business's income, cash flow and financial position will force you to think through the financial transactions you plan to complete at a fairly high level of detail. Through this process, any discrepancies, gaps or unrealistic assumptions will more than likely come to light.

The information you will need to pull the financial projections together will, for the most part, already have been created when you completed the sales, operating and human resource plans in earlier sections. Since much of the information you'll be working with is subject to uncertainty, you'll be wise to create three sets of projections:

- a "pessimistic" scenario;
- a "most likely" scenario; and
- an "optimistic" scenario.

The change in profits and cash requirements from one scenario to another will indicate to you the degree of risk you're likely to be facing.

A more complete analysis of profitability and risk should be completed and a discounted cash flow should be prepared and included in your informal business plan.

When preparing a financial plan for an existing business, statements for the past two to three years should be included.

When the business plan is being used to acquire financing, detailed lists of inventories, accounts receivable, accounts payable, insurance coverage, copies of legal agreements, orders, letters of intent, appraisals, personal net worth statements and references may also be required.

The British Columbia Ministry of Agriculture, Fisheries and Food has Planning Packages available to producers to assist them in their planning process. The following schematic illustrates how the financial planning package can be used when developing a financial plan. Copies are available from the Farm Management Branch or your closest district office.

*The example financial statements have been prepared using the BCMAFF Planning Package format. You may choose to follow this format or use one that you are more familiar with or one that your accountant or lender prefers.*



## 1. Income Statement

Prepare a schedule showing projected income from sales for the next three years. For an existing business, include information for the last two or three years. The following form shows an example for the Davidson Ranch. The "most likely" production target scenario has been used throughout the financial statements. The numbers used have been intentionally altered so that they do not reflect an actual situation and therefore you should not use them in preparing your own budget.

The letters in the example are references to help explain how an income statement is prepared. Definitions for the financial terms are included in the glossary. (*See page 49.*)

**Inventory adjustments.** Farm income is normally reported on a cash basis or when produce is sold. To accurately estimate expected income, unsold inventory and unused supplies are included in the income calculations thus showing accrued income. Farm expenses should also be adjusted to include expenses incurred but not paid or delete prepaid expenses.

# Income Statement Example

Period from	1989 to 1990 and projected 3 years				
	1989	1990	Year 1	Year 2	Year 3
<b>Income</b>					
Cow Calf	78,607	77,072	77,984	79,221	80,108
Crops	6,000	6,000	6,000	8,000	9,600
NTS/FII	2,700	2,700	2,700	2,700	2,700
a) <b>Total Cash Income</b>	<b>87,307</b>	<b>85,772</b>	<b>86,684</b>	<b>89,921</b>	<b>92,408</b>
<b>Direct Expenses</b>					
Crop Expenses	6,599	6,599	6,599	6,599	6,599
Livestock Expenses	8,030	8,030	8,030	8,030	8,030
Equip. Fuel & Repairs	10,200	10,200	10,200	10,200	10,200
Marketing & Trucking	2,250	2,250	2,250	2,250	2,250
NTS/FII	1,875	1,875	1,875	1,875	1,875
b) <b>Total Direct Expenses</b>	<b>28,954</b>	<b>28,954</b>	<b>28,954</b>	<b>28,954</b>	<b>28,954</b>
<b>Indirect Expenses</b>					
Building & Fence Repair	1,500	1,500	1,500	1,500	1,500
Land Taxes	1,000	1,000	1,000	1,000	1,000
Labour	4,000	4,000	4,000	4,000	4,000
Legal & Accounting	850	850	850	850	850
Insurance & Licences	2,400	2,400	2,400	2,400	2,400
Utilities, Misc.	2,850	2,850	2,850	2,850	2,850
Operating Interest	2,094	1,874	1,722	1,419	896
Term Loan Interest	10,035	9,311	8,586	7,862	7,137
c) <b>Total Indirect Expense</b>	<b>24,729</b>	<b>23,785</b>	<b>22,908</b>	<b>21,881</b>	<b>20,633</b>
d) <b>TOTAL EXPENSES</b>	<b>53,683</b>	<b>52,739</b>	<b>51,862</b>	<b>50,835</b>	<b>49,587</b>
e) <b>NET RETURN</b>	<b>33,624</b>	<b>33,033</b>	<b>34,822</b>	<b>39,086</b>	<b>42,821</b>
<b>CASH EXPENSE (a-d)</b>					
Depreciation	-12,100	-10,990	-9,970	-9,070	-8,240
Inventory Change		2,400		400	1,200
f) <b>Total Adjustments</b>	<b>-12,100</b>	<b>-8,590</b>	<b>-9,970</b>	<b>-8,670</b>	<b>-7,040</b>
g) <b>NET FARM INCOME (e+f)</b>	<b>21,524</b>	<b>24,443</b>	<b>24,852</b>	<b>30,416</b>	<b>35,781</b>



