MANITOBA ANALYTICS

Financial Performance of Agriculture 2017

Financial Performance of Agriculture in Manitoba

Manitoba's agriculture sector continues to evolve while farm businesses are becoming more sophisticated and capital-intensive with growing debt and asset values. As a result, financial analysis has become an important tool for farm business management more than ever before. The purpose of this report is to provide analysis of key farm financial ratios at the sector level against which Manitoba producers could evaluate their own farm-level financial performance.

Balance Sheet of the Agriculture Sector in Manitoba as at December 31st, 2017 (Thousands of Dollars)

	2015	2016	2017	% 17/16
Total Assets	**43,398,947**	**45,670,409**	**47,826,468**	**105**
Current assets	4,540,872	4,565,564	4,860,666	106
Quota	1,323,690	1,548,717	1,624,106	105
Breeding livestock	1,493,910	1,235,979	1,391,397	113
Machinery	5,310,603	5,47,564	5,600,148	102
Farm real estate	30,083,214	32,228,255	33,775,926	105
Other long-term assets	646,658	610,330	574,227	94
Total liabilities	**7,622,259**	**8,275,721**	**8,712,265**	**105**
Current liabilities	1,622,439	1,734,907	1,799,364	103
Long-term liabilities	5,999,821	6,540,814	6,912,901	106
Equity	**35,776,687**	**37,394,688**	**39,114,203**	**105**

Source: Statistics Canada, Table 32-10-0056-01

Manitoba's total farm assets reached nearly $48 billion in 2017, an increase of 5% as compared to the previous year. Farm real estate (land and building), which accounts for two third of the total farm assets, also increased by 5% in 2017 as compared to 2016. Total farm liabilities in 2017 is close to $9 billion, an increase of 5% from the 2016 level. Farm equity also increased by 5% in 2017 to just over $39 billion.

Financial Ratios

More and more farm operators and financial managers use financial ratios to assess, benchmark and monitor farm profitability and overall financial performance. Creditors and investors use financial ratios to understand the profitability and risk of farming when they make lending or investment decisions.

Financial ratios commonly used to assess the strength of an industry include:

- Liquidity: Current Ratio
- Solvency: Debt-to-Asset Ratio
- Profitability: Return-on-Asset Ratio
- Financial efficiency: Operating Expense-to-Revenue Ratio

The validity and usefulness of financial ratios largely depend on the accuracy of financial data, from which the ratios are generated. As farm financial statements reflect all the production, operating and financial decisions, they often provide the most useful data about a farm operation.

Manitoba

Since no single ratio can give an absolute picture of farm business performance, it is important to monitor and analyze different financial ratios and their trends over time in order to identify areas of strength and weakness for a better farm business management.

