

# 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 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 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 from the last two or three years. The following form shows an example for Peace Farms. 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.

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. Also delete prepaid expenses.

## Income Statement Example

Period from \_\_\_\_\_, 19\_\_ to \_\_\_\_\_, 19\_\_

	Year One	Year Two	Year Three
<b>Income</b>			
Crop sales (net of GRIP payment NISA	272,442	278,080	296,746
a) <b>Total Income</b>	<u>272,442</u>	<u>278,080</u>	<u>296,746</u>
<b>Direct Expenses</b>			
Seed	18,776	18,776	18,776
Fertilizer	53,752	53,752	53,752
Pesticides	24,946	24,946	24,946
Fuel/oil/lube	18,406	18,406	18,406
Equipment R&M	16,731	16,731	16,731
GRIP/Crop Ins.	20,582	20,582	20,582
Land cash rent	<u>9,600</u>	<u>9,600</u>	<u>9,600</u>
b) <b>Total Direct Expense</b>	162,793	162,793	162,793
<b>Indirect Expenses</b>			
Paid labour	5,600	5,600	5,600
Utilities	3,000	3,000	3,000
Operating int.	4,000	4,000	4,000
Term loan int.	24,945	19,809	14,672
Promotion	750	750	750
Manager's draw	20,000	20,000	20,000
Licenses/ins.	2,500	2,500	2,500
Taxes	<u>550</u>	<u>550</u>	<u>550</u>
c) <b>Total Indirect Expenses</b>	<b>61,345</b>	<b>56,209</b>	<b>51,072</b>
d) <b>Total Expenses</b>	224,138	219,002	213,865
e) <b>Net Return (a-d)</b>	48,304	69,078	82,881
Depreciation	-90,630	-66,559	-69,226
Inventory Change	<u>3,254</u>	<u>5,124</u>	<u>8,886</u>
f) <b>Total Adjustments</b>	<b>-87,376</b>	<b>-61,435</b>	<b>-60,340</b>
e) <b>Net Farm Income</b> (e+f)	-39,072	7,643	22,541



## 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 Peace Farms.

The British Columbia Ministry of Agriculture, Fisheries and Food has Planning Packages available to producers with detailed instructions 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

Projected Cash Flow from \_\_\_\_\_, 19\_\_ to \_\_\_\_\_, 19\_\_

Quarter	Yr 1				Yr 2				Yr 3			
	1	2	3	4	1	2	3	4	1	2	3	4
<b>Cash Inflow (\$,000)</b>												
Sales	272	130	10	132	278	135	10	133	297	144	11	142
Program Payments												
<b>Total Cash Inflow</b>	272	130	10	132	278	135	10	133	297	144	11	142
Accts Received												
Loans Received												
Capital Sales									20			
Personal Contributions										20		
<b>Total Cash Inflow</b>	272	130	10	132	278	135	10	133	317	144	31	142
<b>Cash Outflow</b>												
Cash Expenses	204	20	133	31	199	20	129	30	194	19	127	29
Term Loan Principal	45			45	45			45	45			45
Accounts Paid												
Capital Purchases												
Living Expenses	20	5	5	5	20	5	5	5	120	5	5	5
<b>Total Cash Outflow</b>	269	25	138	36	264	25	134	35	379	24	252	34
Cash Surplus or Deficit												
Opening Cash Balance	105	(128)	(36)	62	110	(124)	(35)	63	120	(221)	(34)	73
<b>Closing Balance</b>	105	(23)	(59)	3	113	(11)	(46)	17	137	(84)	(118)	(45)



### **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 shows how Peace Farms completed this schedule.

The letters on the example are references to help explain how this statement is prepared. Definitions for the financial term 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 instructions 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**

	Year one	Year two	Year three
<b>Assets</b>			
<b>CURRENT ASSETS</b>			
Cash	25,000	62,490	34,360
Accounts Receivable	-	-	-
Inventory	151,000	141,000	146,000
Fall fertilization	4000	4000	4000
<b>a) Total current assets</b>	<b>180,000</b>	<b>207,490</b>	<b>184,360</b>
<b>INTERMEDIATE ASSETS</b>			
Equipment Cost	307,400	307,400	407,400
Less depreciation	83,630	60,260	63,560
Net equipment	223,770	163,510	199,950
<b>b) Total intermediate</b>	<b>223,770</b>	<b>163,510</b>	<b>199,950</b>
<b>FIXED ASSETS</b>			
Buildings Cost	70,000	70,000	70,000
Less depreciation	7,000	6,300	5,670
c) Net buildings	63,000	56,700	51,030
d) Land	280,000	280,000	280,000
<b>e) Total fixed (c+d)</b>	<b>343,000</b>	<b>336,700</b>	<b>331,030</b>
<b>f) Total Assets (a+b+e)</b>	<b>746,770</b>	<b>707,700</b>	<b>715,340</b>
<b>Liabilities and Equity</b>			
<b>CURRENT LIABILITIES</b>			
CWB Advance	52,000	52,000	52,000
Operating Loan			
<b>g) Total Current Liabilities</b>	<b>52,000</b>	<b>52,000</b>	<b>52,000</b>
<b>INTERMEDIATE (1-10 YR)</b>			
Equipment Loan	122,000	81,330	40,660
<b>h) Total Intermediate</b>	<b>122,000</b>	<b>81,330</b>	<b>40,660</b>
<b>LONG TERM (&gt; 10 YR)</b>			
Mortgage	88,000	79,200	70,400
<b>i) Total Long Term</b>	<b>88,000</b>	<b>79,200</b>	<b>70,400</b>
<b>j) Total Liabilities (g+h+i)</b>	<b>262,000</b>	<b>212,530</b>	<b>163,060</b>
<b>k) Owner's Equity (f-j)</b>	<b>484,770</b>	<b>495,170</b>	<b>552,280</b>
<b>Total Liabilities and Equity</b>	<b>746,770</b>	<b>707,700</b>	<b>715,340</b>



