

The Turnaround: A Rancher's Story

David Pratt



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Chapter 3

Napkin Math: Creating a Profit Target

“Too early for a beer?” Kate looked at her watch. 2:30.

“I’d better not. I don’t think I could stop with one,” Lori lamented.

They ordered cheeseburgers and sodas all around.

While they were waiting, Kate asked, “Lori, was there anything that really stood out in the session for you this morning?”

“Well, like I said, I’ve been stewing on the question of owning a business or just a bunch of jobs ... or do the jobs own us? I feel like we work harder for the ranch than it does for us.”

Chris saw Wayne shift in his seat. It was obvious he wasn’t comfortable with where this was going.

“Everyone talks about the ranching lifestyle, but for me that lifestyle involves a 40-minute commute twice a day to a job that ...” Lori’s voice trailed off. “To tell you the truth, sometimes I just get mad at myself!”

“Mad at yourself? Whatever for?” Kate asked.

“I get mad because I get jealous. I get jealous of Wayne. I know he works his rear end off, but he gets to work it off at home. He doesn’t have to commute five days a week.” Lori wiped a tear away. She continued, “I get home and the house is a mess, someone’s got to get dinner going.” Her fist came down on the table harder than she had expected, making the silverware rattle. After a moment she looked up at Kate and said, “I’m just worn out. I’m impatient with the kids. I’m impatient with Wayne.

“Funny thing is I don’t dislike what I do. I like the people I work with, but I want to be on the ranch. I want to be able to homeschool Matthew and Justin. I don’t want to *have* to work in town. I know we need the money and the insurance. God knows, with this drought, it’ll be the only thing bringing in any money.

“The thing that really eats me up is that I take my frustration out on Wayne and the kids. It’s not fair to them and ...” With tears rolling

down her cheeks, she concluded, "Sometimes I just don't like who I've become."

Kate hadn't expected the conversation to take this turn. No one knew what to say, especially Wayne, who sat there feeling guilty, but for what he wasn't sure.

Chris finally said, "You are dealing with some tough issues." He was reluctant to pry and thought it best to avoid the temptation to offer advice. He knew that sometimes it was important to just let people know you heard what they had to say. After a few seconds of silence, he asked, "What would it take to quit or at least scale back your job at the bank?"

Lori was embarrassed about her minor meltdown and pretended not to hear the question. She wanted to let the subject drop and shift the focus away from herself.

Chris rephrased the question, "How much more would the ranch have to make for you to be able to quit your job at the bank?"

"More than we make now," Wayne answered.

"Our place isn't big enough to support us and Buddy," Lori said.

Wayne's dad, Buddy, had ruled the ranch with an iron fist until 13 years ago when he'd had a stroke. The stroke affected his vision and left him with limited use of his left arm. Wayne, who had always wanted to come back to the ranch, dropped out of college to help out.

Chris wondered how far he should push the conversation. "Look, it's clear we are on sensitive ground here, but it's also clear that you aren't happy with the way things are. I wonder if there could be some way to make the ranch more profitable. Do you want to explore some possibilities?"

"There isn't much point," Lori sighed.

Kate spoke quietly to Lori, "A year ago, I thought it'd be impossible to ever be full time on the ranch, but I'll be half time in six months and if things go the way we expect, I'll be able to be full time on the ranch by this time next year." Looking Lori in the eye, she added, "You know how frustrated I was."

Chris shot Kate a questioning look. He suddenly realized that she may have been more frustrated than she had let on. Kate saw his look

and responded with a slight shrug. Then, talking directly to Lori, she said, "One of the questions they asked us at the school was, 'What is something that seems impossible to do, but if you could do it, it would change everything for the better?'"

"That's easy," Lori said. "For the ranch to make enough money to support us full time."

"That's it," Wayne agreed. "Word for word what I was going to say."

Jumping right to the point, Chris asked, "How much? How much would the ranch need to clear for you to be able to quit?"

"I don't know." Shaking her head slowly, Lori repeated, "Chris, I really don't know."

"Wayne, what do you think?" Chris asked.

"I don't know, \$100,000?"

"Why \$100,000?"

"I don't know," Wayne said. He was growing irritated at his friend for pushing him into a sensitive, uncomfortable subject. "It's a big number. It ought to be enough."

