FINANCIAL TARGETS

You worked through the Financial Performance topic in the Readiness Assessment Phase where you reviewed your historical financial performance. You will work through another financial topic in the Plan Development Phase. The topic is called Financial Performance — Transition Scenario.

The first topic examines your past performance. The second topic examines the impact that different transition scenarios will have on your financial performance. A very important step that links the two exercises is setting financial targets.

Without the targets, it is difficult to assess the impact of changes in financial performance that may result from a transition scenario.

Targets can be used as measures to strive for. For example, setting a high threshold target and seeing if it can be reached. They can also be measures to not fall below. For example, setting a low threshold target and making sure decisions don't cause you to fall below it.

The exercise in the Readiness Assessment Phase indicated that you should look at a basket of ratios when analyzing financial performance. For purposes of setting financial targets that are specifically applicable to transition planning, you should consider using a minimum of six ratios. It's a good idea to include a ratio from each of the categories.

Important: The ratios include 'good', 'average' and 'poor' categories. Farms in different situations will experience different performance at different stages in their development or business lifecycle.

For example, a farmer nearing retirement may have less debt and therefore, a low debt servicing ratio (which would mean that he would be in the 'good' category). However, if the farm needed to borrow some money as part of the transition plan, the debt servicing ratio would increase (possibly meaning that he would be in the low 'average' category). This may be unavoidable during the transition.

EXAMPLES

Liquidity - The ability of a business to meet financial obligations as they come due in the ordinary course of business. Liquidity relates to cash flow and short-term risk.

Ratio	Formula	Explanation	Good	Average	Poor	Sample Farms Ltd.
Working capital Percentage of Total Cash Expenses	(Current assets – Current liabilities) / Cash Operating Expenses	If current liabilities are retired as they come due what current assets will be left? (percentage of annual expense)	> 50%	20 – 30%	< 10 %	**150%**

Solvency — The financial ratios that measure the amount of business debt relative to the amount of owner's capital invested in the business. Solvency relates to longer-term risk and how the business is financed.

Ratio	Formula	Explanation	Good	Average	Poor	Sample Farms Ltd.
Leverage Ratio*	Total Liabilities / Total Equity	For every dollar in equity, how many dollars of debt are there?	< 4 : 1	0.65 : 1	> 1 : 1	**0.70:1**
Debt Servicing	(Net income + Amortization + Interest -Family Wages**) / (Annual Principal and Interest Paid)	Can the farm come up with enough income to pay the debt requirements?	> 2 : 1	1.5 : 1	< 1.1: 1	**1.75:1**

* Industry standards based on assets at market value.

** If not already included in expenses (ex: non-corporate farms).

Profitability — The extent to which a business is able to generate profit (income) from the use of business assets. Profitability rates investment decisions based on their ability to generate net income.

Ratio	Formula	Explanation	Good	Average	Poor	Sample Farms Ltd.
Return on Assets*	Net Income / Total Assets	What return is the farm generating as a percentage of capital assets?	> 4%	2%	< 0%	**6%**

* Industry standards based on assets at market value.

Financial Efficiency — the extent to which a business is able to use its resources (inputs) efficiently. Financial efficiency rates the annual operating cost decisions on their ability to generate gross revenue.

Ratio	Formula	Explanation	Good	Average	Poor	Sample Farms Ltd.
Gross Margin	Gross Margin / Total Revenue	Is the farm generating acceptable margin as a percentage of revenue?	> 65%	55%	< 50%	**65%**
Net Profit Margin	Net Profit / Total Revenue	Is the farm generating acceptable margin as a percentage of revenue?	> 20%	10%	< 5%	**15%**

Why is this relevant?

Setting financial targets helps to assess decisions made as part of the transition planning process.

How will this help transition planning?

- Knowing how different transition scenarios affect your financial performance is very valuable information. To be able to do this, you need to first establish financial targets.
- Agreeing on financial performance targets can potentially help to avoid conflict that may stem from poor financial results.

Instructions

1. Family members actively involved in the farm should participate in this exercise.
2. Review and discuss your historical performance from the readiness assessment phase.
3. Based on your historical performance and the good, average or poor thresholds, determine what your targets will be for each of the ratios included above.
   a. The targets you set should specifically take your transition planning into consideration.
4. Talk to your MAFRD Business Development Specialist - Farm Management or to an advisor.

How does this apply?

You will be able to test the financial impact of different transition scenarios against your financial targets.

PLANNING POINTERS:

- Review financial performance annually and test the performance against your targets.
- Talk to an advisor or your MAFRD Business Development Specialist - Farm Management if you are concerned about your performance, or if you have questions.

WHAT TO WATCH FOR:

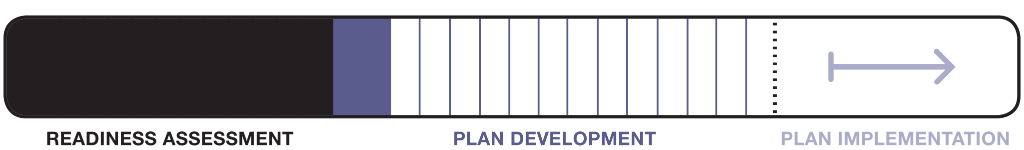
- If you do not have a good base of financial information, setting targets can be difficult.
- The six targets only represent a portion of an overall financial performance assessment.
- If your performance in any of the six areas is less than desired, it is a good idea to apply a more detailed evaluation.

EXERCISE: Go to the forms appendix at the back of this guide for a blank copy of the Financial Targets exercise on pages 275-276.

Next steps

Congratulations on completing this topic. You are now a step closer to having a transition plan for your farm. Please proceed to the next topic area on your Transition Plan, but don't forget to add any assigned tasks that were generated by working through this topic.

Planning progress



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