Income Statement

The income statement is organized into seven parts:

- Sales (Revenue)
- Cost of Goods Sold (COGS)
- Direct Operating Expenses (DOE)
- Operating Overheads (OH)
- Cost of Capital (COC)
- Interest Expense
- Other Income and Expenses

The following section explains these parts, their subcategories and what should be included in each.

Sales (Revenue)
This is the value of sales of products from farming operations. The section has spaces for crop and livestock sales as well as other sources of farm income. It should not include government payments except for production insurance. It should not include gains or losses on sales of assets such as machinery or land, nor any form of non-farm income or expenses. These items go at the end of the income statement under “other income and expenses”.

Non-Market Livestock
Non-market livestock are livestock that provide ongoing products. Includes breeding stock, milking animals or animals that provide another renewable product (e.g. wool). Sales of cull animals from these herds/flocks would appear as Market Livestock.

Market Livestock
Livestock sold for their meat, fur, etc.

Cost of Goods Sold (COGS)
This is the cost of inputs that go directly into producing your product. For crops this includes expenses for seed, fertilizer and crop protection material. For livestock it is feed, feeder animals, veterinary fees, medicines, and

breeding expenses. This category also includes costs of crop insurance and marketing fees.

Direct Operating Expenses (DOE)
These are costs of farm operations such as electricity, tools, repairs, operating labour, transportation costs, and custom work. The most common items are listed in the spread sheet, including changes in inventories and prepaids. We have adopted the practice of including any management salaries in the operating labour category instead of operating overheads because of the variety of ways owner-operators pay themselves.

Farmers sometimes expense machinery and equipment in this category instead of in Cost of Capital below. Please include only the annual cost of operating machinery and equipment in this category. Annual depreciation, leasing and/or rental expenses are capital costs. Entering them into this category will make your ratios inaccurate.

Cost of Capital (COC)
The costs that come from owning/renting/leasing land, equipment, facilities etc. This includes depreciation/amortization, land rent, machinery or building lease or rental fees, and land clearing/tiling.

Interest Expense
The cost of financing your operation. Includes interest on long-term debt, interest on operating loans or lines, and, if it can be separated out, interest included in lease payments. It is helpful to list each of the three separately because this information may be important in developing a financing strategy for your business.

Other Income/Expenses
Revenue earned or expenses incurred that is not directly from the business – i.e. NOT from farming operations. Examples include interest income, rental house, solar panels, equity markets, gains or losses from sales of capital items, expenses for home renovations, etc.

Principal Payments
Principal payments are not a part of the income statement. However, they are included on the income statement spreadsheet as this information is needed to calculate your debt-service ratio, found under the “Ratios” tab.

Additional definitions for terms you may find in the income statement can be found below

Gross Margin
Calculated as revenue minus cost of goods sold.

Contribution Margin
Calculated as revenue minus cost of goods sold and direct operating expenses.

Income Tax
The purpose of this format is to assess the operations of the farm business, not the tax management aspects. Thus, income tax expenses are not included as expenses because of the wide range of methods used to manage income tax.

EBITDA
Earnings before interest, taxes, depreciation, and amortization.

EBIT
Earnings before interest and taxes.

Net Income
Calculated as all revenue minus all expenses.

Balance Sheet

The Balance Sheet lists your company’s assets, liabilities and equity at a particular point in time. While the Income Statement shows a summary of the year’s performance, the Balance Sheet shows exactly where the farm’s finances are when the document is produced. Here are some helpful points that explain the different sections of the balance sheet:

- Current assets are assets that will be used within the current year, current liabilities are the obligations that are due within a year.
- Demand loans must legally be included in short term liabilities on your official statements despite them being long term in nature. For our purposes here, include only the current portion of demand loans as current liabilities to properly calculate your ratios. The remainder should go in long term liabilities.

- Similarly, include the current portion of your long-term debts as current liabilities, and the remainder as long term.
- Long term assets are those which have useful life beyond one year, including land, buildings and equipment or machinery.
- Long term liabilities are loans that will be paid out over more than a year. This includes mortgages, equipment loans and leases.
- Other assets are those which are not farm related. Some examples might be investments or shares in a co-op.
- Equity represents the net value of ownership in your business. This section may include owners' initial investment in the business, any additional cash injections, and retained earnings.
- Goodwill is any portion of a company's purchase price that is higher than the sum of the net fair market value of all of the company's assets and liabilities. Common examples include the value of a brand name, a solid customer base, good customer relations, good employee relations, and proprietary technology.
- Marketable securities are financial instruments that can be quickly converted into cash at a reasonable price. They typically have prices that are very stable, with maturities of less than one year.

