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Welcome to Getting on Track: Understanding Financial Performance. In this course you will learn how to analyze the health of your business using financial ratios.

Click the next arrow to start at the beginning of the course or click the Menu link to select a lesson from the Main Menu. We recommend that you view the lessons in order the first time through the course.

Lesson 2

What is Financial Analysis?



What is Financial Analysis?

Are You Healthy?

What is financial analysis? How is it different from creating and reviewing our financial statements?

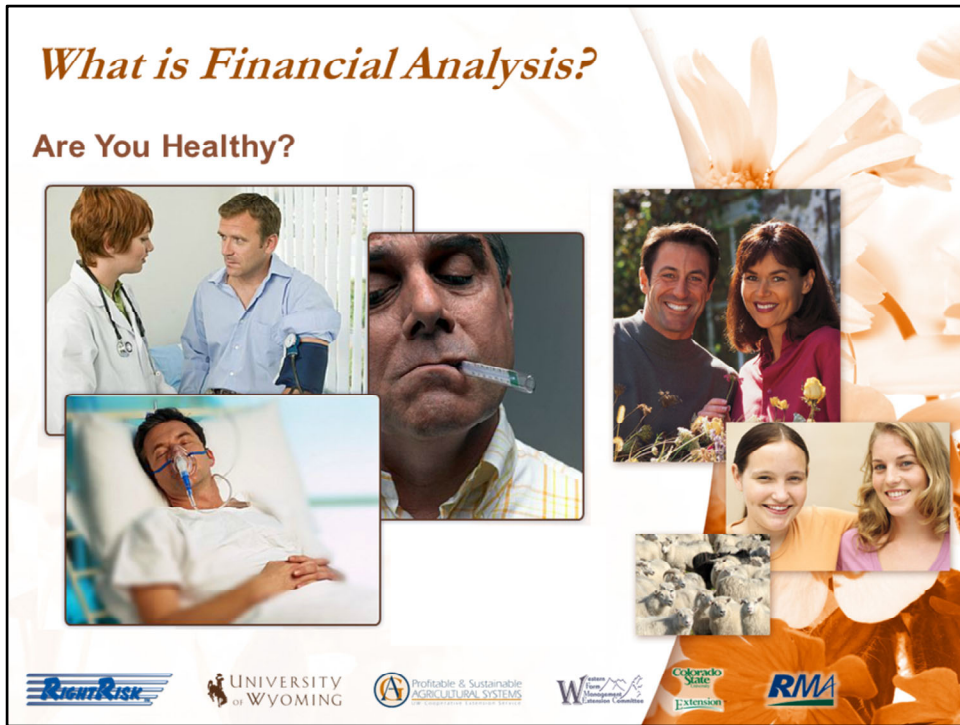


What is Financial Analysis?

Are You Healthy?

In financial analysis, you use the values on your financial statements to assess your financial health much like a doctor uses your vital signs to assess your physical health.





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When you go to the doctor for a check-up, they gather information; such as your blood pressure, your temperature, your pulse, and any other information they deem necessary for determining your medical health.

Each vital sign has some general guidelines of what the measure should be. For example, the temperature for a healthy adult should be between 97.8 and ° 99.1F.

Anything outside this range might indicate a potential health problem. It does not indicate what the problem is, but gives the doctor and patient an indicator that some action may be necessary.

What is Financial Analysis?

Are You Healthy?

Indicators of Physical Health	Indicators of Financial Health
	
<ul style="list-style-type: none">• Blood pressure• Body temperature• Heart rate• Respiration rate• Blood chemistry	<ul style="list-style-type: none">• Liquidity• Profitability• Solvency• Financial efficiency• Repayment capacity



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The process is similar for analyzing financial performance. In financial analysis producers assess the business's financial health and chart its progress. The analysis identifies any strengths and weaknesses and where action may be necessary to correct a problem.

What is Financial Analysis?

Why Do Financial Analysis?

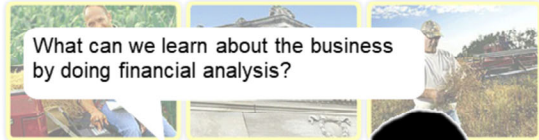
Financial analysis provides information that can be used in different ways by different individuals.

Click on the images below to see how these individuals use information from financial analysis

Farm Manager

Lender

Farmer/Rancher



What can we learn about the business by doing financial analysis?



What is Financial Analysis?

Why Do Financial Analysis?

Financial analysis provides information that can be used in different ways by different individuals.

Click on the images below to see how these individuals use information from financial analysis

Farm Manager

Lender

Farmer/Rancher



Financial analysis provides information that can be used in a variety of ways.



What is Financial Analysis?

