Understanding Your Historic Financial Results.

It is important to understand your historic financial results. Unfortunately the more analysis you do the more confused you can get. As a wise old banker once told me you can get "paralysis by analysis".

But if you don't understand your historic results, then you are unlikely to understand what the future holds for your business.

No one measure will tell the true story. Simply put, what you need to understand is:

- Did my net debt go up or down?
- Why did it go up or down?
- And what does this mean for the future?

Analysing your historic financial results is an important part of planning for your future. Your historic results will give an insight as to how well your business has performed financially over previous years.

If your budgets are showing significantly different results to your historic results, it is important to understand why there is a difference. If the differences can be explained and/or justified then that is fine. However if they cannot be justified the question needs to be asked, are you being overly optimistic with your projected financial results.

As a business coach I see my role as one of challenging my clients to ensure that they are not setting themselves up with either unrealistic expectations or overly cautious expectations. I come with no agenda other than to help my client's businesses succeed. Challenging my clients on their financial performance is an important part of my role.

It is also important to realise that your annual accounts produced by your accountant are taxation reports. Therefore your accountant makes adjustments to the cash result to take advantage of current tax laws. A number of non-cash items such as depreciation are included to help reduce the amount of tax you have to pay. This can also lead to items being on your balance sheet that may have no material bearing on the strength of your business. For example inter-entity debt.

In analysing your historic results an attempt is made to unwind the taxation changes your accountant has made to try and get your annual accounts to more resemble what is known as management accounts. Management accounting is only concerned with the true cash flow of the business. Also with several different entities an attempt is made to amalgamate these to try and get a clearer picture of the reality.

When analysing historic results it is wrong to focus solely on one key aspect. There are a number of important measures that need to be understood and analysed in balance. Some of the key things to look are:

Net cash result.

This is simply a difference between the total income received and the total expenditure, including capital expenditure. But does not include any new debt borrowed or any existing debt repaid. So if for example, you had purchased a new property or completed a dairy conversion you would have a large negative cash result.

While the net cash result is an important measure it does not tell the whole story.

It is also important to understand what happened to your net cash result. If you have a positive result, what happened to the surplus? Did you pay off term debt, reduce your bank overdraft, increase the amount of cash in the bank or maybe purchase more investments?

If you had a negative cash result how was the loss funded? Did your bank overdraft increase or did you take on more term debt?

The net result will equal changes to your balance sheet. If you have a positive cash result your net debt would reduce and conversely if you have a negative cash result your net debt will increase.

Net debt.

Your net debt is calculated as follows:

	Term debt
	Bank overdraft
	Sundry creditors (Eg CRT, Stock Company, GST etc)
	Total debt
Less	Investments (Farm shares, Fonterra shares, other investments)
	Cash in the bank
	Sundry debtors (stock and produce sold but not paid for)
	Net Debt

As discussed above your net cash result will equal the change in your net debt for the year.

Pre-capital cash result.

As the name suggests this is the measure of your cash result before you have spent anything on capital expenditure. It is calculated as follows:

	Gross farm income
	Stock purchases
	Total farm income
Less	Farm working expenditure
	Interest and rent
	Personal drawings
	Tax
	Pre-capital cash result

The pre-capital cash result is also something that cannot be looked at in isolation. For example what happened to stock numbers? Are you building numbers or are you selling off capital livestock? It also does not take into account what happened with the farm working expenditure. Was maintenance fertiliser applied, was there a lot of catch up R&M? The other thing that this measure does not take into account is the fact that your plant and machinery is depreciating.

Pre-capital adjusted result (PCAR).

Some banks use this measure to determine the underlying profitability of the business. An attempt is made to adjust your pre-capital result with changes in stock numbers and changes in produce on hand. It is then further adjusted for a plant and machinery replacement allowance. So the PCAR is a manufactured result but does give an indication of the business's underlying profitability. The formula is shown below:

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                Gross farm income
                Stock purchases
                Total farm income
        Less    Farm working expenditure
                Interest and rent
                Personal drawings
                Tax
                Pre-capital cash result
        +/-     Change in produce on hand
                Change in stock numbers
                Annual plant and machinery allowance
                Pre-capital adjusted result
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Economic farm surplus.

This is a well-known term but maybe not a well understood term. Once again it is slightly manufactured in that there are some non-cash adjustments made. It is a measure that is sometimes used to benchmark the financial performance of one business against another. The EFS does not include interest, rent, tax, drawings or capital expenditure. However it is adjusted for any significant one off events such as development expenditure hidden in R&M or whether no fertiliser or capital fertiliser was applied. It also allows for a wages of management (WoM) adjustment. The formula is shown below:

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                Gross farm income
                Stock purchases
                Total farm income
        Less    Farm working expenditure
                Wages of management
                Stock adjustments
                Plant and machinery allowance
                Farm working expenses adjustments
                Economic farm surplus
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Often the EFS is then shown as a ratio. For example EFS/ha or S.U. It can also be used to calculate your Return on Asset (ROA).

This is an important function for bench marking your business against someone elses.

CashManager

For those of you who use CRS CashManager, you have the ability to run reports to give you a financial performance summary of your business. These reports are easy to use and to understand, and can be very powerful tools in helping you analyses and understand your business.

If you have CashManager, go into the reports and have a look at what is available. If you do not understand the reports or know how to generate them, please contact me.

Key ratios.

Key ratios are very good at giving a quick snapshot of where all the money is being spent. Each category of expenditure is shown as a ratio of your total farm income. However it is important to understand that your total farm income should be adjusted for changes in stock numbers, otherwise the Key ratios will be out of kilter if there was a significant change in your stock numbers.

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If your Key ratios add up to more than 100% then obviously you are spending more than you are earning.

The key ratios can also break everything down to $/S.U., $/ha and or $/kgms.

Summary.

As discussed, it can get awfully confusing. So keep it simple. Stand back and ask the three questions that I discussed at the start:

- Did my net debt go up or down?
- Why did it go up or down?
- And what does this mean for the future?

Work out the 2 or 3 key ratios that important to drive success in your business. Then you need to gain a deep and clear understanding of their impact. You then need to have a plan to systematically improve these ratios over time.

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