



Getting Started in Ag: Evaluate Your Financial Position with RD Financial

If you are new to production agriculture, just starting out, or even running a part-time venture, you probably have more than enough daily business concerns. Day-to-day activities can take over quickly, leaving the financial management side of the business to take a back seat.

It is important to remember, however, that production agriculture in today's unstable world is a diverse and often complex business that requires sound management practices. Successful financial management depends on the ability to construct and properly interpret financial statements. In addition, it is essential to understand how the financial ratios associated with these statements work and what they can tell you about your business.

Over the long term, up-to-date financial analysis is a key part of becoming and remaining profitable. It is important from a risk management standpoint, where a comprehensive picture of the financial health of the business allows you to better plan for uncertainty. It also provides the manager with a better understanding of what a lender might conclude when evaluating the operation. Analysis offers a measure of the financial position and overall performance of the business, as well as identifying potential issues and allowing time to make changes before they become emergencies.

RD FINANCIAL FROM RIGHTRISK.ORG

RD Financial is an interactive tool designed to demonstrate the relationships between the financial statements and financial performance of the business. The tool uses a step-by-step approach that allows the user to enter their own data or modify pre-existing example data.

RD Financial generates four financial statements from the information entered: an income statement, cash flow statement, balance sheet and statement of owner equity. It also produces a set of financial ratios, based on the data entered. The tool includes help functions and allows users to save their information or reset and start over. For a detailed presentation on the RD Financial Tool, select "Tool Support" from the opening menu or view an online presentation at RightRisk.org.

MULTI-ENTERPRISE FARM EXAMPLE

Most farms and ranches in Wyoming produce more than one output or product.

	WW-Fallow	Corn-Dry	Corn-Irr	Fallow	Unused	Unused	Unused	Unused	Unused	Unused
Yield Per Unit	35.0	50.0	200.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Planted Acres Per Enterprise	750.0	500.0	500.0	750.0	0.0	0.0	0.0	0.0	0.0	0.0
Sales Price Per Unit	\$5.75	\$4.00	\$4.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Percent Crop Used on Farm	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Percent Acres Leased	50.0%	50.0%	50.0%	50.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Landlord Crop Share Lease Percentage	17.0%	17.0%	25.0%	13.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Base Acreage Per Enterprise	890	755	0	0	0	0	0	0	0	0
Percent of Base Leased from Others	50.0%	50.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Direct Payment Rate by Commodity	\$0.52	\$0.24	\$0.00	\$0.00	\$0.80	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Direct Payment Yield by Commodity	38	151	0	0	0	0	0	0	0	0
Loan Rate	\$2.75	\$2.75	\$0.00	\$0.00	\$9.30	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Target Price	\$3.92	\$3.92	\$0.00	\$0.00	\$10.10	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00

RD Financial data entry screen

Those outputs and the activities that generate them are often called enterprises. It is important to consider data for all enterprises when building financial statements.

The first step to using RD Financial is to enter the necessary financial data. This includes completing sections for crop revenue and expenses; livestock revenue and expenses; taxes and insurance; assets and liabilities; and miscellaneous and overhead expenses.

The example input form offers an illustration of how these revenues are allocated by enterprise. Crop expenses are split by enterprise as well, and the tool includes extra space for users to include expenses not otherwise listed. Taxes and insurance (except crop insurance) are entered for the entire operation, followed by asset and liability values. The tool accounts for both short-term and long-term liabilities and calculates real estate values based on per acre estimates entered by the user.

GENERATING FINANCIAL STATEMENTS

RD Financial generates the four basic financial statements. The balance sheet lists values of assets and liabilities for the business along with overall net worth. The cash flow statement outlines the farm's sources and uses of cash, income, and expenses as well as the monthly inflows and outflows of cash. The accrual-adjusted income statement is the true measure of profitability for any business and lists both cash and non-cash effects on the bottom



line for the year. The statement of owner equity provides the details required to calculate changes in net worth from year to year.

RD Financial helps users see the interaction of information entered across the financial statements; the statement of owner equity provides the needed reconciliation and highlights any discrepancies in the information entered.

Category	Ratio	Beginning	Ending
Liquidity	Current Ratio	1.63	1.56
	Working Capital	\$54,034	\$48,554
Solvency	Debt/Asset Ratio	0.134	0.122
	Equity/Asset Ratio	0.866	0.878
	Debt/Equity Ratio	0.16	0.138
Profitability	Rate of Return on Business Assets		0.76%
	Rate of Return on Business Equity		-0.07%
	Operating Profit Margin Ratio		0.05
	Net Business Income		\$47,681
	Check Sum		100.00%
Repayment Capacity	Term Debt and Capital Lease Coverage Ratio		1.07
	Capital Replacement and Term Debt Repayment Margin		\$5,975
Financial Efficiency	Asset Turnover Ratio		0.14
	Operating Expense Ratio		0.74
	Depreciation Expense Ratio		0.11
	Interest Expense Ratio		0.06
	Net Farm Income From Operations Ratio		0.08

RD Financial ratio screen

IMPORTANT FINANCIAL RATIOS

RD Financial generates a set of 16 financial ratios based on the financial statements. These ratios are divided into five categories and are commonly used by lenders to evaluate a borrower's financial situation. Categories include liquidity, solvency, profitability, repayment capacity and financial efficiency.

To see a detailed explanation of each ratio, simply click the Off/On button next to each ratio. The tool generates a gauge of each ratio (red to green) based on industry standards to indicate a level of concern for the calculated value.

CREDIT SCORING

RD Financial includes a credit-scoring model intended for educational purposes. This section gives two examples of how a lender might evaluate the creditworthiness for two different loan models: operating and term loans. The tool generates a credit score for each loan type, based on the information provided. The operating loan model relies on four financial ratios, each with a score from 1 to 5 (1=excellent, 5=high risk). For the example farm, low debt levels help to offset the rather low profitability numbers to rate the operating loan score at 1.6. This feature offers the user a way to identify and address problem financial areas before meeting with a potential lender.

MORE FROM RIGHTRISK.ORG

The RD Financial Tool is just one of many useful resources RightRisk.org offers for new and beginning producers. Visit RightRisk.org to access numerous online tools and courses, including a wide variety of agricultural risk management topics ranging from crop insurance to production management, risk calculators, estate planning and more. These resources provide invaluable insights to those new to agriculture.

OTHER TOOLS AVAILABLE AT RIGHTRISK.ORG:

- Forage Risk Analyzer
- Risk Scenario Planner
- Multi-Temporal Risk Analyzer
- Enterprise Risk Analyzer