Why Do Financial Analysis?

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Click on the images below to see how these individuals use information from financial analysis

Farm Manager



Lender



Farmer/Rancher



Audio:

The information that can be gleaned from financial analysis is useful to different people in different ways. Click on the images to see how different individuals use information from financial analysis.

What is Financial Analysis?

Why Do Financial Analysis?

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Farm Manager



Lender



Farmer/Rancher



Farm managers can use the information to assist in decision making and goal setting to compare business performance to previous years and similar operations.

The measures point out areas of strength and weakness.

Negative trends can provide an early warning system that changes or adjustments need to be made before catastrophic situations occur.



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Farm Manager



Lender



Farmer/Rancher



Lenders also identify areas of financial strength and weakness and look at trends to evaluate credit risk.



What is Financial Analysis?

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Farm Manager



Lender



Farmer/Rancher



Financial analysis can allow farmers/ranchers to answer the following questions:

- Will I be able to pay all my bills on time without disrupting normal operations?
- How do my profits compare to my neighbors or similar operations?
- How do my profits this year compare to last year?
- Can my business financially survive a severe drought or two straight years of drought?
- How efficiently am I using my land and other assets to generate revenues?
- Am I generating enough farm income to repay my land loan?



What is Financial Analysis?

What Should We Measure?

The Farm Financial Standards Council recommends five categories of measurement for financial analysis.

Click the tabs to learn about each category.

- Liquidity
- Solvency
- Profitability
- Financial Efficiency
- Repayment

Ok, we're convinced that financial analysis is a good idea, but how will we know what to measure?



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In 1990 a group of industry experts began working together to promote uniformity in financial reporting and analysis for agriculture. This group, now called the Farm Financial Standards Council, developed Financial Guidelines for Agricultural Producers. The recommended measures were categorized into five broad categories: Liquidity, Solvency, Profitability, Financial Efficiency, and Repayment Capacity.

Click the tabs to learn more about these categories.

What is Financial Analysis?

What Should We Measure?

The Farm Financial Standards Council recommends five categories of measurement for financial analysis.

Click the tabs to learn about each category.

Liquidity

Solvency

Profitability

Financial Efficiency

Repayment Capacity

Liquidity measures the ability of the farm business to meet financial obligations as they come due without disrupting the normal operations of the business.



What is Financial Analysis?

What Should We Measure?

The Farm Financial Standards Council recommends five categories of measurement for financial analysis.

Click the tabs to learn about each category.

Liquidity

Solvency

Profitability

Financial Efficiency

Repayment Capacity

Solvency measures the long run ability of the business to pay all obligations and ability to withstand adversity.



What is Financial Analysis?

What Should We Measure?

The Farm Financial Standards Council recommends five categories of measurement for financial analysis.

Click the tabs to learn about each category.

Liquidity

Solvency

Profitability

Financial Efficiency

Repayment Capacity

Profitability measures the ability of the business to generate more revenues than expenses over a period of time.



What is Financial Analysis?

What Should We Measure?

The Farm Financial Standards Council recommends five categories of measurement for financial analysis.

Click the tabs to learn about each category.

Liquidity

Solvency

Profitability

Financial Efficiency

Repayment Capacity

Financial efficiency measures whether or not the physical resources (assets, operating inputs, borrowed funds) of a business are being utilized and combined in a profitable manner.



What is Financial Analysis?

What Should We Measure?

The Farm Financial Standards Council recommends five categories of measurement for financial analysis.

Click the tabs to learn about each category.

Liquidity

Solvency

Profitability

Financial Efficiency

Repayment Capacity

Repayment capacity measures the ability of the business to repay term debt from farm and non-farm income.



What is Financial Analysis?

Financial Ratios

- There are hundreds of different financial ratios. Each one indicates a different aspect of financial health.
- Smart business managers focus on only a few that are key to the success of their business.
- The Farm Financial Standards Council recommended 21 formulas for measuring the financial viability of farm and ranch operations

How do we measure liquidity, solvency, profitability, financial efficiency, and repayment capacity?



What is Financial Analysis?

Financial Ratios

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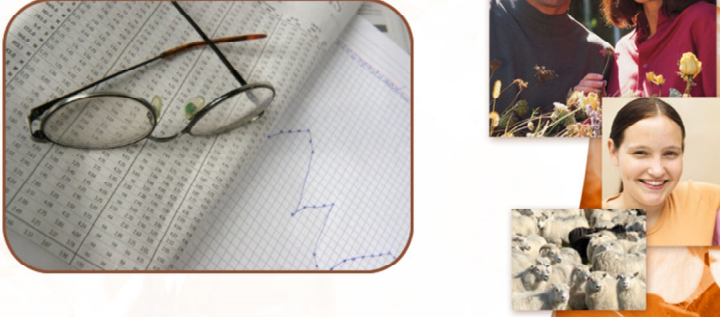
You measure these things by calculating financial ratios. Financial ratios indicate the relationship between different values found on your financial statements.