## 2. Cash Flow Summary

Accurate cash flow planning is essential. Inadequate working capital is a common cause of small business failure, especially during the first three to five years.

When cash flow is tight, you may want to evaluate the benefits of leasing rather than purchasing capital assets.

Identify the cash inflows and outflows for your business operation over three years of operations. Remember that cash may not be received until one or more months after the sale is made. Similarly, some expenses, such as insurance, are paid all in one payment, creating peaks and valleys in cash flows. The surplus or deficit at the bottom of the statement will show the increase or decrease of any bank loan which you will require during the year. Quarterly summaries are often adequate but occasionally monthly summaries are required. The example form illustrates the inflows and outflows for the Davidson Ranch.

The letters in the example are references to help explain how a Cash Flow summary is prepared. Definitions for the financial terms are included in the glossary.

The British Columbia Ministry of Agriculture, Fisheries and Food has Planning Packages available to producers to assist them with detailed instruction on how to prepare a farm cash flow projection. Copies are available from the Farm Management Branch or your closest district office.

# Cash Flow Chart Example

	Yr 1				Yr 2				Yr 3						
	Total	1	2	3	4	Total	1	2	3	4	Total	1	2	3	4
<b>Cash Inflow</b>															
Sales	86684	2700	6000	77984	89921	86684	2700	6000	77984	89921	86684	2700	6000	77984	89921
<b>Total Cash Income</b>	86684	2700	6000	77984	89921	86684	2700	6000	77984	89921	86684	2700	6000	77984	89921
<b>Loans Received</b>															
Capital Sales															
<b>Total Cash Inflow</b>	86684	2700	6000	77984	89921	86684	2700	6000	77984	89921	86684	2700	6000	77984	89921
<b>Cash Outflow</b>															
Cash Expenses	51862	9582	16061	9634	16585	51862	9582	16061	9634	16585	51862	9582	16061	9634	16585
Term Loan Principle	6300				6300	6300				6300	6300				6300
Capital Purchases	24800	4950	9950	4950	4950	24800	4950	9950	4950	4950	24800	4950	9950	4950	4950
Living Expenses and Income Tax	82962	14532	26011	14584	27835	82962	14532	26011	14584	27835	82962	14532	26011	14584	27835
<b>Total Cash Outflow</b>	82962	14532	26011	14584	27835	82962	14532	26011	14584	27835	82962	14532	26011	14584	27835
<b>Cash Surplus or Deficit</b>	3722	(14532)	(23311)	(8584)	50149	3722	(14532)	(23311)	(8584)	50149	3722	(14532)	(23311)	(8584)	50149
Opening Cash Balance	9757	9757	(4775)	(28086)	(36670)	9757	9757	(4775)	(28086)	(36670)	9757	9757	(4775)	(28086)	(36670)
Closing Balance	13479	(4775)	(28086)	(36670)	13479	13479	(4775)	(28086)	(36670)	13479	13479	(4775)	(28086)	(36670)	13479



### **3. Projected Statement of Assets, Liabilities and Owner's Equity**

Prepare a schedule showing a projected statement of assets and liabilities at the end of each year for the next three years. For an existing business, include information for the last two or three years. The example form illustrates how the Davidson Ranch completed this schedule.