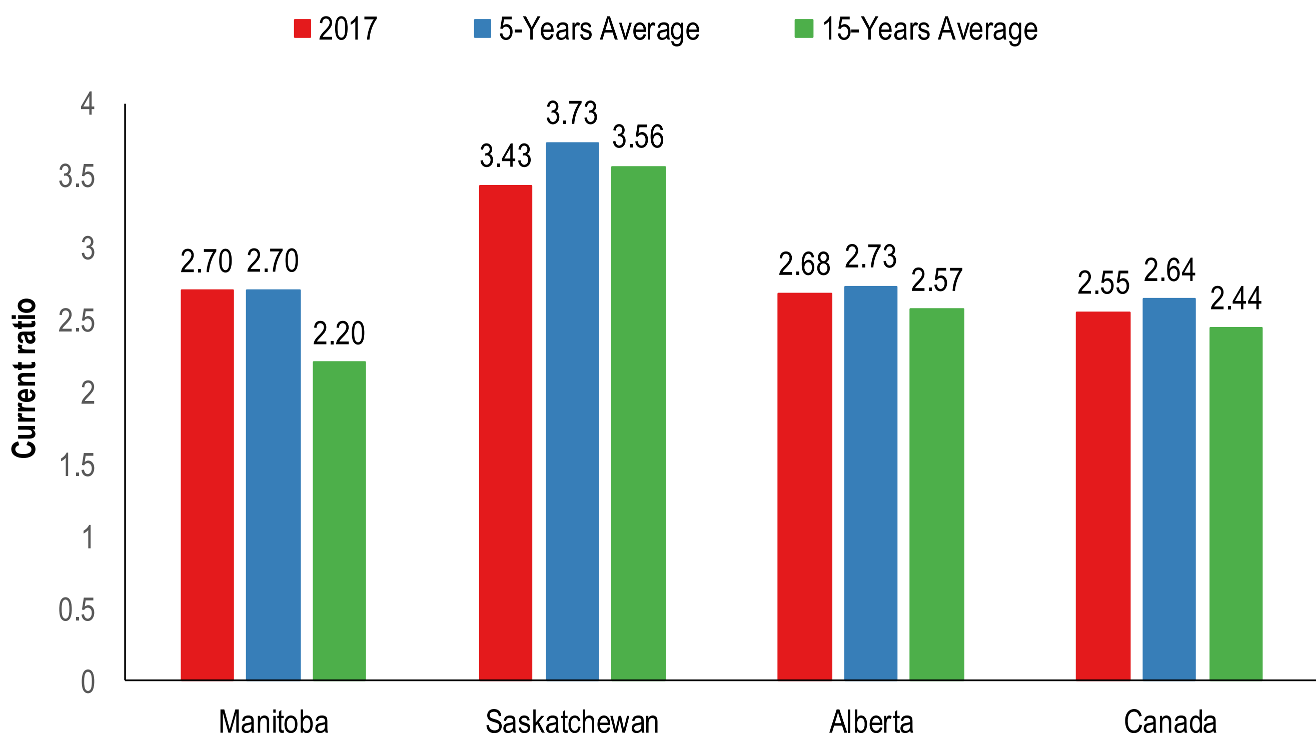
Trend analysis is commonly used to compare a farm's current performance to its past performances. In this analysis, the direction of the trend often carries more weight than the absolute values of financial ratios. Additionally, comparative analysis can be carried out to compare a farm's performance to other similar operations in the industry or to the industry average. A comparative analysis must be done with great care, as the degree of accuracy and consistency of financial data can vary considerably from one operation to another. Often, combining trend and comparative analyses gives a more complete understanding of a farm's financial position and overall performance.

Liquidity

Liquidity refers to the degree to which short-term debt obligations can be paid from cash or other assets. Current ratio is the most commonly used measure of liquidity. This ratio compares current assets (e.g., cash, accounts receivable, inventories) to current liabilities or debt (e.g., accounts payable). It indicates a farm's ability to meet its debt obligations coming due within the next year. A low current ratio (often below one) may indicate that a farm is developing a cash flow problem. On the other hand, a high current ratio (often greater than three) may indicate that a farm is not using cash efficiently, as a large portion of its assets is tied up in conservative investments with lower rates of return.

The overall current ratio of Manitoba farms in 2017 was 2.70, the same as the last five-year average but higher than the fifteen-year average. In 2017, for every dollar debt obligation in the next year, Manitoba farms had 2.70 dollars of assets (current assets) that they can cash out within the next year. In 2017, Manitoba farms had the second highest current ratio in Canada, only behind Saskatchewan.

It should be noted that these current ratios do not reflect those of individual subsectors (e.g. grains, dairy). Rather, these ratios provide relevant information about the financial health of the agriculture industry as a whole, as a higher current ratio indicates less risk of fulfilling short-term debt obligations.



