

Financial Analysis From A Lender's Perspective

Editor's Note: This is the sixth of a seven part series to explain how Farm Credit analyzes farm and ranch businesses. A different aspect of financial analysis is addressed in each issue.

Net earnings — the barometer for your future

Consider the farmer who is trying to answer the simple question — how did I do last year? His cash flow statement shows a \$42,000 shortfall while his earnings statement shows net earnings of \$17,000. Which one is right? The answer — they both are correct.

Knowing cash flow isn't enough

While cash flow analysis shows if there is enough cash to pay bills in a given period, the key to knowing the true profitability of a business is to analyze its net earnings on an accrual basis. That means taking numbers from cash income and expense records and adjusting them for changes reflected on balance sheets from year to year.

Determining if an operation is profitable requires the farmer to compare the cost of production with the value of crops — regardless of when he paid the bills associated with the crop or when the crop is sold.

For example, a farmer might prepay fertilizer costs — an expense that will be used to generate income next year but shows up on the cash flow statement this year. Or a farmer may choose to hold crops produced in one year and sell them in the next.

How to determine net earnings

Start with your actual cash flow which shows the cash income you received and expenses paid during a certain period of time. Adjusting cash income begins with recognizing income generated but not yet received. For example, if the inventory of crops or livestock you plan to market is greater than it was last year at the same time, that increase is income your farm generated even though it has not been sold. Income generated in prior years, but sold in the period analyzed, must also be adjusted.

Cash expenses should be adjusted to

Numbers tell the story

CASH FLOW Cash Accounting		NET EARNINGS Accrual Accounting	
Cash income	\$40,000	Cash income	\$40,000
		Inventory adjustment	49,000
		Accrual Income	89,000
Cash expenses	82,000	Cash expenses	82,000
		Accrual Adjustments	
		Unused fertilizer	(15,000)
		Unpaid items	1,000
		Accrual Expenses	68,000
		Depreciation	4,000
		Total expenses	72,000
Net cash income	\$(42,000)	Net accrual income	\$17,000

consider supplies such as fertilizer or feed that you have purchased but will not use until next year. In other words, if an expense was incurred for something that was not produced during the period of time you are measuring profitability, it is not counted as an expense for that period.

Interpreting the results

Once net earnings have been determined, the next step is to look at how those earnings are used, which usually falls into three categories: family living expenses, reduction of term debt, or changes in the net worth or equity in the farm or ranch operation.

Analyzing net earnings is important in evaluating your financial progress. When net earnings are positive, you should be building equity. Increased equity can reduce your need to borrow, provide a cushion for adversity or provide a financial base for expansion. ♦

Next week we will look at off-farm income.

FFA's Learn

(Continued from Page A1)

Included at the conference were workshops on the legislative process, college preparation, ag literacy, supervised ag experience/new project ideas, fundraising ideas,

and others.

On Thursday, Kleibocker visited many county FFA chapters to speak to members about their roles as FFA officers.

Use Vaccinations For What They Are

ELKTON, Md. — Vaccinating livestock is an inexpensive way to assure healthy, productive animals on your farm. Always work with your veterinarian in designing a vaccination schedule because each farm is unique and a "typical" recommendation won't be the best recommendation.

How do vaccines work? A true vaccine takes advantage of the animals own immune system and stimulates it to produce antibodies towards the disease. You give an injection of the disease-causing bacteria or virus into the healthy animal and they react.

In a day or two your livestock may seem sickly (fever, droopy head, tired, no appetite, etc.) due to the vaccination. This is normal as long as the animal doesn't become extremely ill. Their bodies are fighting off the disease and, in the process, producing antibodies which will prevent serious outbreaks when they are exposed to higher, more dangerous levels of the disease.

Immunity doesn't last forever. Newborn animals which receive adequate colostrum from their mother's first milk will receive antibodies in a "passive" form. This passive immunity will work for about 6 months and then the level drops off.

Now the young animal has to produce its own antibodies; this is known as "active immunity." Remember, though, the animal will fight off only the diseases it is exposed to.

Now you can see the potential for problems when moving animals from farm to farm, show to show, because they will suddenly be exposed to a wide variety of diseases all at once. Properly vaccinated animals will carry resistance to many common diseases.

Why give booster shots? Here again, the immunity doesn't last forever and multiple exposure to a disease causes the animal to create more antibodies and have greater resistance. (Figure 1)

Vaccines come in different forms. A live vaccine (LV) is simply the "bug" in its normal form. A modified live vaccine (MLV) is a slightly changed organism. The bacteria/virus may have been heated, cooled down or treated in some way that it is no longer so dangerous.

A MLV vaccine will still cause a reaction and the animal will produce antibodies. A killed vaccine (KV) is the safest form to work with, but it might not cause the greatest reaction and less antibodies will be made.

These different forms have different advantages. Pregnant animals could abort if given a LV or MLV, so they must be given a KV of certain diseases. Read the label to be sure the vaccine is safe for that animal.

One other factor to remember — young animals with passive immunity will NOT react to vaccinations well.

If you try injections at an early age, the antibodies present from the mother's colostrum will fight off the disease and no new antibodies will be produced. You just wasted your time and money.

Also, remember that animals given the LV can "shed" the disease. If you treated certain animals and they come in contact with bred animals, the pregnant animals could pick up the disease and abort. Be careful!

Vaccinations are part of the proper management of your livestock, but vaccinations are not perfect.

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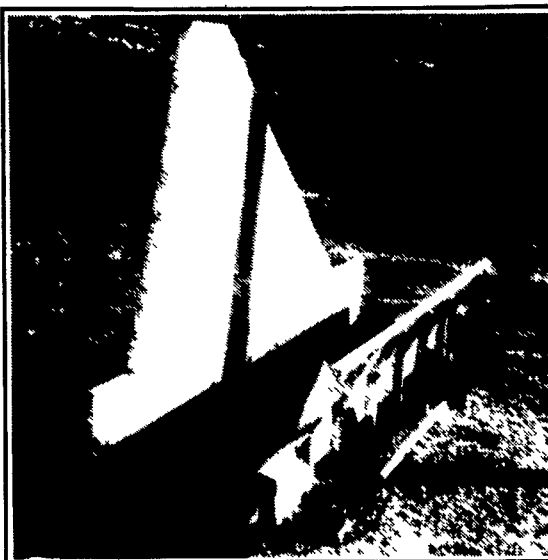
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