The letters in the example are references to help explain how this statement is prepared. Definitions for the financial terms are included in the glossary.

The British Columbia Ministry of Agriculture, Fisheries and Food has Planning Packages available to producers to assist them with detailed instruction on how to prepare a farm balance sheet. Copies are available from the Farm Management Branch or your closest district office.

# Statement of Assets, Liabilities and Owner's Equity Example

Assets                      1989   1990   Year 1   Year 2   Year 3

## CURRENT ASSETS

Cash	7,824	9,757	13,479	20,465	31,686
Crops	22,400	24,800	24,800	25,200	26,400
a) Total Current Assets	30,224	34,557	38,279	45,665	58,086

## INTERMEDIATE ASSETS

Cow Herd	155,250	155,250	155,250	155,250	155,250
Equipment	91,800	82,620	74,360	66,920	60,230
Other	8,800	8,800	8,800	8,800	8,800
b) Total Intermediate Assets	255,850	246,670	238,410	230,970	224,280

## FIXED ASSETS

Buildings	36,100	34,290	32,580	30,950	29,400
House	85,000	85,000	85,000	85,000	85,000
Land	340,000	340,000	340,000	340,000	340,000
c) Total Fixed Assets	461,100	459,290	457,580	455,950	454,400
d) Total Assets	747,174	740,517	734,269	732,585	736,766

## Liabilities and Equity

### CURRENT LIABILITIES

e) Total Current Liabilities	6,300	6,300	6,300	6,300	6,300
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### INTERMEDIATE (1 - 10 YRS)

f) Total Intermediate	9,400	7,600	5,800	4,000	2,200
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### LONG TERM (> 10 YRS)

g) Total Long Term	66,000	61,500	57,000	52,500	48,000
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h) Total Liabilities	81,700	75,400	69,100	62,800	56,500
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i) Owner's Equity (h-d)            665,474   665,117   665,169   669,785   680,266

Total Liabilities and Equity (h+i)            747,174   740,517   734,269   732,585   736,766



## 4. Capital Sales, Purchases

Investors and lenders will require detailed information on the capital purchases that are anticipated during the planning period as well as information on how these assets are to be financed and expected useful life of the asset. This can be done for a new business where totalled values would be given, or for an established or expanding business which would detail just the changes anticipated. The Davidson Ranch is not anticipating any sales or purchases of capital.

Leasing assets and contracting services should be considered where they can be employed as a feasible way to increase profitability or reduce risk.



# Capital Sales, Purchases Example

## Planned Capital Sales and Purchases

Item	Sales Trade In	Purchases	Cash Down	Required Financing	Expected Life Yrs	C.C.A. (Depreciation)
Intermediate Assets						
Equipment						
<b>Total Intermediate</b>						
Long Term Assets						
Land						
Buildings						
<b>Total</b>						



## 5. Loan Summary

Information on loans is required for both existing loans and new loans. Loan information should outline the interest rate being paid, frequency of payments, security given, type of loan, i.e. amortized (where annual payments remain the same over the life of the loan) or non-amortized and outstanding balance, the amount of the loan for new loans and the outstanding balance, and financial institution for existing loans.

# Loan Summary Example

Loan Schedule				Year One						
	Amount Owing	Interest Rate	Payment Frequency	Annual Payment	Principal	Interest	Source/lender	Security Provided	Term Years	Amortized Non-Amortized (A)/(N)
<b>Existing Loans</b>										
Operating Loans		13.00%								
Intermediate Loans	9,400	Prime + 1.00%		2,928	1,800	1,128		Assignments on Inventory	10	A
Long term Loans	66,000	Prime + 1/2 %		11,958	4,500	7,458		1st Mortgage	20	A
<b>Total</b>	<b>75,400</b>			<b>14,886</b>	<b>6,300</b>	<b>8,586</b>				
<b>New Loans</b>										
Short Term Loans										
Operating Loan										
Intermediate Loans										
Long term Loans										
Land										
Buildings										
<b>Total</b>										



## 6. Financial Performance Indicators

In this final section, project profit, risk, and growth ratios for your business. These ratios are calculated from information on the financial statements and provide guidelines to measure the progress of your business and alert you to problems.

