**Capital Purchases Terminology**

**Capital Purchases are durable and expensive**

**Durable –** has an expected life of two or more years (usually many more). For example, a flatbed truck.

**Expensive** – the item costs more than $250.00, often thousands of dollars. For example, a barn.

**Simple Payback Period**:

The length of time it will take the buyer of a capital purchase to earn back the amount of money spent to purchase the item. This is how you calculate the payback period:

Full cost of the purchase ÷ Annual change in profits = Simple Payback period

For example: $50,000 Tractor ÷ $5000 change in annual profits = 10 year payback period

**Profit:**

The money that remains after the direct costs of production (variable costs), the overhead costs (fixed costs), and the owner’s salary (owner draw) have been subtracted from the gross sales of a farm/ranch. For example:

Total farm sales of $50,000 - $21,000 direct costs - $12,000 overhead costs - $12,000 owner draw = $5,000 profit

**Depreciation:**

The decline in value of the things that farms/ranches own that occurs over time. Every year, durable assets loose a little of their value due to wear and tear. For example, a 10-year old barn is less valuable than a brand new barn because time, use, and weather slowly degrade the barn.

**Opportunity value of your time:**

The loss of potential gain from choosing one alternative over another. In other words, what you are giving up when you choose one alternative over another in terms of your time. For example, you could spend your time pulling weeds by hand (low $ cost, but takes lots of time) or you could buy a cultivating tractor to kill the weeds (high $ cost, but gets the job done faster).