Source: Statistics Canada, Table 32-10-0056-01

Foresight and Analysis, Manitoba Agriculture, 2018-12-12

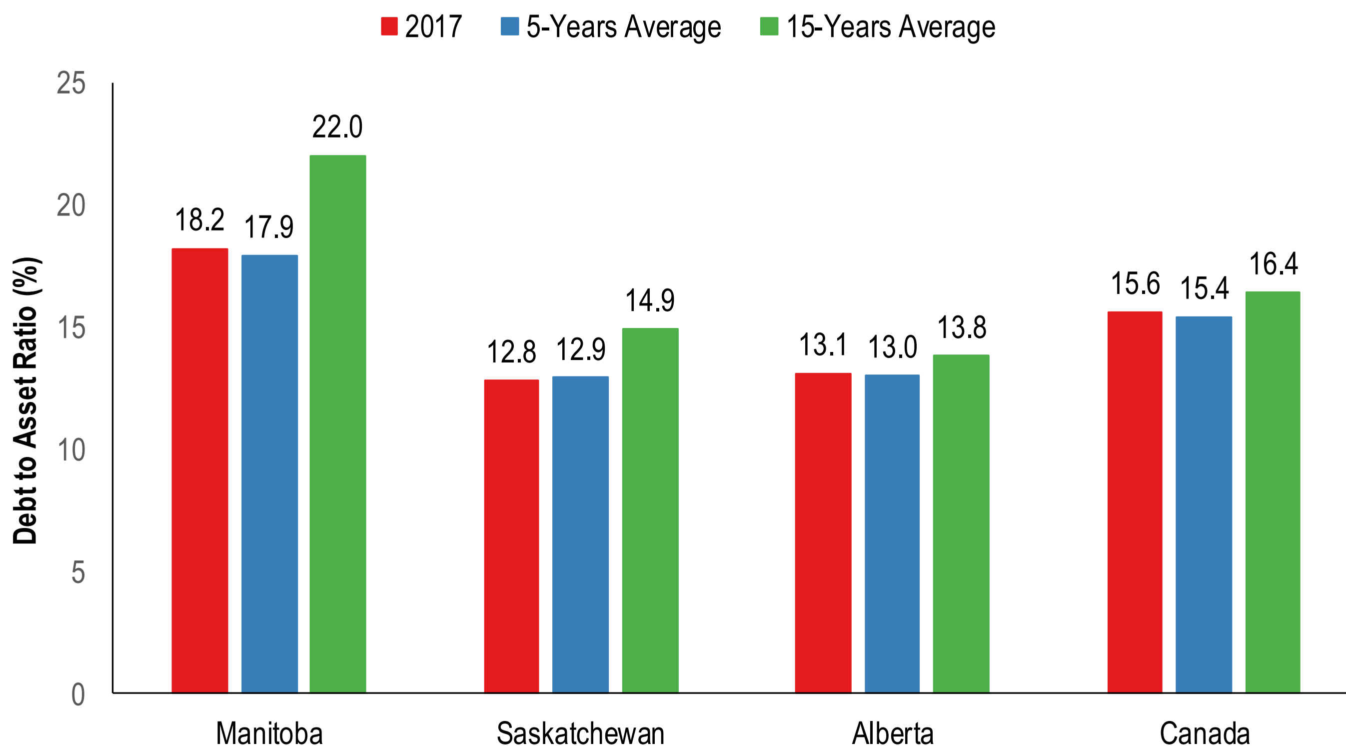
Solvency

Solvency indicates a farm's ability to meet long-term debt obligations. It is concerned with the level of equity and debt of the farm. The most common measure of solvency is debt-to-asset ratio, which indicates the portion of assets financed through debt rather than equity.

Higher debt-to-asset ratio indicates more risk. As the debt-to-asset ratio increases, farm management flexibility decreases and earnings are more stressed to service debt. Monitoring debt-to-asset ratio is very important in agriculture, as a farm's cash flows are subject to seasonal fluctuation due to variation in prices and output level. On the other hand, a low debt-to-asset ratio indicates a farm's flexibility in paying back its debt and being able to borrow more if a need arises.

Manitoba farms reported a debt-to-asset ratio of 18.2% in 2017, meaning that there are 18.2 cents of liabilities for every dollar of assets on the balance sheet of all Manitoba farms. This debt-to-asset ratio is slightly higher than the last five-year average (17.9%) but much lower than the fifteen-year average (22%). It is also higher than the 2017 national average (15.6%). In 2017, Saskatchewan and Alberta had the lowest debt-to-asset ratio, 12.8% and 13.1%, respectively.

Financial risks are relatively low when a debt-to-asset ratio is less than 30%. The fact that all provinces had a debt-to-asset ratio below that threshold in 2017 indicates that the agriculture sector in Canada is financially in a good position.