Profitability ratios including Return on Equity and Return on Investment indicate how efficiently your capital is being used.

Risk ratios including the Current Ratio, the Debt Servicing Ratio, and Debt to Equity Ratio indicate the ability of your business to carry on when unexpected problems arise.

Growth ratios including the Sales Growth ratio and the Equity Growth ratio can be used to track financial progress.

Future ratios should be based on the "most likely" sales forecast. For more information and examples of how to calculate these ratios refer to the British Columbia Ministry of Agriculture, Fisheries and Food Factsheet: 1990-07 *Financial Analysis Using Financial Ratios*.

The example form shows the ratios for the Davidson Ranch.

# Financial Performance Indicators Example

Financial Ratios (Formula)	1989	1990	Year 1	Year 2	Year 3	Bench-mark
<b>Profitability Ratios</b>						
Return on Equity (%) $\frac{\text{net income}}{\text{total equity}} \times 100$	3.2%	3.7%	3.7%	4.5%	5.3%	> term deposits
Return on Investment (%) $\frac{\text{net income} + \text{paid interest}}{\text{total investment}} \times 100$	14.6%	14.9%	15.2%	16.4%	17.4%	> interest on term loans
<b>Risk Ratios</b>						
Current Ratio $\frac{\text{current assets}}{\text{current liabilities}}$	4.8	5.5	6.1	7.2	9.2	> 2
Debt to Equity Ratio $\frac{\text{total liabilities}}{\text{owners' equity}}$	0.12	0.11	0.10	0.09	0.08	< or = to .18
Interest Coverage Ratio $\frac{\text{net income} + \text{interest}}{\text{interest expense}}$	1.2	1.3	1.3	1.3	1.4	positive
Debt Servicing Ratio (%) $\frac{\text{annual payments}}{\text{total revenue}} \times 100$	18.7%	18.2%	17.2%	15.7%	14.5%	< or = to 30%
<b>Growth Ratios</b>						
Sales Growth (%) $\frac{\text{sales increase}}{\text{previous sales}} \times 100$	n/a	-1.8%	1.1%	3.7%	2.8%	positive
Equity Growth (%) $\frac{\text{equity increase}}{\text{previous years equity}} \times 100$	n/a	-0.1%	0.0%	0.7%	1.6%	positive

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# The Long-Range Plan

The long range plan (covering the next 5 to 10 years) helps to keep your business progressing toward goals which are consistent with your long-range goals and objectives. Answers to questions such as "where would I like the business to be in 10 years?" and "what will the business look like?" will form the backbone of your long-range plan. When you've defined the goals and objectives, you can then anticipate the major steps or milestones which must be reached over the next five years in order to achieve the longer term objectives.

Reaching these milestones will likely require additional management, production or marketing skills. You can begin to think about what these needs are now and formulate plans to acquire them. The sample form on the next page shows the plans the Davidson Ranch has for the future.

# **Long-Range Planning Example**

## **Business Goals and Objectives**

- Maintain the production goals set forth in this plan.
- Maintain a profitable business with a positive net income.
- Provide high quality beef and respond quickly to market changes.
- Maintain high quality of life.

## **Major Milestones**

- Train children in management and involve in management decisions.
- Formalize plan for children to take over farm if desired undertaking estate planning as required.
- Retire mortgage and turn operation over to children or sell within 15 years.

## **Additional Production, Financial and Labour Management, or Marketing Skills Required**

- Develop labour management and financial management skills and pass on to children.
- Attend workshops and conferences to improve knowledge on various aspects of ranching.

## **Other Assistance (non financial) required**