



Capital Solutions

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How much cash flow does your business generate?

Most business owners and their managers are familiar with many key financial statistics about their companies.

Ask them what sales were last year, or what their net income was, or how much cash they had at the bank, and they will likely be able to give you ready and accurate answers.

But ask them how much cash the business generated and used in the last year? Crickets. They don't know.

We often ask why this is so, given that cash flow is the lifeblood of every enterprise.

We have come up with at least a partial explanation.

Most small businesses don't know their annual cash flow because it can be time consuming to determine, and because they are not in the habit of creating and reviewing cash flow statements as much as they are reviewing monthly P&L's and Balance Sheets.

The more bank accounts, credit cards, lines of credit and other means of funding are used, the more cumbersome and complicated it gets to construct a cash flow statement that truly instructs.

What do we mean by annual cash flow? It is the amount of cash your business generates or spends from three areas of the business:

- 1) Operations-the main operation of the business and the cash collection cycle,**
- 2) Investing- Any investing or divesting the business did in long term assets, and**
- 3) Financing- the net flow of cash from any loan activity plus any owner contributions or withdrawals.**

Each of these 3 areas of the Cash flow Statement can be a user, or a producer, of cash for the business.

If both Operations and Investing are net users of cash, then in order to preserve liquidity in the business, the Financing activities-loans and equity contributions-will need to be a source of cash in an amount equal to or greater than the cash demands from Operations and Investing.

Here is a simple sample Cash Flow Statement with an explanation of what you are looking at:

Cash Flow Statement

Operating Activities

Net Income	\$100,000
Depreciation	\$50,000
Amortization	\$25,000
Changes in Accts Receivable	(\$50,000)
Changes in Inventory	\$15,000
Changes in Accts Payable	(\$20,000)
Cash From Operating Activities	\$95,000

Investing Activities

Changes in PP&E	(\$45,000)
Changes in Long Term Assets	\$10,000
Changes in Long Term Liabilities	\$0
Cash from Investing Activities	(\$35,000)

Financing Activities

Net Increase/(Decrease) Short Term Debt	(\$30,000)
Net Increase/(Decrease) Long Term Debt	\$100,000
Equity Contributions	\$0
Equity Withdrawals	(\$75,000)
Net Cash from Financing Activities	(\$5,000)
Net Cash Increase/(Decrease) from All Activities	\$55,000

So, what does all of this tell you?

The company generated \$95,000 from Operating Activities, in the form of net income and the adding back of non-cash expenses (depreciation and amortization). Cash flow was reduced by the \$50,000 increase in Accounts Receivable (use of cash), increased by \$15,000 from lower Inventory (source of cash), and then again lowered by the \$20,000 reduction to Accounts Payable (use of cash).

In Investing Activities, the company purchased (\$45,000) of new equipment (use), and sold \$10,000 of older stuff (source), such that the net cash outflow from Investing Activities was (\$35,000).

Finally, the company paid down S-T Debt by (\$30,000), increased long term borrowings by \$100,000, and then made equity disbursements of another (\$75,000), for a net effect of cash out by (\$5,000) from Financing Activities.

All told, this business would have seen an increase in its cash position by \$55,000 from the year's activity. But you now know how it got there, and the fact that debt was increased by a greater amount than cash rose, you could argue this was not a great cash flow year for the business.

You should get into the regular habit of looking at recent monthly cash flows as well as a forecast of cash flow for the next 6-12 months. In the long run you will be glad that you directed more attention to such a vital trend for your business.

Thanks for reading. Let us know if you would like our help securing your next source of funding.



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