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**ALRICH FARMS: CASH FLOW ANALYSIS**

*Richard Bloomfield wrote this case under the supervision of Elizabeth M. A. Grasby solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.*

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On January 4, 2016, Rick and Hailey Alrich were reviewing the operations of their farm, located on the outskirts of London, Ontario, Canada. Specifically, Rick and Hailey wanted to evaluate how well they had managed the farm’s cash over the past year. Given the volatility of the agricultural industry, cash flow was critically important to the long-term stability of any farm. After 30 years of successfully sustaining their farm business—one that had been passed down through multiple generations of the family—the Alriches hoped that strong financial management would allow them to continue by passing the farm on to the next generation.

CANADIAN AGRICULTURE HISTORY

Agriculture was arguably the most important industry in the world, given the critical importance of food production to the survival of all human societies. While farming practices had been documented for thousands of years, the past century had seen the most dramatic changes in how farms operated and what they produced. Prior to the green revolution[[1]](#footnote-1) between the 1930s and 1960s, most farmers produced food for their immediate family members and then directly sold or exchanged whatever surplus they had at local farmers’ markets. The rapid acceleration in technology resulted in the mechanization of cultivation methods, new varieties of seeds, chemical fertilizers, and pesticides. In response, individual farm owners became less likely to produce a variety of food products and instead rapidly began to specialize in one or two specific food commodities. These commodities were sold in bulk at wholesale prices to grain elevators or brokers.[[2]](#footnote-2) With this dramatic shift in agricultural production, farming had become much less labour-intensive and more dependent on modern machinery and other technological advancements. Over time, as the lifestyle of Canadians became increasingly urban, farming became an alternative lifestyle. For example, in 1931, approximately half of the Canadian population lived in rural settings, and by 2011, 81 per cent of Canadians lived in urban centres.[[3]](#footnote-3) Furthermore, the number of farms in Canada dropped by 10.3 per cent between 2006 and 2011;[[4]](#footnote-4) by 2011, only 1.8 per cent of the total Canadian population lived on a farm.[[5]](#footnote-5)

In the 21st century, Canadian farms continued to use less labour. For example, while the total farmland area in operation remained virtually unchanged between 2006 and 2011, in 2006, there were 327,060 farm operators, and this number had dropped to 293,925 by 2011.[[6]](#footnote-6) Over the same time period, gross farm receipts had increased by almost four per cent, and the average farm size in acres had increased by seven per cent. The majority of the growth in gross farm receipts was concentrated on larger farms. The age of farm operators also increased during this period; the percentage of farm operators aged 55 and older had increased from 32.1 per cent in 1991 to 48.3 per cent in 2011.[[7]](#footnote-7)

Despite the ongoing trend towards larger farms and commodity specialization, the last few decades had also witnessed a renaissance of the “farm-gate-to-consumer” relationship.[[8]](#footnote-8) More consumers were demanding not only fresh food products but also knowledge about where their food was produced and by whom. These consumers cited health and social benefits for choosing local farmers’ markets over grocery retailers. Thus, local farmers’ markets became increasingly important and prevalent in the marketplace. By selling directly to consumers, farmers eliminated intermediaries (wholesalers, traders, and retailers) and obtained higher margins on these sales.[[9]](#footnote-9)

ALRICH FARMS

Rick and Hailey Alrich were both raised on farms in Southwestern Ontario. Their ancestors had owned and operated their farms since immigrating from England and Scotland in the late 1700s. Farming was viewed as much more than a livelihood for generations of the Alrich family. Despite the demographic shift over time, most of the Alrich family continued to live in rural settings, and many of them continued to operate farms.

Rick and Hailey Alrich had been involved in livestock[[10]](#footnote-10) and crop production since 1985. After discontinuing their beef operation in 1990, they purchased another farm from Rick’s grandfather and focused exclusively on producing commodity crops such as corn, wheat, oats, peas, and soybeans.[[11]](#footnote-11) As recent consumer trends demanded more food products directly from the farm gate, Rick and Hailey had begun producing organic pasture-raised chicken and eggs. For three and a half years, Rick and Hailey had been selling chicken and eggs directly to customers who drove to the farm to purchase their products. They planned to soon expand into raising organic grass-fed beef.

The Alrich farm had survived the abnormally high interest rates of the 1980s, various drought periods, commodity price collapses, and devastating epidemics of crop disease and pest outbreaks. Often, a change in weather patterns could mean the difference between a healthy profit margin and a net loss in any given fiscal year; due to these many unpredictable variables, profitability was a poor metric of the farm’s performance. Although they had had to make some difficult financial decisions through the years, the Alriches had never considered selling the farm as a desirable option. For these reasons, the couple focused on maintaining a healthy cash position; if they could remain solvent during vulnerable economic times, they would be well positioned to take advantage of the often contiguous stable years.