"Enough to do what?" Chris was pushing his luck and he knew it.

"Enough for Lori to quit," Wayne said slowly and loudly as though trying to communicate with someone who did not understand English.

"I know I'm being pushy, but go with me on this a little," Chris pleaded. He glanced at Wayne, then Lori. Lori frowned but nodded her agreement to go ahead. "Look, quitting is describing what you don't want," he explained. "You don't want to have to work at the bank or need to rely on an off-farm job. You don't want to have to commute every day. But what *do* you want?"

"What do you mean, 'What do I want?'" Lori asked. If she had ever thought about what she wanted, it had been a long time ago. She and Wayne were so busy trying to get by and keep *bad* things from happening, it didn't feel like there was much point to think about *good* things that they wanted to make happen.

Lori sat there staring across the booth at nothing and slowly shaking her head. "I want to quit ..." She caught herself, "No that's what I don't want." She asked herself again, "What do I want? I want ... Wayne to be happy. I want," she paused as though once she said the first two words the rest would come automatically. "I want my boys to be safe and enjoy their childhood." She thought for a moment about the doctor appointment she had for Justin next week. Justin had broken his collar bone last month when he was helping work cattle in the corrals. He didn't do anything wrong. It was just a crazy cow that decided she wanted to be someplace else and Justin was in her way. He climbed the corral fence, but she came climbing after him. Lori had never been so scared as when she saw him lying unconscious in the pen. She thought about the frequency with which close calls happened. "It's a miracle we aren't all crippled or dead," she muttered. Trying to refocus, she mumbled, "Okay, I want ..." She was obviously struggling to come up with things.

Kate suggested, "It sounded like you wanted to homeschool the boys."

Lori appreciated the suggestion. "Yes, I think so. I mean, really, I just want to have more constructive time with them. I don't want to feel like I'm always nagging. There I go with what I don't want again. It's so much easier to describe what you don't want, isn't it?"

"Yeah, it is," Chris agreed. "But the absence of something bad doesn't mean you've got something good." He continued, "Do you want to retire?"

"From the ranch? Every day!" Wayne joked. Then he said seriously, "Well, I'd like the kids to have it someday. I guess I don't want to be a burden on them." Wayne realized that he was answering a question posed to Lori again. He had a bad habit of doing that. "Sorry," he said.

"Don't be sorry." Chris said. "It might be a good idea if you each made your own list. Kate and I did, then we discussed each thing on our lists. That was a big deal for us. I assumed I knew what Kate wanted, and I had a lot of it right, but I missed the mark on some things."

"And we got into more than just what each of us wanted," Kate explained. "We got into *why* the things we wanted were important to us. Identifying the *why* behind the *what* was the most valuable part."

Looking at Wayne, Chris continued, "A minute ago you said you wanted to be able to retire someday. What kind of income would you need to not be a burden on the kids?"

"I don't know, \$50,000?" Wayne guessed.

"To get a solid number you'll need to really think through what you want your life to look like then. You'll probably want to travel a little?" Chris suggested.

"More likely the kids will want us to travel," Lori joked.

"It's probably going to wind up being more, but let's leave it at \$50,000 for now," Kate suggested. She saw Lori's frown. She knew that Lori, who liked detail, would be uncomfortable with "ballparking" figures. Kate tried to reassure her. "Look, every number we put down will be wrong. We just want to get close." She added, "You can get more precise later."

Chris continued, "So, \$50,000?" He looked at Wayne for confirmation. When Wayne nodded, Chris asked, "So what are you now, 50?" He knew Wayne was 36.

"Hey, play nice," Wayne grumbled.

Chris shrugged and said, "Let's say you want to retire 30 years from now. If you had a million dollars invested and got a 5% return, that'd be \$50,000."

Chris realized that he was oversimplifying things. For one thing, he wasn't accounting for inflation or interest, but it was a place to start.

"How much do you have squirrelled away right now?" It occurred to Chris that Wayne and Lori might think it was none of his business. "Have you guys got anything saved for retirement?"

"The ranch is our retirement," Wayne said. He had figured that they would be secure when they got older by putting all their money in the ranch. Suddenly he wasn't so sure.

