FDC Farming Newsletter

Summer, 2005

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Dairy Partnerships

With an ever shrinkin[illegible] n labour and the increasing costs of that labour, dairy farmers may be well advised to investigate the pros and cons of entering into a dairy partnership with one or two neighbouring farmers. There can be many different motivations for entering into a milk production partnership but typical reasons would be:
•To create more free time and improve quality of life generally.
•To avail of the benefits associated with larger production units, i.e. economies of scale.
•To make better use of the labour available on the individual units involved.

There are two types of dairy partnership, which are:
•Milk Production Partnership
•New Entrant / Parent Partnership

Features particular to each type are:

Milk Production Partnership
•Maximum of three, normally unrelated, parties within 12 miles (20 km) of each other
•Maximum ratio of quotas cannot be more than 4:1

New Entrant / Parent Partnership
•Provisional approval from milk processor required first
•New entrant cannot have owned / leased milk quota beforehand
•Maximum combined quota of 500,000 litres (110,000 gallons)

Features common to both types are:
•Minimum term of five years
•Registration and annual fees apply
•Off-farm income limit of 27,000 for parent / partner and 24,000 for new entrants
•Only one herd number for the partnership, other herd numbers must be made dormant or cancelled
•Cannot have a separate farming operation outside of the partnership
•Maximum age for any partner / parent is 62 at commencement of partnership
•At least 70% of quota(s) must have been supplied in preceding two years
•Individual milk quota rights would still remain
•Newly acquired / leased / rented land must be brought into the partnership

The body responsible for the administration of partnerships is the Dairy Partnerships Registration Office, which is located in Moorepark, Fermoy, Co. Cork. They would be regarded as being quite approachable and will assist in any way they can.

The formal approval of a partnership is based on the partnership agreement drawn up between the parties. The Registration Office has a number of points that they will insist on being included and a proposed partnership will not be endorsed until all these issues are addressed.

The real complications become apparent in the working agreement, which basically governs the day-to-day aspects of the partnership. It is possible to treat these two areas of the partnership agreement separately but it would be strongly inadvisable to create an agreement that covers enough points just to get approval from the Registration Office and then neglect to address the remainder. There are potentially hundreds of points to be addressed but typical areas that would be covered in the working agreement would be:

•Working arrangements e.g. weekends, holidays
•Banking and Finance
•Appointment of Accountants, Solicitors, Arbitrator etc
•Responsibilities of each partner

Dairy Partnerships are fraught with potential pitfalls and so the decision to enter into one should only be made after much consultation and deliberation. Legal advice and representation may be necessary as would accountancy input to cover areas such as taxation. The overriding feature of any partnership agreement is **trust**. If one partner either seems or feels mistrusted, then the partnership will flounder before it has even begun. If the partnership agreement is properly drawn up, then any potential disputes will either be already addressed or can be dealt within the terms of the agreement.

Denis Fitzgerald, FDC Agricultural Consultants, Cahir

Mortgage/ Borrowing.

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Corporate Finance (BES)

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Income Tax Planning

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Inheritance/Wills

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CGT Planning

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Corporation Tax

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Auditing

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Co. Formation

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Co. Secretarial

Investment Review May/June 2005

•Global equities rallied in May rising 3.24% in terms (FT World index). Since the beginning of 2005, Global equity markets have gained 5.49% in terms. Global equity markets have gained 6.96% in terms over the last six months.

•The European recovery has lost momentum since mid-2004, but it should resume in 2006. Growth is projected to drop from just below 2% in 2004 to 1.25% in 2005 before recovering to around 2% in 2006, with final domestic demand firming. The output gap will remain negative and the unemployment rate high at over 8.5%.

• Once the impact of the oil price hike peters out, headline inflation should fall to 1.25%. Another hike in oil prices or a further appreciation of the euro could sap the recovery further.

•The Bank of England (BoE) trimmed its forecast for economic growth for 2005 and said a slowdown in consumer spending has become more marked, strengthening the expectation of an interest rate cut in the second half of this year. The BoE expects growth of 2.6% in 2005, down from February's projection of 2.7%.

•The US Federal Reserve raised interest rates by 0.25% to 3%, the eighth 0.25% rise since June 2004. The accompanying statement by the Federal Reserve reiterated its intention to continue to raise rates at a measured pace, but acknowledged that spending growth was slowing and consumer inflation was rising as a result of higher energy costs.

•The US dollar continues to trade near a six-month high against the Euro. The recovery in the dollar was driven by expectations that the US economy will outperform Europe. US dollar strength was helped by the unexpected decline in the US trade deficit in March.

•The Irish equity market had a very good month in May, up nearly 7%. It is now marginally positive year to date. Irish financials recovered some significant ground in May and

New Exclusive 30 Day Notice Deposit Rate

FDC Financial Services are pleased to announce that we have access to a very attractive deposit rate of 3.65% on a 30 day notice basis. For further information contact your local FDC office and ask to speak to one of our financial consultants. Alternatively you can contact our head office on 021-4509022.

