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# 17<sup>th</sup> Australian Cotton Conference

## Key profit drivers for evolving farm businesses

Michael Ryan – Booth Associates



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## BOOTH ASSOCIATES

- Agribusiness and Environmental Consultants
- Founded in 1981 and based in Griffith
- Service diverse client base
- Background in agronomy



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## RIVERINA – MELTING POT OF AGRICULTURE



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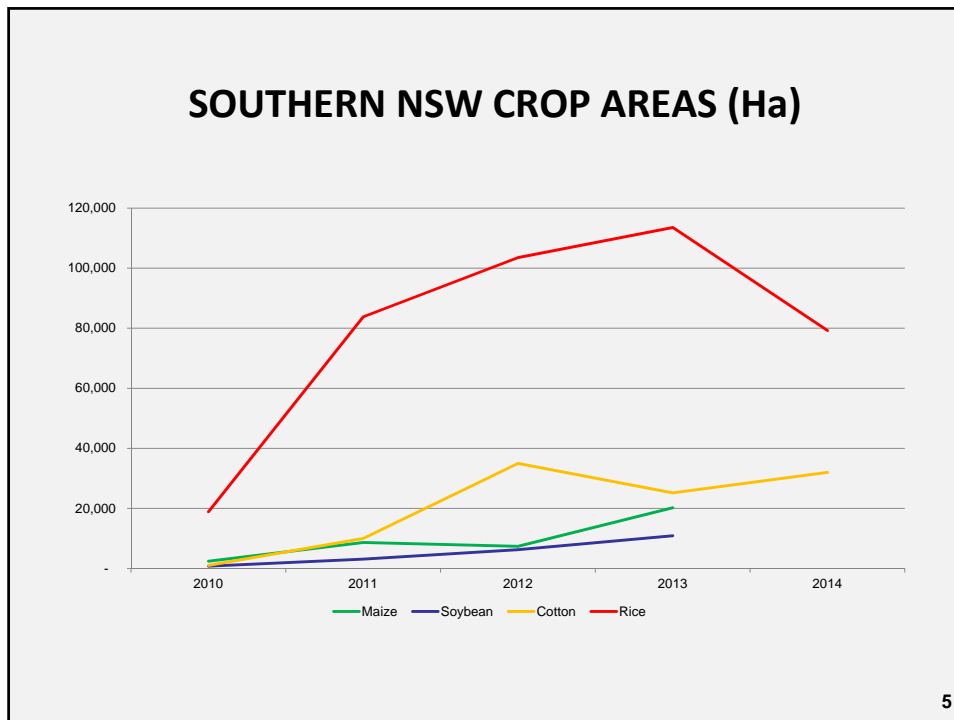
### COTTON EVOLUTION IN THE SOUTH

- Improved genetics and technology to suit climate risk
- Yield trends up with 12+ bale/ha farm averages common
- 2 gins operating & another 2 gins under construction
- Corporate investment in land and water – lower capital costs
- Water allocations more reliable
- Water markets more diverse



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### PROFITABLE CROP PRODUCTION


- **Don't confuse viability and sustainability**
  - Viability is “surviving” from one boom to the next whilst meeting commitments
- **Sustainable profit**
  - The capacity to shock absorb, grow and provide lifestyle.
  - Cash to improve Balance Sheet
- **Think and act long with agile decision making**

**Profit**  
/pro-fit/  
def: The money earned when a business sells products or services for more than the cost to produce them.

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## Enlarging the bullseye


- **Key Profit drivers**
  - Understand drivers of yield
  - Monitor and manage prices and costs
  - Attention to detail – timeliness of operations
  - Agile decision making
  - Plan strategically with tactics for short term adjustments
  - Think and act long



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## Enlarging the bullseye

- Decisions based on gross margins (\$/ML or \$/Ha) often overlook whole of business returns
- Focus on whole of business profit not just an enterprise
- **Planning year-to-year may belie the longer term sustainability of your business**
  - Budget out 3 to 5 years (even annual reviews)
  - Assess opening and closing balance sheet position
  - If necessary accept diminished profit in year 1 for enhanced profit in years 3 to 5.