"How's that working for your dad?" Chris asked. He was pretty sure that Wayne's dad, Buddy, had put every nickel he ever made back into the ranch. Even though Buddy was unable to do much work anymore, he probably still depended on income from the ranch. It might have supported one family before, but now it needed to support

two. "Do you guys have any retirement savings? Kate and I didn't until recently, and what we have isn't nearly enough."

Wayne wasn't sure how much he and Lori had in savings, and he was even less certain he wanted to discuss his personal finances with Chris and Kate. He felt defensive, but he was too tired to argue so he lied, "About \$120,000."

Lori gave him a questioning glance. She knew they didn't have anything close to that in their savings and nothing specifically for retirement, but she didn't say anything.

Chris continued, "Fine. Like Kate said, every number will be wrong, but we'll see if we can get in the ballpark. Let's say you need to put away another \$900,000 over 30 years." Chris did the math out loud while Kate used the calculator on her cell phone. "\$900,000 divided by 30 years ..." Chris's eyes darted up to the ceiling as though he expected the answer to be written on a ceiling tile.

"That's \$30,000 per year," Kate said.

"Good Lord, we won't be able to afford to eat," Lori said.

Kate added, "You'll probably have some Social Security income. That will reduce the amount you need to save. We haven't accounted for interest on what you save and invest. That will contribute a lot. We haven't accounted for inflation either. Regardless, it's still going to be a wad of money."

"Let's just say that after you adjust for inflation and figure in the interest you'd earn, you need to put away \$20,000 every year for retirement," Chris said. He wrote "Retirement \$20,000" on a napkin. "I'm thinking that might be a little high, but it's safer to guess too high than too low. I bet it's in the ballpark."

"What else do you need money for?" Chris asked.

Lori started listing, "Groceries, clothes ..."

"No, that's not what I mean," Chris said. "Those are personal expenses. You pay those out of your salary. What I want to know is what you need profit for. If you made a profit, what else would you do with it?"

"What else?" Wayne asked.

“Well, we just figured you need at least \$20,000 in profit every year to invest for retirement savings,” Chris explained. “What else would you use your profit for?”

“I might actually pay myself a salary,” Wayne said.

“That’s good, but that’s not coming out of profit. Your salary is a cost to the business. Profit is what is left over *after* your salary and other costs. What else would you do with it if you made a profit?” Chris prodded.

“I suppose we’d pay down our debt,” Wayne said. He knew there must be other uses for profit, but he was drawing a blank.

“It would be a load off my mind if we had some reserves, some savings,” Lori added.

“We got that didn’t we?” Wayne asked. “\$20,000 for retirement.”

“No,” Kate said emphatically. “Your retirement savings are off limits. I think Lori is talking about an emergency fund — two or three months of operating expenses in reserves. Is that what you meant?”

“Exactly,” Lori confirmed.

“Look, we’ll have our food in a minute, and I want to push this through,” Chris said impatiently. “How much for paying off the debt and how much for reserves?” When no one responded, he asked, “What if you could add \$10,000 to your reserves for the next five years and pay your long-term debt down by \$50,000 each year?”

“Sure.” Wayne was anxious to be done with this. The cook must have had gone out to slaughter a cow. It was taking forever to get their meal.

Pretending to be oblivious to Wayne’s impatience, Chris wrote “Pay Down Debt \$50,000, Reserves \$10,000” on the napkin. Then he asked, “Would there ever be a dividend to shareholders?”

“A dividend?” Wayne thought Chris had lost his mind. “You’ve got to be kidding.”

The discussion went back and forth, but eventually Chris’s napkin had a list showing things that Lori and Wayne could do with their profit, if they ever made one, and how much profit they’d need to do

all of those things. Some things were filled in, others just had a question mark. At the bottom of the list, Chris wrote "Profit Target \geq \$100,000."

| <u>Profit Target</u> | |
|-----------------------------|-----------------------------------|
| <i>Retirement</i> | <i>\$20,000</i> |
| <i>Pay Down Debt</i> | <i>\$50,000</i> |
| <i>Build Reserves</i> | <i>\$10,000</i> |
| <i>Expansion</i> | <i>\$20,000</i> |
| <i>On-Farm Improvements</i> | <i>?</i> |
| <i>Off-Farm Investment</i> | <i>?</i> |
| <i>Dividends to Owners</i> | <i>?</i> |
| <i>Donations</i> | <i>?</i> |
| <i>Profit Target</i> | <i>\geq\$100,000</i> |