Concern for the Euro

Euro Survives and interest rates should stay low.

As if the euro zone economy hadn't enough to deal with in terms of struggling growth, the playground tantrums in Brussels seem to be conspiring to throw the economy off the rails.

The French gave a resounding **No** to the EU constitution on May 29th. This might well have a knock on effect on business confidence. There now is evidence of concerns about the sustainability of the European project.

This has been compounded further by Messrs Blair and Chirac deciding to use the important debate about European Budget management going forward, to settle old scores and turn the entire process into a cat fight.

We have already seen the negative impact this has had on the Euro exchange rate against the dollar and with oil prices reaching an all time high of $60 a barrel; this will increase the inflationary pressure throughout Europe.

But it is not all doom and gloom as a weaker currency should substantially assist our exports and this will assist in improving future growth forecast. Fundamentally with nearly 400 million people in the European Union and with sustained growth managed by sensible budgetary policy the Euro while shaken is far from being in danger of collapse.

The forecast in terms of ECB rate movements has now moved from expectations of increase at the start of the year to now expecting the current rate of 2% to be maintained or even slightly reduced over the next 6 months. This is obviously good news for all of us mortgage payers but will also act as a further catalyst in the never ending domestic house price growth.

On the home front despite the nerves coming from Europe, exchequer returns are still beating all forecasts and GDP estimates for 2005 have been revised upwards from 3.5% to 4.25%. Employment growth is also well ahead of expectations so I

Topical Tax Issues:

Stamp Duty

The recent Finance Act has confirmed the Stamp Duty changes announced in the Budget. First Time Buyers who are Owner-Occupiers of second hand property are now exempt from Stamp Duty if the purchase price is less than €317,000. Purchasers of new houses should also be aware that Stamp Duty is only chargeable on the VAT exclusive purchase price. As the price of new homes is quoted as a VAT inclusive figure, purchasers should ensure that no unnecessary liability is incurred.

Young Trained Farmer Relief was not extended in the Budget and is due to expire on 31 December 2005. This Relief provides for exemption for Stamp Duty on the transfer/purchase of land by farmers under 35 who meet certain educational requirements. This relief has been very popular especially in the context of passing the farm to the next generation. We would strongly advise anyone contemplating any such transfer to seek taxation advice well in advance of this deadline. Both the tax and personal circumstances need to be examined before any transaction is entered into. It is imperative that security is provided for the transferor and from our experience these matters need to be considered carefully and detailed planning is necessary.

Corporation Tax

With a very attractive rate of Corporation Tax of 12.5% many sole traders are contemplating incorporation of their business. While there are many benefits a careful approach needs to be adopted. Firstly there is little benefit in incorporating if all company profits are to be extracted by means of wages. Income Tax and levies at the persons Marginal Rate will still apply so the benefit of the lower tax rate is lost. Directors also need to be aware of the requirements imposed by law, which could lead to criminal prosecution, these are new and onerous. There has been major growth in the area of pension planning for companies. The area of Self Administered Pensions has seen enormous growth and offers a great opportunity for tax efficient retirement planning.

The Irish Taxation Institute recently held a well-publicised Tax Return Week. This initiative was intended to educate taxpayers of their basic tax

The Revenue Investigation into undisclosed Life Assurance products has generated a lot of activity, and will lead to a significant source of revenue for the Exchequer. We would like to remind all those who opted for the Voluntary Disclosure that the deadline for submission of calculation and payment of all outstanding liabilities is July 22, 2005.

John Butler – FDC Tax Department

Using a Computer for Financial Projections

A personal computer with appropriate software can help prepare financial projections. A computer-based model reduces the tedium of carrying out numerous repetitive calculations; simplifies the alteration of assumptions; and improves the presentation of results.

When using a computer, a manager or planner can utilize a spreadsheet to build a model from first principles. While the development of a spreadsheet model of a company's profit & loss account should be well within the capabilities of many managers, the development of an integrated and comprehensive financial planner is an infinitely more challenging, time consuming and difficult task. A manager must know when to draw the line between using a spreadsheet to plan and becoming a spreadsheet programmer.

As an alternative to a DIY model, a manager or entrepreneur can purchase a ready-made model which can be either (a) loaded as a template into a spreadsheet or (b) run as a stand-alone package.

The main advantage of building a bespoke model is that it can be fine- tuned to meet very specialised requirements. However, the drawback is that building a comprehensive, error-free and user-friendly financial model could require hundreds of hours of development and testing along with considerable programming and financial expertise. This work inevitably distracts from the real task of planning the business and begs the question as to why managers, entrepreneurs, advisers etc. should reinvent

How Financial Planning Models Work

A computer-based financial model is the electronic equivalent of a very large sheet of ruled paper which, depending on circumstances, could be 10 to 20 square feet in area. The computer's screen serves as a small window on this electronic sheet which usually displays variables and values along rows and time periods in columns.

