

Cash is king: Cash flow planning

Chapter: 10

Money goes out earlier and faster than it comes in. And, because it's easy to run short of cash without realizing it, it's often too late for the owner, the bank, or anyone else to do anything about it. Cash flow planning can't stop a bad business from failing, but it can help a solid business succeed.



Introduction





What is a cash flow statement?

Two primary definitions:

- Balance of cash received less the amount of cash paid out over a period of time
- Moving cash in or out of a business

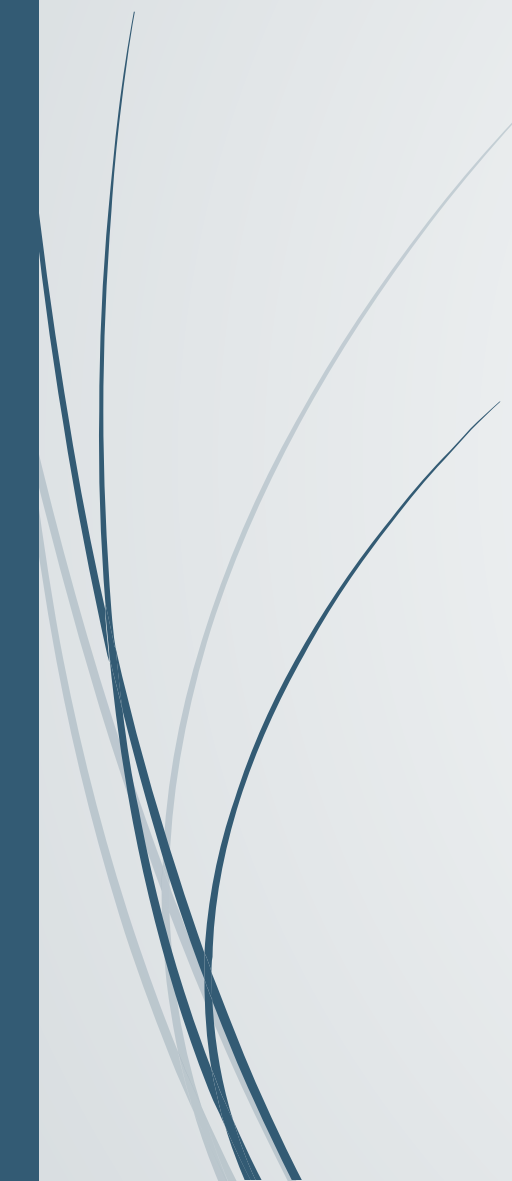


Cash Is King

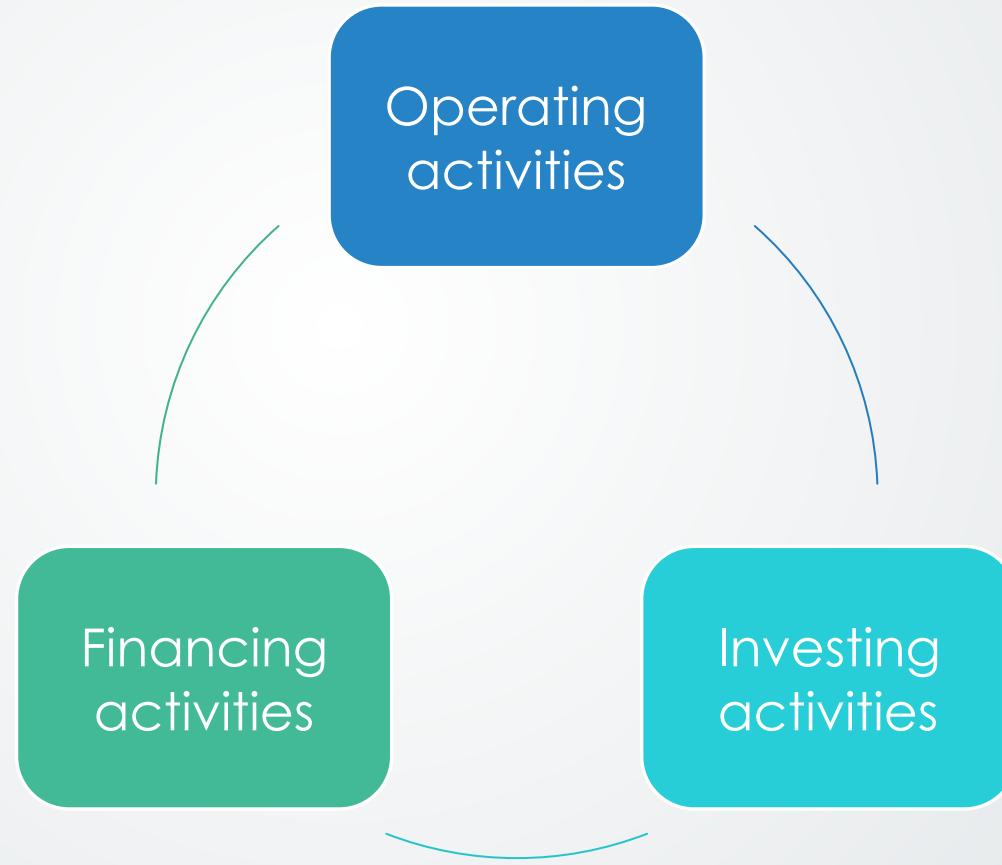
- ▶ The importance of cash flow to the short term credit grantor is based on a simple fact, trade obligations are satisfied with cash not profit.
- ▶ This statement is useful for decision making
- ▶ The cash flow statement can use to determine if a customer is able to generate sufficient cash to meet its trade obligations.
- ▶ Using the cash flow statement in the credit analysis process can help users evaluate a customer's solvency, liquidity position, and its financial flexibility