"Good Lord," muttered Lori. That seemed like an impossible target. She had started feeling a little hopeful, but as soon as she saw the target, her hope vanished. If Wayne's salary had to come out before profit, she wasn't even sure it was possible to break even. It felt like this had been a cruel waste of time. Even so, she didn't have the energy to tell Chris to stop

"It's pathetic isn't it?" Lori asked. "We've never talked about the ranch in terms of it being a business. We've never ever talked about making a profit. We've always just focused on all the work we have to do just to get by. We've certainly never ever talked about what profit is for."

"You aren't alone," Kate spoke softly. "We hadn't either before that class. I don't think anyone else in the class had ever thought about what profit was for or had ever set a profit target. But it's pretty hard to hit a target that doesn't exist."

Lori shook her head slowly as though she was looking at a mess the kids had made that she would have to clean up. But she couldn't point her finger at anyone who was responsible for this mess.

"It's funny," Chris said. "I don't think anyone is motivated by money. At least no one I know. I'm not. Kate's not. I don't think either of you are. It's not the money. It's what you can do with the money

that's important. Having a secure future. Supporting the kids. Taking a trip to Australia ..."

"Oh, that's something Wayne has always talked about," Lori said.

"Us too," said Kate. "And we want to do it with the kids, before they are off to college. We know we need to be responsible and prepare for the future, but we want to experience life *now* too."

"Have your cake and eat it too?" Wayne asked.

"You could put it that way. But why not? I'll bet on our balance sheets we're both worth a couple of million, but I know we both live like we're flat broke. That's crazy," Chris said.

"No, that's agriculture," Wayne said.

"It is for some. It may be for most, but it isn't for everyone, and it isn't going to be for us," Chris insisted. "I really don't want to keep talking about the school, I know you're tired of hearing about it, but there was this guy and his wife who were repeating the class who told us that they'd struggled to get to the school the first time they took it. He said that they'd never been away from the ranch for a week. A couple of years later they took their family on a vacation. How long was it, Katie?"

"Chuck and Bonnie?" Kate asked as she searched her memory. "Bonnie was on my team. I think she said they were gone for three months. They went to Australia. They visited a half dozen properties and stayed with families that had taken the course over there. One family had a tame kangaroo ... Bonnie showed me pictures of their kids with this kangaroo. They are so weird looking."

Chris continued, "One night after class we were in the hotel bar with other people from the class talking about our families. We were talking about how busy we are all the time. It was like each of us was trying to prove we were busier than the next guy." Chris puffed out his chest and boasted, "I work 20 hours a day." Then, in a lower voice, said, "That ain't nothin', I work 28 hours a day!"

"Anyway, Carl, this guy about our age, said something about wanting to go to Australia and Chuck and Bonnie are sitting there. Chuck says, 'You'd love it. You should go.' Carl looks at Chuck like he came from another planet then starts going into all the reasons it would be impossible to go. Then Chuck cut him off and asked, 'I know

why you can't go, but what would have to happen for you to be able to go?' I'm listening to Carl's answer and, as he's talking, I started to realize that if we really want to do this, we can find a way. If we don't, we can keep making excuses. Anyway, three years from now, in March, we are going. Me, Katie, Robyn, and Sally. We are going," Chris said with determination.

"To Australia?" Lori asked.

"Yep, Australia. That's what our profit is for — at least part of it. It's not about the money. It's about our life."

Kate nodded. "We are doing it," she said resolutely. After a moment she added, "So, you don't have to figure it all out right now, but it's something you might want to think about. What is your profit for?"

SUMMARY OF CHAPTER 3 CONCEPTS

- Your salary and your business's profit are two different things. Salary must be deducted as a cost when calculating profit.
- Investing all of the profit the ranch earns back into the ranch may create big challenges for retirement and generational succession.
- It's impossible to make an intelligent plan without a goal.
- One important goal is your profit target.
- To establish a profit target, you must first determine why you want to make a profit. What is your profit for?