#### **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 the expected useful life of the asset. This example is for an ongoing business and the detailed information itemizing the cost of equipment has been included in the production schedule. A new business would probably have purchase schedules for various categories of fixed assets.

Leasing assets and contracting services (custom work) should be considered where they can be employed in a feasible way to increase profitability or reduce risk.



**Capital Sales,  
Purchases  
Example**

**Planned Capital Sales and Purchases**

**Year One**

<b>Item</b>	<b>Sales Trade In</b>	<b>Purchases</b>	<b>Cash Down</b>	<b>Required Financing</b>	<b>Expected Life Yrs</b>	<b>C.C.A. Depreciation</b>
<b>Intermediate Assets</b>						
Equipment	20,000	120,000	100,000	-	7-15 years	20-30%
<b>Long term Assets</b>						
Land						
Buildings					20 - 30 yrs	10%



## **5. Loan summary**

Information on existing 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

	<b>Long Term</b> Land & Buildings	<b>Intermediate Term</b> Equipment	<b>Short Term</b> Operating Loan
Amount Owing	88,000	122,000	70,000 Max.
Interest Rate	12 3/4% - 5 yr.	Floating: current is 11 1/4%	Floating: current is 11 1/4%
Payment Frequency	Annual	Annual	Revolving loan
Annual Payment	15,620	54,395	N/A
Principle	4400	40,670	N/A
Interest	11,220	13,725 (approx)	4000 (approx)
Source/Lender	Bank	Bank	Bank
Security Provided	1st Mortgage	Equipment	Assignment of Receivables and Inventory
Term	20 years	1-5 years, a number of small loans have been grouped for this example	N/A



## 6. Financial Performance Indicators

In this final section, calculate 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 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 projections of business activity by Peace Farms.

## Financial Performance Indicators Example

Financial Ratios (Formula)	Year one	Year two	Year three	Bench-mark
<b>Profitability Ratios</b>				
Return on Equity (%) $\frac{\text{net income}}{\text{total equity}} \times 100$	neg	1.5%	4.1%	> term deposits
Return on Investment (%) $\frac{\text{net income} + \text{paid interest}}{\text{total investment}} \times 100$	neg	3.8 %	5.0 %	> interest on term loans
<b>Risk Ratios</b>				
Current Ratio $\frac{\text{current assets}}{\text{current liabilities}}$	3.5	4.0	3.5	> 2
Debt to Equity Ratio $\frac{\text{total liabilities}}{\text{owners' equity}}$	0.54	0.43	0.30	< or = to .5
Interest Coverage Ratio $\frac{\text{net income} + \text{interest}}{\text{interest expense}}$	- 0.35	1.32	2.21	positive
Debt Servicing Ratio (%) $\frac{\text{annual payments}}{\text{total revenue}} \times 100$	25.7%	25.2 %	23.6 %	< or = to 30%
<b>Growth Ratios</b>				
Sales Growth (%) $\frac{\text{sales increase}}{\text{previous sales}} \times 100$	n/a	2.1 %	6.7%	positive
Equity Growth (%) $\frac{\text{equity increase}}{\text{previous year's equity}} \times 100$	n/a	2.1 %	11.5 %	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 opposite shows what Peace Farms plans for the future.

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## **Long-Range Planning Example**

### **Business Goals and Objectives**

- Maintain a dependable reputation for high quality grains and seeds production
- Provide the opportunity for the son to enter the industry
- Eliminate the dependence on off-farm income in 5 years
- Implement production and labour practices which will optimize yields; aim at market prices within the top 25% of ranges
- Maintain a profitable business with a positive net income

### **Major Milestones**

- Eliminate existing mortgage in 5 years
- Develop estate plan in next 3 years
- Support both managers from farm income in 5 years
- Comprehensive assessment of performance under this plan in 3 years

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

- Develop marketing, record keeping and production skills
- Increase tenure of hired workers

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