A model utilises assumptions for sales volumes, prices, operating costs, funding etc, to produce projected balance sheets, profit & loss accounts and cashflow statements. Typically, it makes monthly projections for the first year and less detailed projections for the following years. For example, FDC specialists' models will produce projections (P&Ls, cashflows, balance sheets) for the first year on a monthly basis and for the following two years on a quarterly basis. As all the components of a model are linked by formulae, a change to any assumption in any period results in appropriate adjustments to profits, cashflows etc, throughout the model for the remaining months, quarters and years.

Once initial assumptions have been entered, they can be readily altered to evaluate alternative scenarios. For example, a model could be used to explore the extent to which future sales can be increased while holding borrowings within predetermined limits; to assess the effects of varying selling prices and/or volumes on net profits; or to determine the optimum level and mix of future funding for a business.

As a practical example, Figure 2 overpage shows the results of using one of FDC's models to undertake a "what-if" analysis where sales volumes and prices have been increased by a fixed percentage.

Figure 2 - Results of Sensitivity Analysis

Scenario	Base Case covering 12 months	Sales Volumes increased by 20%	Selling Prices increased by 10%
Sales (€000)	553	664	608
Sales (% change)	n/a	+20	+10
Pre-tax Profits (€000)	28	65	85
Pre-tax Profits (% Change)	n/a	+132	+204
Net Cashflow (€000)	43	68	93
Net Cashflow (% Change)	n/a	+58	+116
Peak Monthly Loans (€000)	72	65	57
Peak Monthly Loan (% Change)	n/a	-10	-21
Full-Year Return on Capital (%)	16	30	35

Given a choice between a 20% increase in sales volumes or a 10% increase in selling prices, the model shows that the latter would be a far more attractive option. The results also offer an insight into the underlying cashflows and funding requirements. FDC consultants offer extensive facilities and utilities for doing "what-if" sensitivity analyses.

Planning to Make Business Plan Projections

For managers of an existing business, or promoters planning a substantial new venture, financial modelling can be an invaluable tool to assist the preparation of a business plan. However, business planning should not be confused with the preparation of financial projections. The former must provide the foundation for the financial projections which can be derived arithmetically by a model. The model and its forecasts should contribute to but never dictate the contents of a written business plan. Once basic issues relating to markets, sales and operations have been fully researched and considered, a model can be used to produce the financial projections. However, the veracity and usefulness of these projections will be completely determined by the quality and reliability of the underlying assumptions determined outside the model. For example, if sales or cost forecasts are unrealistic or inadequately researched, then the value of a model's output is greatly diminished. An impressive set of financial projections is of little benefit if unsupported by research or only based on speculation or wishful thinking.

Before using a financial model to help plan the future of a business, a manager orentrepreneur should:

1.Decide at the very outset on the central

2.Identify and think through all the critical assumptions. Prepare outline projections to confirm their overall direction, examine the critical elements in detail and consider strategic issues relating to sales, profitability, funding etc.

3.Check that all key assumptions (e.g. sales forecasts) and data (e.g. opening balance sheet and any prior-year financial results) are to hand, and have been adequately researched.

Recognize the danger of presenting too much detail or too many reports. Most senior managers, investors and financiers seek simple financial statements which have been based on detailed analysis and realistic assumptions.

Tips & Traps when Projecting Finances

When preparing financial projections, be conscious of the pitfalls and dangers listed in Figure 3 below. These can arise as the result of a lack of foresight or insight, or because of excessive optimism. As they can lead to underestimation of the resources required to develop a business with potentially disastrous consequences, it can be counterproductive to overstate its potential.

Figure 3 - **Financial Planning Traps**

- Using financial forecasting as a substitute for business planning.
- Ignoring historic trends or performances at company, sectoral and national levels.
- Overstating market shares and growth, sales forecasts, and profit levels.
- Giving insufficient consideration to requirements.
- Underestimating costs and delays likely to be encountered.
- Disregarding industry performance norms and competitors' responses.
- Breaching generally-accepted financial guide lines and ratios.
- Making unduly optimistic assumptions about the availability of loans, trade credit, grants, equity etc.
- Seeking spurious accuracy while failing to recognize matters of strategic importance.

Realistic views should always be taken of a business's prospects, prospective profits, funding requirements etc. There is often merit in compiling "worst" case projections to complement "most likely" or "best" forecasts. In practice, the realization of financial projections, especially for a new business without any trading history, might easily take twice as long and cost twice as much as expected. Remember that it is much less painful to deal with a flaw in a business at the planning stage, than later on when commitments have been made and the business has started trading.

The Next Steps in Business Planning

Preparing a set of financial projections is only a means to an end. Once plans or projections have been approved or in the process of being implemented, they should be regularly updated and compared with the results being achieved.

A plan is only useful if it is being adhered to, if it serves as a benchmark for control purposes, and if the projected outcomes are being realized.

While a clear business plan with sound projections cannot guarantee success, the absence of a plan or poor projections could ensure the eventual failure of a business.

FDC specialist financial planners generate fully integrated profit & loss accounts with cashflow statements and balance sheets for up to