CASH management

Although fiscal 2015 had been a good year (see Exhibits 1 and 2), Rick and Hailey wanted to evaluate their sources and uses of cash during this period. For example, had they used appropriate sources to fund capital expenditures? The couple knew better than to expect a positive cash balance, since the timing of expenses and revenues involved with farming invariably resulted in an overdraft balance at fiscal year-end. However, they did need to ensure that they had not exceeded their negotiated overdraft limit on their business account with their local bank.

CONCLUSION

Rick and Hailey intended to pass on a viable farm operation to their two children, just as the previous Alrich generation had done for them. The couple had farmed for over 30 years, and the time for succession planning was quickly approaching, so taking steps to improve the solvency of their farm operation was paramount.

Rick and Hailey sat down with a pot of locally roasted coffee to create a statement of cash flows for fiscal 2015. They would then assess the current solvency of the farm.

EXHIBIT 1: ALRICH FARMS—STATEMENT OF EARNINGS  
Year ended December 31, 2015 (in Canadian dollars)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| REVENUE |  |  |  |  |
|  |  |  |  |  |
| Crop revenue |  | 198,465 |  |  |
| Livestock revenue |  | 26,278 |  | $224,743 |
|  |  |  |  |  |
| Variable crop costs |  | 125,665 |  |  |
| Variable livestock costs |  | 7,971 |  | 133,636 |
|  |  |  |  |  |
| Contribution |  |  |  | 91,107 |
|  |  |  |  |  |
| FIXED COSTS |  |  |  |  |
|  |  |  |  |  |
| Fuel––machinery & vehicle |  | 5,488 |  |  |
| Maintenance––machinery & vehicle |  | 15,911 |  |  |
| Insurance––machinery & vehicle |  | 3,208 |  |  |
| Equipment repairs |  | 3,330 |  |  |
| Loss on sale of equipment |  | 1,924 |  |  |
| Gain on trade-in of machinery |  | (3,944) |  |  |
| Depreciation––fixed assets |  | 17,582 |  |  |
| Salaries |  | 35,000 |  |  |
| Interest |  | 8,687 |  |  |
| General & administration |  | 11,022 |  |  |
| Total fixed costs |  |  |  | 98,208 |
|  |  |  |  |  |
| Net income before taxes |  |  |  | (7,101) |
| Income taxes |  |  |  | – |
|  |  |  |  |  |
| Net income after taxes |  |  |  | $(7,101) |

Note: Fixed assets were depreciated using the straight-line method; in fiscal 2014, Alrich Farms’s net income was $3,042 on gross revenues of $224,560.

Source: Company files.

EXHIBIT 2: ALRICH FARMS—STATEMENT OF FINANCIAL POSITION

As at December 31 (in canadian dollars)

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **ASSETS** |  | **2015** | | | |  | **2014** | | |
| Current assets: |  |  | |  | | | | | |
| Cash |  |  |  | | $(57,532) |  |  |  | $(59,394) |
| Accounts receivable |  |  |  | | 6,477 |  |  |  | 4,487 |
| Inventory |  |  |  | | 14,529 |  |  |  | 11,585 |
| Total current assets |  |  |  | | (36,526) |  |  |  | (43,322) |
|  |  |  |  | |  |  |  |  |  |
| Fixed assets: |  |  |  | |  |  |  |  |  |
| Land |  |  |  | | $478,000 |  |  |  | $478,000 |
| Land improvements, drainage |  | $100,317 |  | |  |  | $100,317 |  |  |
| Less: Accumulated depreciation |  | (36,180) |  | | 64,137 |  | (32,160) |  | 68,157 |
| Machinery & vehicle |  | 208,448 |  | |  |  | 198,518 |  |  |
| Less: Accumulated depreciation |  | (43,865) |  | | 164,583 |  | (54,708) |  | 143,810 |
| Equipment |  | 97,258 |  | |  |  | 126,713 |  |  |
| Less: Accumulated depreciation |  | (22,673) |  | | 74,585 |  | (30,216) |  | 96,497 |
| Total fixed assets |  |  |  | | 781,305 |  |  |  | 786,464 |
|  |  |  |  | |  |  |  |  |  |
| Total assets |  |  |  | | $744,779 |  |  |  | $743,142 |
|  |  |  |  | |  |  |  |  |  |

EXHIBIT 2 (CONTINUED)