MY RATIOS

All values in this sheet are calculated and require no input. A summary of the income statement and balance sheet can be found on the left. Further to the right there are five groups of financial ratios that measure the performance of your farm.

- **Margin Ratios:** Measure your farm's operational earnings. Benchmark values for grain and oilseed farms are found in the top-right corner of each measure.

    - **Gross Margin Ratio:** The gross margin ratio compares the gross profit of a company to its net sales to show how much profit a company makes after paying its cost of goods sold. Gross margin is revenue minus cost of goods sold, and the gross margin ratio is gross margin divided by revenue. Gross margin is what's left from revenue after paying for the costs of production materials.

  - **Contribution Margin Ratio:** Contribution margin is calculated by subtracting direct operating expenses from gross margin, and %CM is contribution margin divided by revenue. It is what remains from each dollar of sales after paying all variable input and operating expenses.
  - **Operating Efficiency Ratio:** Operating efficiency ratio is EBITDA divided by revenue. EBITDA is a measure of operating income that has long been used, especially outside of agriculture, to understand the ability of an operation to generate cash after paying operating expenses.
  - **EBIT Ratio:** The EBIT ratio determines whether the fixed costs of the company are too high for the production volume. Earnings before interest and taxes (EBIT) is calculated by subtracting financing costs (cost of capital) from EBITDA. Interest expenses are then subtracted to get earnings before taxes (EBT). The EBIT ratio is found by dividing EBIT by revenue.
  - **Profit Ratio:** The profit ratio measures the amount of net income earned with each dollar of sales generated. It is calculated as net profit divided by total sales.
- **Cost Ratios:** Measure how much you spend relative to your sales. Benchmark values for grain and oilseed farms are found in the top-right corner of each measure.
  - **Cost of Goods Sold Ratio:** The cost of goods sold ratio measures the relationship between cost of goods sold and sales. It is used to check the efficiency of a business and is calculated as cost of goods sold divided by gross revenue.
  - **Direct Operating Expenses Ratio:** The direct operating expense ratio shows how efficient a company's management is at keeping costs low while generating revenue or sales. It is calculated direct operating expenses divided by gross revenue.
  - **Operating Overhead Ratio:** The operating overhead ratio is the comparison of operating expenses and the total income which is not related to the production of goods and service. It is calculated as operating overhead divided by gross revenue.

    - **Cost of Capital Ratio:** Calculated as cost of capital divided by gross revenue.
    - **Interest Expenses Ratio:** The interest coverage ratio is used to determine how easily a company can pay their interest expenses on outstanding debt. It is calculated as interest expenses divided by gross revenue.
- **Liquidity Ratios:** Measure your ability to pay off your current debts, i.e. your short-term financial risk.
    - **Working Capital:** Calculated as current assets – current liabilities.
    - **Working Capital Ratio:** The working capital ratio is a measure of the business's ability to meet its payment obligations as they fall due. It is calculated as working capital divided by total operating costs (operating overheads, cost of goods sold, and direct operating expenses).
    - **Current Ratio:** The current ratio measures a company's ability to pay off short-term liabilities with current assets. It is the standard measure of short-term liquidity, along with working capital (current assets – current liabilities), for most types of business.
- **Solvency Ratios:** Measure your ability to pay off your long-term debt. Measures your general financial risk.
    - **Debt to Equity Ratio:** The debt to equity ratio calculates the weight of total debt and financial liabilities against shareholders' equity. It is calculated as total liabilities divided by owner's equity.
    - **Debt to EBITDA Ratio:** The debt/EBITDA is a measure of long-term solvency risk. It is similar to debt service ratio, but since precise payments are not generally part of financial statements, it can be calculated from what is always included.
    - **Bank Debt to EBITDA Ratio:** The bank debt/EBITDA Ratio reveals how easily a company can pay its bank debt obligations. It is calculated as operating credit and long-term bank debt divided by EBITDA.
- **Profitability Ratios:** Measure your return on assets and equity.

  - **Asset Turnover Ratio:** The asset turnover ratio measures a company's ability to generate sales from assets. It is calculated as total sales divided by total assets.
  - **Return on Equity Ratio:** Calculated as net operating profit divided by owner's equity.
  - **Return on Assets Ratio:** The return on equity ratio measures how efficiently a company is using its equity to generate profit. It is calculated as net operating profit divided by total assets.
- **Debt Service Coverage Ratio:** This ratio is important as it is what banks use to assess loans. The concept is straight forward: it is the ratio of how much money the business has to service your annual debt obligations (after paying operating expenses)

  - **Debt Service Ratio:** The debt service coverage ratio reveals how easily a company can pay its debt obligations. It is calculated as EBITDA divided by all debt (interest, principal, rental, and lease).