Source: Statistics Canada, Table 32-10-0056-01

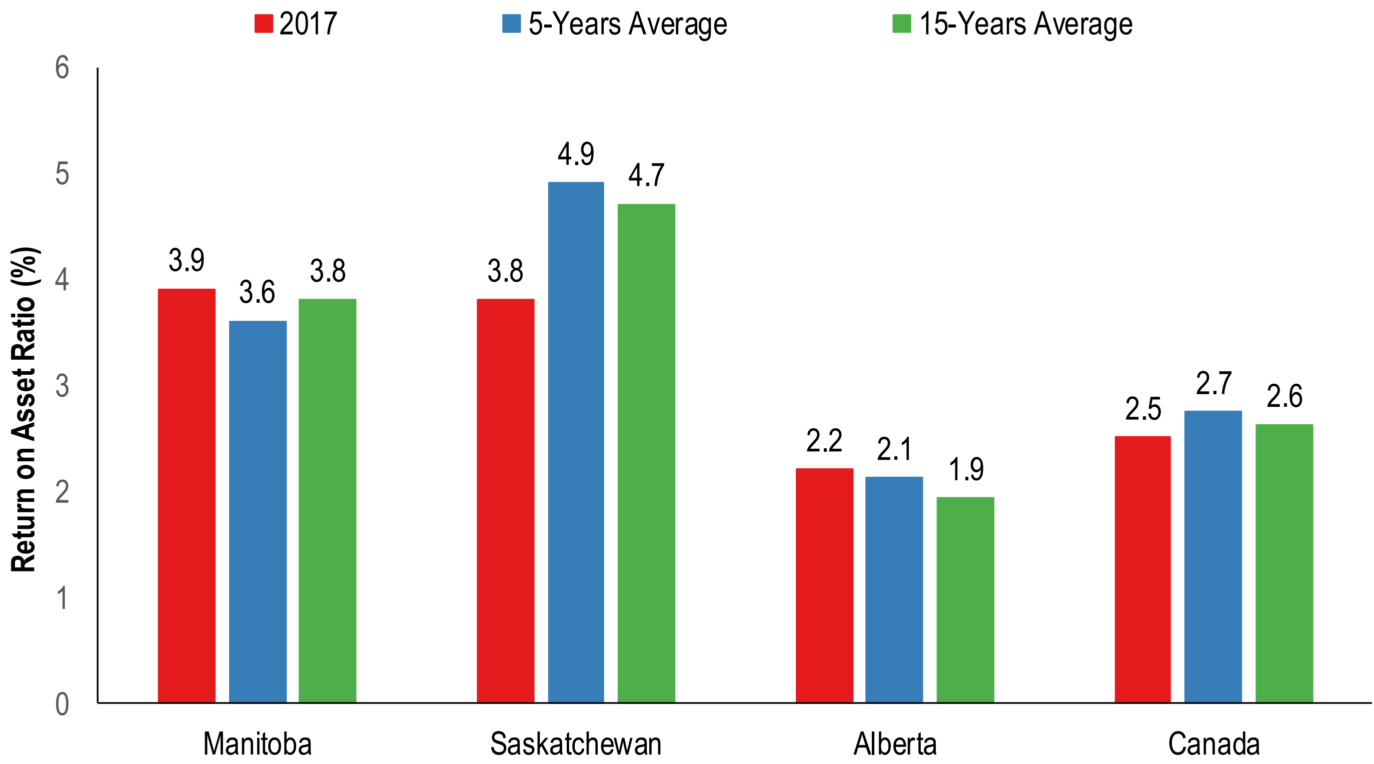
Foresight and Analysis, Manitoba Agriculture, 2019-02-25

Profitability

Profitability is one of the most important measures of farm financial performance. It measures farm's ability to generate profit from its land, labour, and other capital resources. While a farm can operate on break even or negative returns in the short run, it needs profits to sustain its business, service debt, build equity, and support a family in the long run.

A key financial ratio to measure profitability is return on assets, which evaluates total farm income against total assets employed to generate this income. Unpaid family labor is deducted from the total farm income, as it represents a non-cash expense. This adjustment helps to compare farms which pay family wages to those that do not.

In 2017, the return on assets for Manitoba farms was 3.9%, the highest among the Prairie Provinces. This ratio was slightly higher than both the five-year and fifteen-year average. In 2017, the national average return on farm assets was 2.5%. Saskatchewan farms have the highest five and fifteen year average return on farm assets.