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **LIABILITIES & SHAREHOLDERS’ EQUITY** |  | **2015** | | |  | **2014** | | |
|  |  |  |  |  |  |  |  |  |
| Current liabilities: |  |  |  |  |  |  |  |  |
| Accounts payable |  |  |  | $2,454 |  |  |  | $4,454 |
| Current portion––Farm Credit Canada |  |  |  | 3,500 |  |  |  | 3,500 |
| Current portion––R&E |  |  |  | 6,750 |  |  |  | 6,750 |
| Total current liabilities |  |  |  | 12,704 |  |  |  | 14,704 |
|  |  |  |  |  |  |  |  |  |
| Long-term liabilities: |  |  |  |  |  |  |  |  |
| Bank loan payable |  |  |  | 27,352 |  |  |  | 4,775 |
| Tile loan––Township |  |  |  | – |  |  |  | 1,589 |
| Mortgage payable––Farm Credit Canada |  |  |  | 95,957 |  |  |  | 99,457 |
| Mortgage payable––R&E |  |  |  | 42,000 |  |  |  | 48,750 |
| Promissory note––T&E |  |  |  | 50,000 |  |  |  | 50,000 |
| Total long-term liabilities |  |  |  | 215,309 |  |  |  | 204,571 |
|  |  |  |  |  |  |  |  |  |
| Total liabilities |  |  |  | 228,013 |  |  |  | 219,275 |
|  |  |  |  |  |  |  |  |  |
| Shareholders’ equity |  |  |  |  |  |  |  |  |
| Common stock |  |  |  | 100 |  |  |  | 100 |
| Retained earnings |  |  |  | 516,666 |  |  |  | 523,767 |
| Total shareholders’ equity |  |  |  | 516,766 |  |  |  | 523,867 |
|  |  |  |  |  |  |  |  |  |
| Total liabilities and shareholders’ equity |  |  |  | $744,779 |  |  |  | $743,142 |

Notes: The Alrich farm had a $65,000 overdraft limit at the bank; T&E was an arm’s-length financial institution of the local municipal township; R&E was a loan from the previous generation of the Alrich family.

Source: Company files.

1. The term “green revolution” refers to rapid changes in agriculture, aided by research and the development of new technology, which focused almost exclusively on increasing the efficiency of food production, typically through higher yielding crops. [↑](#footnote-ref-1)
2. Wendell Berry, *The Unsettling of America: Culture and Agriculture* (San Francisco: Sierra Club Books, 1996), 34. [↑](#footnote-ref-2)
3. “Population, Urban and Rural, by Province and Territory (Canada),” Statistics Canada, February 4, 2011, accessed January 19, 2017, www.statcan.gc.ca/tables-tableaux/sum-som/l01/cst01/demo62a-eng.htm. [↑](#footnote-ref-3)
4. “Chapter 1: Number of Farms in 2011,” Statistics Canada: Snapshot of Canadian Agriculture, January 25, 2016, accessed January 19, 2017, www.statcan.gc.ca/pub/95-640-x/2011001/p1/p1-01-eng.htm#II. [↑](#footnote-ref-4)
5. “Table 004-0127—Socioeconomic Overview of the Farm Population, Distribution in the Total Population and the Farm Population for the Rural and Urban Centres Population by Sex and Age, Every 5 Years (Number unless otherwise noted),” Statistics Canada, November 27, 2013, accessed January 19, 2017, www5.statcan.gc.ca/cansim/pick-choisir?lang=eng&p2=33&id=0040127. [↑](#footnote-ref-5)
6. “Characteristics of Farm Operators: Table 8.1: Total Number of Farms and Total Number of Operators, Census Years 2006 and 2001,” Statistics Canada, May 11, 2007, accessed January 19, 2017, www.statcan.gc.ca/pub/95-629-x/8/4182943-eng.htm. [↑](#footnote-ref-6)
7. “Farm and Farm Operator Data: 2011 Census of Agriculture,” Statistics Canada, January 25, 2016, accessed January 19, 2017, www.statcan.gc.ca/pub/95-640-x/95-640-x2011001-eng.htm. [↑](#footnote-ref-7)
8. Whereas many consumers purchased products from grocery retailers, the term “farm-gate-to-consumer” referred to direct relationships and economic transactions between farmers and end-consumers. [↑](#footnote-ref-8)
9. Gilbert Gillespie, Duncan L. Hilchey, Clare Hinrichs, and Gail Feenstra, “Farmers’ Markets as Keystones in Rebuilding Local and Regional Food Systems,” in Remaking the North American Food System: Strategies for Sustainability, ed. Clare Hinrichs and Thomas A. Lyson (Lincoln: University of Nebraska Press, 2007), 65–80. [↑](#footnote-ref-9)
10. Livestock were animals raised on a farm to produce a sellable commodity. Food products such as meat, dairy, and eggs were the most common commodities chosen. [↑](#footnote-ref-10)
11. The couple was also employed in the workforce. [↑](#footnote-ref-11)