

FINANCIAL PERFORMANCE – TRANSITION SCENARIO

In this section you will build on the historical financial performance analysis you conducted back in Financial Performance topic. Analyzing your farm's historical performance helped you decide if your operation was ready to proceed with the transition planning process.

Also, if you have worked through the retirement calculator, you will have determined what level of funds the retiring generation must receive from the farm to finance their retirement. If you haven't completed the retirement calculator exercise, the retiring generation should take the time to do it now, before proceeding with this topic.

You can refer to the Retiring Generation topic for more information on the retirement calculator.

In this section, you will analyze whether the transition scenario, or scenarios, you have discussed is financially possible for the farm.

The first step in this analysis is to prepare a baseline one to three year financial projection for the farm. A financial projection is a budgeting activity that estimates the future financial position of a business. Financial projections begin with estimating sales and their related expenses. For a farm, this involves estimating production and related prices.

To look at testing your different transition scenarios, your financial projection should be based on your historical performance averages, **not** necessarily what the farm actually expects to happen in the near term. This is because the projection is being used to evaluate long-term decisions and therefore, should be based on long-term averages.

It's important to use conservative estimates of production, price and expenses to make sure the scenario you are evaluating will work if the farm encounters one or more bad years.

The baseline projection is prepared on a **no change** basis, **as if** the farm were to remain unchanged for the next one to three years. The baseline projection can be expanded to include a beginning and ending balance sheet or statement of net worth and monthly cash flow.

It's important to know how the transition scenario will affect your balance sheet or net worth. It's also important to know how the transition will ultimately be financed – which has impact on debt and cash flow.

The next step in analyzing your transition scenarios is to add in the transition options you have discussed and decided on to date.

As noted above, refer to the Retiring Generation topic that included the retirement calculator for the amount of money the retiring generation will need from the farm to fund their retirement. Note that the retiring generation may want to think about the option of taking only what they need from the farm. Or, they may want to take more money to allow for a retirement safety net into their future or to give to non-farming children.

Transition scenario factors may include:

- addition of or the increase in wages to the succeeding generation
- addition of or the increase in wages or retirement draw for the retiring generation
- addition of or the increase in draw for non-farming children's estate/inheritance
- the potential for other children joining the farm in the future

- expansion and growth plans and their associated revenues and expenses
- new capital purchases
- new financing
- internally financed buy-out plans
- land or other rental payments

The list of transition factors can be very long and unknown at the time. *However, your farm's analysis needs to include what has been discussed so far. **Your plan does not need to be written in stone at this point.***

The Financial Performance – Transition Scenario analysis becomes a tool used to test what-if situations. That is, your family may have discussed a number of options to date, but the final decision may depend on what works financially for the operation. The scenario analysis helps to put some background to the discussions and decisions.

Why is this relevant?

The financial performance transition scenario helps to bring all the family discussions to date into reality. As mentioned above, the potential scenarios are endless. It's important to understand the financial capacity and limitations of your farm when considering transition options. The transition scenario analysis will narrow your discussions to those that are financially realistic to implement. It is **far better** to have this information at hand before final transition plans are set and implemented.

How will this help transition planning?

- Knowing how possible transition planning discussions impact on financial performance before plans are implemented is extremely important and advantageous.
- The topic promotes communication and understanding of what's being discussed about transition planning.
- The discussion can help to lessen the potential for conflict.

Instructions

1. Prepare a one to three year baseline projection for your farm. You can prepare this information using:
 - a. a spreadsheet tool you may have designed
 - b. FarmPlan, downloadable software available at www.manitoba.ca/agriculture
 - c. another farm projection tool of your choice
2. Analyze the financial ratio results as discussed in Topic 7: Financial Performance on page 35.
 - a. Are ratio results in the baseline projection still trending towards improvement or, at the very least, remaining acceptable?
 - b. If yes, proceed with next step.

- c. If no, you can still proceed with the next step, but usually adding a transition scenario does not by itself improve your financial performance. You should review the baseline projection and look for areas that can be improved or changed so that financial performance can be improved before proceeding with a transition plan.
3. Add your transition scenario to the baseline projection.
4. Compare the financial information (ratios) from your transition scenarios to the financial targets that you established in Topic 7: Financial Performance on page 35.
5. You now have two options:
 - a. If you are satisfied with the viability of the scenario and financial results, proceed to the next step in this guide.
 - b. If you are not satisfied with the viability of the scenario and financial results, try adjusting the scenario to find a combination of things that work financially and still achieve your farm transition goals.

How does this apply?

Use the financial performance transition scenarios step to test multiple possible scenarios. The more scenarios your family tests, the more comfortable you will be with the scenario that you choose to put into your final transition plan. Look for a scenario that:

- yields the best overall financial ratio results
- satisfies cash flow and debt service requirements
- accomplishes your transition goals while putting the least financial strain on the farm
 - Ex: Assume that the farm could complete a retiring generation buy-out plan in 10 years, but retiring generation goals will still be met if the buy-out is extended over 20 years. This would still meet your transition goals but would allow financial room for other farm related opportunities that will likely occur in the future.
- is supported by your lender, accountant and other advisors



PLANNING POINTERS:

- If you are **unable** to find a transition scenario that yields acceptable financial results and accomplishes your transition goals you may want to consider outside help. Consult your current advisors for help or speak to your MAFRD Business Development Specialist - Farm Management.



WHAT TO WATCH FOR:

- Including financial performance in your transition plan discussions can be complicated. It is important that you have the best financial information possible. If you are unsure or have questions about the impact of your transition plan discussions on the farm and family's financial performance, consult your current advisors for help or speak to your MAFRD Business Development Specialist - Farm Management.
- The topic may result in questions that you haven't thought about. These questions can be directed to your advisors or to your MAFRD Business Development Specialist - Farm Management.

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