What is Financial Analysis?

Financial Ratios

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Audio:

There are hundreds of financial ratios that can be calculated.

You can easily become overwhelmed by the number and variety of ratios to choose from. Smart business managers focus on only a few that are key to the success of their businesses.

The Farm Financial Standards Council recommended 21 formulas for measuring the financial viability of farm and ranch operations.

In the following lessons you will learn 11 of these formulas to help you get started with financial analysis. As you become more comfortable with the process, you should include the additional measures that are recommended as well.

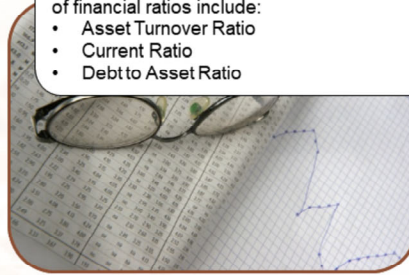
What is Financial Analysis?

Financial Ratios

- There are hundreds of different **financial ratios**. Each one indicates a different aspect of financial health.
- Smart business managers focus on only a few **financial ratios** - key to the success of their business.
- The Farm Financial Ratios are used for measuring the financial position of a business.

Financial Ratios are measures that indicate the financial position of a business. Some examples of financial ratios include:

- Asset Turnover Ratio
- Current Ratio
- Debt to Asset Ratio



What is Financial Analysis?

What Have You Learned?

Question 01 of 03

Select the answer(s) to the questions and click Submit to check your answers.

Select the five key indicators of financial health.

- Solvency
- Repayment capacity
- Net farm income
- Financial efficiency
- Gross profit
- Cash flow
- Liquidity
- Profitability

Submit



Audio:

Answer the following questions to check your understanding of financial analysis. Click Submit to check your answers.

What is Financial Analysis?

What Have You Learned?

Question 01 of 03

Select the answer(s) to the questions and click Submit to check your answers.

Select the five key indicators of financial health.

- Solvency
- Repayment capacity
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- Financial efficiency
- Gross profit
- Cash flow
- Liquidity
- Profitability

Submit

Next Question

That's correct!



What is Financial Analysis?

What Have You Learned?

Question 02 of 03

Select the answer(s) to the questions and click Submit to check your answers.

Which questions can be answered by financial analysis?

- Will I be able to pay all my bills on time without disrupting normal operations?
- How much money did I make last year?
- Is my business as profitable as other similar operations?
- Could I make more money doing something else?
- How efficiently am I using my land and other assets to generate revenues?
- Is my business generating enough income to repay my land loan?

Submit



What is Financial Analysis?

What Have You Learned?

Question 02 of 03

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Submit

Next Question

That's correct!



What is Financial Analysis?

What Have You Learned?

Drag the financial ratio category to what it measures.

Question 03 of 03

Drag the financial ratio category to what it measures.

Liquidity	<input type="text"/>	The long-term ability to pay all debt obligations and the ability to withstand adversity.
Solvency	<input type="text"/>	The ability of a borrower to repay term farm debt from farm and non-farm income.
Profitability	<input type="text"/>	The ability to generate profits over a period of time.
Financial efficiency	<input type="text"/>	The ability to maintain cash flow and pay your bills on time.
Repayment capacity	<input type="text"/>	Whether or not the physical resources of your business are being utilized and combined in a profitable manner.
Submit		



What is Financial Analysis?

What Have You Learned?

Drag the financial ratio category to what it measures.

Question 03 of 03

Drag the financial ratio category to what it measures.

Liquidity	Solvency	The long-term ability to pay all debt obligations and the ability to withstand adversity.
Solvency	Repayment capacity	The ability of a borrower to repay term farm debt from farm and non-farm income.
Profitability	Profitability	The ability to generate profits over a period of time.
Financial efficiency	Liquidity	The ability to maintain cash flow and pay your bills on time.
Repayment capacity	Financial efficiency	Whether or not the physical resources of your business are being utilized and combined in a profitable manner.

Submit
That's correct!



What is Financial Analysis?

Key Points to Remember

- Analyzing financial performance allows you to assess the financial health of your business in the same way a doctor assesses your physical health.
- There are five key indicators of financial health: liquidity, solvency, profitability, financial efficiency, and repayment capacity.
- The five key indicators are measured using financial ratios.



Audio:

You have completed this lesson. Review the key points on screen and then click the Next button to select one of the five key areas of financial performance to explore more deeply.