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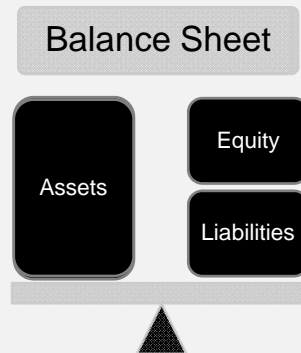
## RETURN ON CAPITAL

- **Aim for best return on capital**
- **Driven by whole farm profit and asset values**
- **Don't have to own all assets**
  - Lease or sharefarm land
  - Lease water or buy on temporary market
  - Share equipment and use contractors

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## DRIVING THE BALANCE SHEET

- An evolving business = an evolving balance sheet



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## PROFIT DRIVING THE BALANCE SHEET

- Profit to drive the balance sheet forward...
  - put your capital in the best position for growth.
- Capital growth is relied upon but there is little control over this outcome
- Scale has considerable influence
  - Scaling up can swallow up required cashflow needed to manage the upsized business
  - *Danger* reduced equity = reduced business resilience



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## PROFIT DRIVING THE BALANCE SHEET

### Location influence on assets

#### Valley comparison to produce 5,000 bales of cotton (cotton/ wheat rotation)

Gwydir	Murrumbidgee
• 900ha farm – 800ha irrigation	• 1,000ha – 900ha irrigation
• 12.5 bales/ ha @ \$475/ bale	• 11.0 bales/ha @ \$475/bale
• 9 ML/ha	• 11 ML/ha
• <b>EBIT = \$587,000</b>	• <b>EBIT = \$397,000</b>
• Land = \$5,000/ha	• Land = \$3,000/ ha
• Water = \$2,200/ ML @ 45% reliability	• Water = \$1,000/ ML @ 65% reliability
• <b>Assets = \$26,011,000</b>	• <b>Assets = 12,091,000</b>
• <b>Return on Capital = 2.3%</b>	• <b>Return on Capital = 3.3%</b>

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### ASSESSING PROFIT AND PERFORMANCE

- Look at whole of business position
- For any period assess change in balance sheet as well as profit and loss
- Compare your performance across years and consider implications of personal needs
  - Children's education
  - Succession planning
  - Aging parents


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### PERFORMANCE MONITORING – THE FINANCIAL FENCE

Template V5

The Financial Fence®  
YTD to end of December In the year to 30 June 2014


Opening Balance Sheet 30 June 2013												Opening Balance Sheet December	
Working Capital	\$	Revenue	Direct Costs	Gross Margin	Overheads & Owner Salary	Debt Free Profit (EBIT)	Finance & Tax Costs	Net Profit	Inventory changes	Adjusted Net Profit	Working Capital	\$	
Cash	0	0	0	0	0	0	0	0	0	0	0	0	
Fixed Capital	0	0	0	0	0	0	0	0	0	0	0	0	
Mgmt	0	0	0	0	-30,000	-30,000	0	-30,000	0	-30,000	0	-30,000	
Total Capital Employed	\$											Total Capital Employed	\$
		Budget											
		Variance (Actual to Budget)											
		Funded By :											
Debt	\$	Profit	Net Profit	Operating Cash Flow	Movements in Fixed Capital	Free Cash Flow	Cash Equity Movements	Net Cash Flow	Non Cash Movements	Equity	\$		
		0	0	0	0	0	0	0	0	0			
		KEY PERFORMANCE INDICATORS (KPI's)											
				Last Year	This Year	PERFORM Group Benchmark							
		KEY MEASURE Return on Capital = EBIT ÷ Total Capital				12.0%							
		ACTIVITY OF BUSINESS Gross Margin = by Revenue				45.0%							
		Overheads = by Revenue				5.0%							
		Debt Free Profit = by Revenue				40.0%							
		STRUCTURE OF BUSINESS Equity = Total Capital				70.0%							
		Working Capital = by Revenue				20.0%							
		Revenue = Total Capital				40.0%							
		Free Cash Flow = Total Capital				15.0%							
Total Funding	\$											Total Funding	\$
Balances												Balances	

### PERFORMANCE MEASURES Booth Associates client data base

KEY PERFORMANCE INDICATORS (KPI's)			Top 20%	Average	Low 20%
Key top level measure	Return on Capital	EBIT ÷ Total Capital	12.0%	6.0%	2.0%
Activity of business	Gross Margin	÷ Revenue	60.0%	45.0%	15.0%
	Overheads	÷ Revenue	2.0%	5.0%	12.0%
	Debt Free (EBIT) Profit	÷ Revenue	55.0%	40.0%	5.0%
Structure of business	Equity	÷ Total Capital	100.0%	70.0%	60.0%
	Working Capital	÷ Revenue	5.0%	20.0%	40.0%
	Revenue	÷ Total Capital	60.0%	40.0%	15.0%
	Free Cash Flow	÷ Total Capital	40.0%	15.0%	5.0%




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## SUMMARY

- Profit is not gross margin
- Even tax profit is not always a true profit
- Yield (revenue) is king
- Optimise cost efficiencies
- Attention to detail
- Agile decision making
- Understand your business and your costs
- Think and act long - understand what you are trying to achieve and have a plan to make it happen.



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