FINANCIAL METRICS
FOR YOUR FARM BUSINESS

USING SOME COMMON FINANCIAL METRICS CAN HELP YOU AND YOUR LENDER EVALUATE THE OVERALL FINANCIAL CONDITION OF YOUR FARMING OPERATION, AND PINPOINT ANY TRENDS THROUGHOUT YOUR BUSINESS CYCLES.

THE FOLLOWING DESCRIBES SOME KEY METRICS AND THEIR CALCULATIONS AND TARGETS THAT WHEN PROPERLY EVALUATED CAN GIVE A CLEARER PICTURE OF YOUR FARM'S OVERALL FINANCIAL PERFORMANCE.

SOLVENCY METRICS

Solvency metrics are captured at a set point in time and measure the amount of debt used by your farm relative to the amount of your equity invested in the business. Debt capital is interest bearing and/or has a date by which it must be paid. Solvency metrics provide an indication of your farm's ability to repay all financial obligations if all assets were sold (for the prices indicated), and is an indication of your farm's ability to continue operations as a viable business after a financial adversity (such as an adverse weather or price event), which typically results in increased debt or reduced equity.

› Net Worth

Net Worth indicates the financial soundness, or solvency, of your business. Net worth is expressed in dollars and is calculated by adding the value of everything you own (your assets) and subtracting all debts that you owe (your liabilities).

Net Worth = Total Assets – Total Liabilities

TIP: Using key metrics gives a clearer picture of your farm's overall financial performance.

› Owner's Equity Ratio

The Owner's Equity Ratio shows net worth as a percentage of total assets measuring your ability to withstand periods of financial stress. The higher the ratio, the greater the solvency and the more total capital supplied by the owner(s) and less by the creditors.

Owner's Equity Ratio = Net Worth ÷ Total Assets

Target: 50–65% or higher

GreenStone® FARM CREDIT SERVICES

LIQUIDITY METRICS

Liquidity measures your farm's ability to meet financial obligations as they come due in the ordinary course of business, without disrupting normal business operations. Higher working capital and liquidity provides you greater flexibility in marketing, acquiring capital assets and operating loans, and a greater ability to withstand short-term adversity.

› Working Capital

Working Capital is a point in time measurement of your ability to pay your debts due in the following 12 months (current liabilities) based on the amount of assets you own that will be liquidated in the following 12 months (current assets). This is expressed in dollars and is calculated by subtracting your current liabilities from your current assets.

Working Capital = Current Assets – Current Liabilities

› Current Ratio

Current Ratio shows the value of assets to be liquidated in the following 12 months (current assets) in relation to liabilities due in the following 12 months (current liabilities). The Current Ratio indicates your ability to pay current liabilities from the normal liquidation of current assets without liquidating long-term assets or incurring more long-term debt. The higher the ratio, the greater the liquidity. For example, a Current Ratio of 2 indicates there are $2 of cash or assets that will be converted to cash in the following 12 months available for every $1 of liabilities due in the following 12 months.

Current Ratio = Current Assets ÷ Current Liabilities

Target: 1.25–1.75 or higher

CASH FLOW METRICS

Cash Flow is a measure of the changes in your working capital as a result of revenues, expenses, unfinanced capital spending and changes in non-current liabilities during a defined period of time. A positive Cash Flow will increase the working capital of your business, while conversely, a negative cash flow will decrease your working capital.

Definitions *(All calculated for a defined period of time)*

Annual Gross Revenues: All income and sales, except for sales of capital assets.

Operating Expenses: All expenses and costs of the business except for Depreciation Expense, Interest Expense, Debt Payments, Income Tax Expense and Owner Withdrawals for Non-Expensed Labor and Management that generally pay for home, insurance, tax and other personal and family living expenses.

Adjusted Net Income: Annual Gross Revenues less Operating Expenses, Depreciation Expense, Interest Expense, Income Tax Expense and Owner Withdrawals for Non-Expensed Labor and Management.

Debt Payments: Principal, interest and lease payments.

Unfinanced Capital Spending: The amount of assets (except Current Assets) that are purchased minus the amount of non-current debts incurred or other non-current assets sold to finance the purchased assets.

Cash Flow: Adjusted Net Income plus Depreciation Expense less Principal Payments on Non-Current Liabilities less Unfinanced Capital Spending.

› Debt Coverage Ratio

Debt Coverage Ratio determines your debt repayment capacity. It is generally calculated on an annual basis comparing adjusted net income before depreciation and interest expense to debt payments. The greater your earnings are to cover debt payments, the easier you can handle planned and unplanned capital spending as well as changes in revenues and expenses, lowering your risk. A debt coverage ratio less than 1.00 means there were insufficient earnings to repay all debt payments and working capital was used to make the payments.

Debt Coverage Ratio = Adjusted Net Income before Interest and Depreciation Expenses ÷ Debt Payments

Target: 1.15–1.50 or higher

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