Making It Happen

Profitability and Success

Case Study 1: Waterville Farm

Can I Pay My Bills?
Should I Make This Investment?

Overview

Waterville Farm is a diversified vegetable and livestock farm growing organic vegetables, as well as raising layers, meat birds and pork. They sell their products at local farmers' markets as well as at the farm. Customers come to the farm to buy their produce, eggs and meat, and pay by the honor system.

Owners Sam and Rachel want to renovate their barn to create more of a "farm-store" area, and a parking lot. They are in a high population area with good traffic counts. But they cannot accommodate more sales from the farm without an improved farmstand. They plan to sell more of their own products, as well as meat and value-added items bought from other farmers. Given the labor and time constraints of selling at farmers' markets, they think an on-farm sales area is important to their growth. One of their goals is to work towards an owner's draw of $50,000 per year.

If they do build a new farmstand, they'd need to take out a loan for the improvements and capital purchases. Converting the makeshift farmstand to a permanent structure would cost approximately $120,000. They'd also need to buy coolers ($5,000), as well as new signage for the front of the building and the street ($2,000). To properly grade and pave the area around the farm store for parking would be an additional cost of $18,000. With the $145,000 loan, they annual payments will be $11,000.

Sam and Rachel think the improvements will pay off. They expect sales will increase with the farmstand. Further, they'll gain efficiencies and their overall cost of production will decrease from 68%. They determined that their expenses would go up because of the increased labor needed to

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staff the farmstand ($35,000), and increased utility bills ($5,000) from the new lighting and refrigeration.

They are not sure whether the investment in a farmstand makes sense or how to decide, so they seek advice from their financial advisor. She suggests they do a sensitivity analysis to compare what the business would look like with and without the improvements. They expect that once the farmstand has been built, the cost of running it will stay stable even if business increases: There really isn't room to hire additional staff, and their utilities bill is limited by the equipment.

Step 1: Review historicals

See Handout 1.

Step 2: Identify incremental changes

a. How will the sales increase?
b. What current expenses will change?
c. What new expenses will they have?
d. What expenses will change with an increased volume of sales and what will stay the same?

Step 3: Outline changes based on new scenario

See chart on next page.

Step 4: Organize your numbers

Examine the profitability with and without the change. What is different?

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	Start Up	Ongoing
Cash Inflows		
Cash Outflows		

Step 5: Does it make sense?

Step 6: Sensitivity & breakeven analysis

Test assumptions. What happens i**f their sales don't meet projections?** At what point will they have problems?

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Step 7: Decision making

After reviewing the numbers—seeing the potential for profit and the minimum sales needed to make the venture work—what would you advise Waterville Farm?

- Would you advise them to go ahead with the renovation?
- What risks are involved? How would you recommend mitigating them?
- What recommendations would you offer to improve their chances for success?
- What new business skills and habits do they need to ensure their success?
- What other options do they have for growing the business?

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