AGRICULTURAL
FINANCIAL AND TAX PLANNING

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In the past issues of the Florida Cattleman Journal our articles were focused on tax savings and special tax issues facing ranches. While looking at the cattle market forecast it became apparent that the best tax saving ideas and plans are worthless if the operation is not making money. Therefore, the focus for the next few articles will be on getting back to the basics of making an operation more profitable. These articles will cover some basic operational accounting issues that just might produce a more timely benefit.

Current forecast for the cattle industry

It is a widely held assumption that cattle prices have and will continue to decrease through the end of 2016. For example, Wyatt Bechtel in his article in the February 2016, Farm Journal "Bred Heifer Bubble Burst" concludes "Market cycle and herd expansion create a buyers market for bred heifers". In addition, Harlan Hughes predicted in February a steep decline in feeder cattle prices through the end of 2016 based on his analysis that showed cattle feeders lost $435 per head in 2015. He is a North Dakota State University Professor emeritus who does in-depth analysis of eastern Wyoming and Western Nebraska feeder cattle prices. The question is: Is your operation prepared to weather this downturn in the cattle market, and if so, will it be ready for the next upswing in order to maximize your profit potential?

Best practice is to have a written financial plan

Having a written plan provides a focus for everyone in your operation and establishes points to measure the operations progress. The plan will become very helpful to identify changes in the cattle market and your options to deal with those changes. The financial plan, also known as a budget, should be in a form that is based on a five year goal. The five year goal should include annual milestones that are required in order for the business to reach that goal. An example of a milestone may be; to have at least 100 heifers bred with an 80% pregnancy rate after year 2. Year one of the budget should be very detailed by month while the later years can be more of a summary level by quarter. The budget should be reviewed quarterly and updated as events and assumptions change. The quarterly review process will help mitigate the impact of any change in the cattle market by identifying those changes earlier. Your financial advisor should be of assistance with this process and some tax planning may be discussed at this point. Tax planning only adds value when tax has been paid or there is potential tax to be paid.

Controlling cost

In order to survive and even grow in a downturn of the cattle market it is imperative that cost be controlled daily. If it is done every day, the months and years will take care of themselves. Cost can be grouped into three major categories; discretionary expenditures, variable cost, and fixed cost. During a market downturn it is much more critical that the discretionary cost be avoided and all variable cost be weighed against the benefit received from those cost. The fixed costs are usually the least susceptible to reduction and usually have a greater long term cost/benefit associated with them. A systematic review of all of your cost should be made with an awareness of the operation's capital reserves when compared to any projected cash burn rate. Methods of cost analysis and projecting cash flows will be covered in a later article.

Know your Key Performance Indicators

In order to control cost there must be an awareness of the operation's Key Performance Indicators "KPI". By monitoring certain KPIs, the operation manager can identify those variable cost that might have the least impact on the overall performance of the herd. Some KPI's identified by Stan Bevers and David Anderson from the Texas A&M University System are:

1. Pounds Weaned per breeding female
2. Revenue per breeding female
3. Nutrition cost as percentage of total cost of ranch operations
4. Labor as percentage of total revenue
5. Operating expense excluding interest and depreciation as percentage of revenue
6. Net income ratio
7. Cost per CWT. of weaned calf
8. Current ratio which is "Current assets divided by liabilities due within a year"
9. Total investment per breeding female
10. Debt per breeding female
11. Equity to Asset Ratio
12. Asset turnover ratio
13. Rate of return on assets

These KPIs are the ones identified by Texas A&M for Cow-calf operations. Texas A&M numbers were calculated after the review of hundreds of herds in the Beef Cow-calf SPA. Other KPIs may be more appropriate for your operation. However, most of these will apply to any cattle operation. A manager/owner should ask the following questions;

- Have KPIs been identified and monitored for my operation?
- If so, are they being calculated properly? For example, when calculating the revenue per breeding female, how are the culls from the breeding herd and the calves kept for the breeding herd handled?
- If KPIs are known, are they being compared to prior years' operating KPIs?
- How do they compare against those calculated by Texas A&M University?

Your tax & accounting professional should be of help in identifying KPIs and making the calculations for your operations

Team up with your financial advisor.

Having the right financial team can provide timely critical financial information to the manager/owner so proper decisions can be made based on facts and not just on gut feelings. In today's world of razor thin margins, there is no room for errors in your numbers. Your accounting professional can help review and/or prepare a budget for your operation, identify and calculate KPIs giving you new tools to better manger the operations. These numbers should be reviewed at least quarterly.

Summary

The main purpose of this article is to discuss the importance of having a financial plan and establishing methods to measure how actual performance compares to those plans. In this period of market flux, good financial information is critical for the manager to make the correct timely decision. If the financial system in your business does not provide this type of information timely, consideration should be given to update that system and/or find an accounting professional to help provide it.

In addition, having a written plan provides a focus for everyone in your operation. It helps to focus the attention at the total profitability and performance of the operations instead of just one part. For example, instead of looking at revenue per cow, maybe revenue per acre might make the over all operation more profitable. A financial plan also aids in tax planning so questionable expenditures are avoided like buying additional equipment to reduce taxes when it has a negative impact on your KPIs and cash flow. In the current market, financial analysis by management is critical and your tax & accounting can be of assistance.

For more information on this topic and other tax and financial planning for ranching, please contact me at (863) 640-2008 or Tom@beasleybryantcpa.com and/or Ryan Beasley at (863) 646-1373 or Ryan@beasleybryantcpa.com . Please visit our website at www.beasleybryantcpa.com for information on other relevant topics.

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