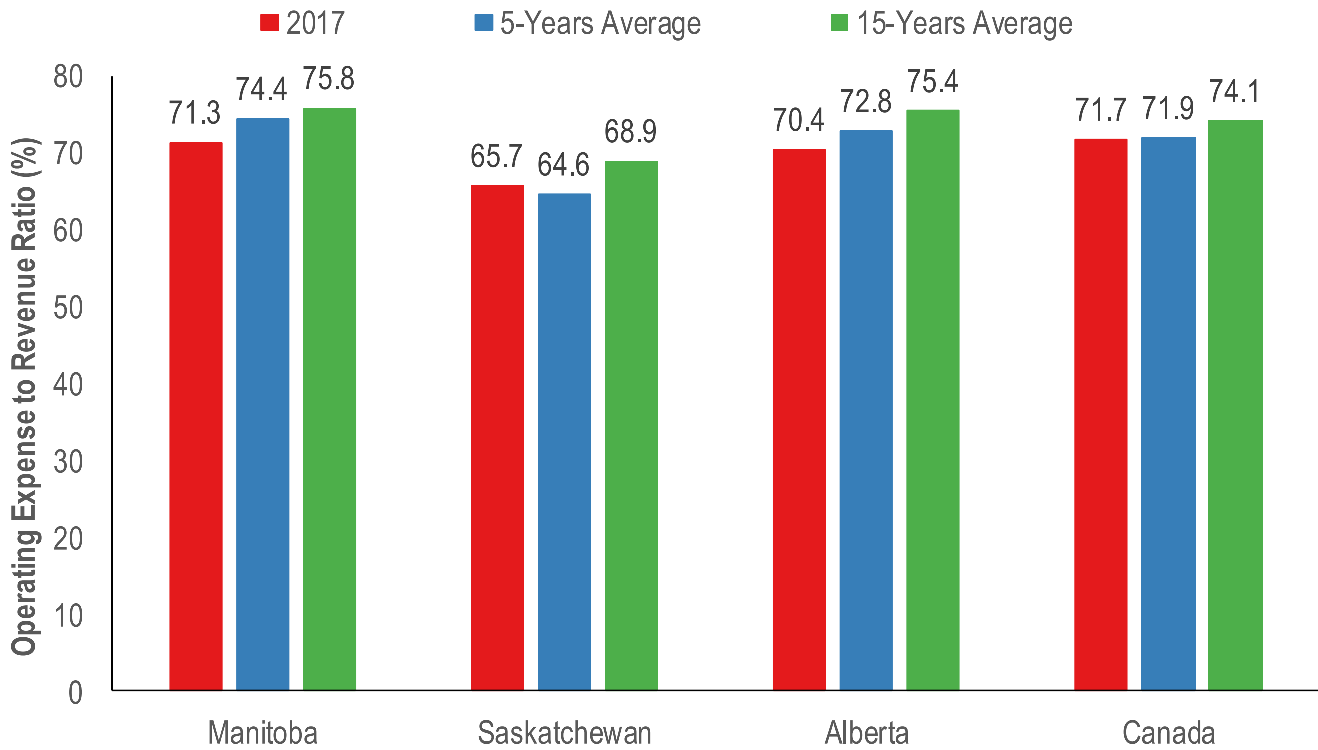


Financial Efficiency

Financial efficiency evaluates how efficiently a farm uses its productive capacities (e.g., inputs, overheads, finance, and machinery) to generate revenue. A key indicator of farm financial efficiency is the operating expense-to-revenue ratio. This ratio provides an answer to the question "how much does it cost a farm to generate $1.00 revenue?" It is derived by dividing total operating expenses (excluding interest costs and depreciation) by gross revenue.

An efficient farm operation would have an operating expense-to-revenue ratio of less than 65%, while an average operation would have a ratio between 65% and 80%. A farm operation with an operating expense-to-revenue ratio above 80% is generally considered inefficient. However, other factors (e.g., land ownership, farm size) should be considered when the operating expense-to-revenue ratio is used to interpret a farm's financial efficiency. For instance, larger farm operations can survive with higher operating expense-to-revenue ratios, because of their larger volume of outputs.

In 2017, Manitoba farms reported an operating expense-to-revenue ratio of 71.3%, slightly above the figures for Alberta (70.4%) and Saskatchewan (65.7%) but close to the national average (71.1%). The operating expense-to-revenue ratios for Manitoba, Saskatchewan, and Alberta ranges between 65% and 80%, which is considered average financial efficiency. There is improvements in financial efficiency over the years in all the three Prairie Provinces.



Source: Statistics Canada, Table 32-10-0049-01 and 32-10-0052-01 Foresight and Analysis, Manitoba Agriculture, 2018-12-18

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