The significance of the cash flow analysis

- ▶ Importance to the analyst in identifying financially troubled companies
 - ▶ It provides valuable information about the quality of earnings
 - ▶ Provides insight into how effective the management team is at utilizing available resources
 - ▶ It provides a picture of where the cash comes from and where it goes
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Components of a cash flow statement





Income flows and cash flows

Income flows

- Shows a company's financial performance a specific time period
- Shows a company's revenue; total expenses
- Including noncash accounting such as depreciation
- Used to determine the financial performance of a company

Cash flows

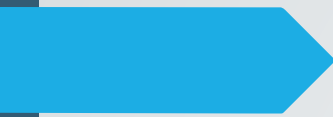
- Measures the sources of a company's cash
- Uses of cash over a specific time period
- Shows how much money a company has received and how much it has spent
- Captures the current operating results and changes on the balance sheet

The cash flow process

The preparation of a cash flow budget requires that you consider two key factors:

- cash in (receipts)
- cash out (outflows)





The cash flow process: Determining cash in


Preparation of the cash flow budget begins with a one-year profit and loss budget

It is based on “accrual” accounting

- Revenue is recorded when goods or services are sold and expenses recorded when they occur

This “accrual” accounting does not:

- Reflect when the cash is actually received
- Take into consideration when the expenses for the labor and material that went into sales were actually paid out

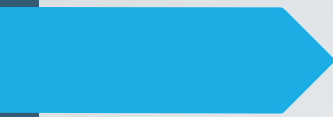


The cash flow process: Determining cash in

Prepare an “aged” list of your receivables, showing the actual payment terms being taken

Consider cash receipts. This include:

- deposits or progress payments on contracts
- supplier rebates
- insurance or other claims
- new loans negotiated with the bank
- cash injection by a new shareholder or equity partner



The cash flow process: Determining cash out



Overhead
expenses

Cash outlays

Intermittent
expenses

Overhead expenses

Overhead expenses

Energy/utility costs

Loan interests

Depreciation

Marketing/
Sales expenses

Administrative expenses

Rent expenses

Subcontractors

Transportation expenses

Cash outlays

Cash outlays

Rent

Office
supplies

Litigation

Salaries

Insurance

Utilities

Intermittent expenses

Intermittent expenses

Loan payments

Purchase of machinery or equipment

Bid deposits (contracting)

Dividends

Income and other tax installments

Insurance premiums

Major selling trips

Training programs

Special projects

Cash flows by activities

Inflows of cash

Operating activities

- Collections from customers Interest income
- Dividends receipts
- Other Operating
- Cash Receipts



Investing activities

- Collection on loans
- Sale of debt instruments
- Sale of equity instruments
- Sale of productive assets



Financing activities

- Issuance of long-term debt
- Issuance of equity securities

Cash flows by activities

Outflows of cash

Operating activities

- Payments to suppliers
- Payments to employees
- Interest payments
- Payment of income taxes
- Other operating cash payments



Investing activities

- Purchase of productive assets
- Purchase of debt instruments
- Purchase of equity instruments
- Making loans



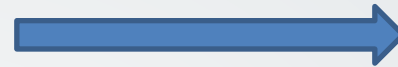
Financing activities

- Payment of dividends
- Acquisition of an entity's own equity securities
- Repayment of amounts borrowed

Preparing the cash flow forecast

Let's look at a sample cash flow projection

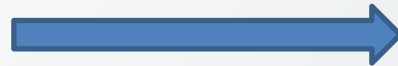
Sources of Cash



Operating Uses of Cash



Non-Operating Uses of Cash



Sources of Cash	Opening Balances*	Month 1	Month 2
Beginning Cash	0	0	0
Cash Sales			
Collections on A/R			
Interest Income			
Loan Received			
Equity Contribution			
Total Cash Available	0	0	0
Operating Uses of Cash			
Contract labor			
Wages			
Payroll Taxes			
Rent			
Phone			
Office Supplies			
Utilities			
Travel			
Insurance			
Licenses			
Marketing			
Professional Fees			
Other			
Total Op Uses	0	0	0
Net Cash	0	0	0
Non-Operating Uses of Cash			
Debt Service			
Equipment Purchases			
Self-Employment Taxes			
Owner's Draw			
Inventory Purchases			
Ending Cash	0	0	0



Cash flow projection

Review the cash flow projection spreadsheet.

To increase cash flow, the owner could:

- Increase the number of items sold
- Increase the price
- Reduce expenses
- Change the timing of expenses
- Save money to have sufficient Opening Cash to get through the “start-up” period



Cash flow projection

To increase cash flow, the owner could:
(continued)

- Obtain sources of cash other than sales
- Reduce or change timing of Owner's Draw
- Buy inventory from vendor at lower price
- Obtain credit from vendor
- Establish policy to get paid sooner by customers



Thanks for your attention