

HOW TO READ **A CASH FLOW STATEMENT**

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*A Man Who Carries a Cat by the Tail
Learns Something He Can Learn in No
Other Way.*

Mark Twain

Do this first.

Print out last year's cash flow statement, balance sheet, and profit and loss. We will demonstrate how to Read a Cash Flow Statement (CFS) and use a generic example (last page) for interpretation. However, you find the most benefit by analyzing your company's CFS in parallel. If you want to start reading your CFS, it might as well be today. This article is a two-minute read, a 30-minute study, and a lifetime of application.



If you only read one section, **let it be this one.**

Look at or near the bottom of your CFS, and you will see a line called “Net Cash Increase/Decrease for Period.” It might have different words, but it should mean the same thing. Our PFS has theirs highlighted in blue. If the number is positive, you had more cash inflow than outflow. Positive cash flow is ideal, but it doesn’t necessarily translate to profit. I will explain how this can happen in a later section. If the number has a “-” or is in parenthesis, you had negative cash flow for the year. The cash outflow for your company was more significant than the cash inflow, which is something you will need to prioritize correcting. We are looking at 12 months, and although you might have had a net profit, you are losing cash. Companies that lack the money to pay bills are likely to fail.



No business was ever **destroyed by diagnosing.**

The CFS divides Cashflow into three primary sections; Operating, Investing, and financing. Our example highlights these sections in light grey and labels them accordingly. The totaled number for each shows the correlating cash flow, positive or negative, for that section. What's different about the CFS compared to the other reports like the Profit and Loss is that it can't be manipulated or estimated inaccurately. Cash and Debt are the only facts in your financial statements. This reality is why every publicly traded company must file a CFS each quarter to accompany their earning reports. It's important to note that the CFS is not comprehensive and does not give the entire story. It must be used in conjunction with other statements to make accurate conclusions about your company. It is my opinion that if I could only look at one report, I would choose the cash flow statement. The CFS is factual, it shows Net Profit, and it's a condensed version of my checkbook.



If business were a game, **cash would be how we kept score.**

The first section in your CFS is your operating activities. Operating activities are defined differently in every business, but typically they are your product or service. If you were a drywall contractor, the cash flow will be all transactions directly connected to installing drywall. Examples would be checks received from customers, payroll, payments to vendors, and other operational expenses. This section is very similar to your profit and loss statement. Naturally, it starts with the net income. Our example CFS has net income highlighted green. Next, adjustments are made to net profit to show the actual cash flow to make your operational activity's cash flow correct. For instance, depreciation is not a cash expense, so it is added back to net income. Also, adjustments for working capital items are updated. Things like accounts payable, accounts receivable, and payroll liabilities. After all adjustments, the final number is the total cash flow associated with your operations.

Investing is **the movement towards wealth.**

The investment activities section is the most straightforward. Any cash flow from the purchase or sales of income-producing assets will appear here. If you bought a truck for \$60,000, it would be an investing activity regardless of whether you paid cash or got a loan. If you purchase an asset, it is a negative cash flow because somebody's money pays for it. It would be positive cash flow when it sells because the money comes into your company. Most companies that use assets to make money will have negative cash flow in this section; don't get too worried. It is an excellent place to see the total cash invested into company assets. In our example, the entire cash flow from investment activities is highlighted yellow. It will be essential to notice if your company appropriately reinvests into a sufficient amount of the correct assets. This section is a great place to start scrutinizing.





If you laugh when you borrow, **you will cry when you pay.**

The third section is Financing activities. When you grow your business, you will either use your money or outside money (for example, banks). If you bought a \$60,000 truck and borrowed the money from the bank, you would have positive cash flow because cash was brought into the company. Negative cash flow occurs when you make a monthly principal payment of \$1,000 on that truck loan. The other transactions affecting this section are funds flowing in or out of the company's ownership. For instance, if the owner had a cash disbursement, it would show up in this section as a negative cash flow. This financial activity section shows the cash flow from creditors and ownership.

Don't trip over **something** behind you.

Your business requires a positive cash flow. Suppose you discover you have a negative cash flow. In that case, you are using previous profits or outside lending to fund your negative cash flow. This is not sustainable, and you need to make changes. Don't focus on past failures; instead, be happy you know now before it's too late. Below are nine key things to consider.

- 01 | Locate the section or sections that have negative cash flow. Focus on that area.
- 02 | It's possible to make a profit and have a negative cash flow.
- 03 | You can grow broke, meaning you can grow too fast! Please don't believe me ask your banker.
- 04 | Raise your prices—a simple way to increase profit and cash flow. You would be surprised how often we recommend this.
- 05 | Increase volume to get your overhead and labor in proportion.
- 06 | Reduce your Expenses. Print your P & L and look for ways to cut costs. Believe that cuts are possible, and you will find what you are looking for.
- 07 | Negotiate your payment terms with vendors. Get lines of credit, extend them past 30 days if possible, pay with credit cards, Pay vendors on the last possible day.
- 08 | Work with banks to finance income-producing assets at the lowest possible interest, for the most extended terms, and the least amount down. If you rent equipment, consider financing if it produces a better cash flow.
- 09 | Invoice clients early, often, accurately, and follow up with them. Get your money in your bank account and out of theirs. Often companies have cash in receivables that have been neglected. Yet, they have paid all the expenses associated with that income.

					Jan - Dec
				OPERATING ACTIVITIES	
				Net Income	1,208,097.58
				Adjustments to reconcile Net Income	
				to net cash provided by operations:	
				17000 · Accumulated Depreciation	309,118.98
				11000 · Accounts Receivable	-26,508.00
				11250 · Retainage Receivable	-7,634.24
				11500 · Underbillings	-119,742.00
				20000 · Accounts Payable	-96,412.02
				21000 · Credit Card	22,325.49
				22000 · Overbillings	-221,217.00
				24005 · Federal Withholding	1,077.00
				24010 · Federal 941 Tax	2,067.94
				24020 · Federal 940 Tax	112.43
				24030 · TN Unemployment Tax	-165.73
				24040 · Wage Garnishments	112.84
				Net cash provided by Operating Activities	1,071,233.27
				INVESTING ACTIVITIES	
				15100 · Heavy Machinery	-789,646.05
				15200 · Vehicles	-231,814.32
				15300 · Construction Equipment	-166,534.06
				15400 · Office Furniture & Equipment	-44,720.75
				Net cash provided by Investing Activities	-1,232,715.18
				FINANCING ACTIVITIES	
				25120 · Bank Of America Loan	-14,272.11
				25120 · Cat Financial Loan	-8,206.52
				25234 · Loan Consolidation #1	254,819.28
				25235 · Loan Consolidation #2	284,838.09
				30300 · Owners Draw	-207,123.00
				Net cash provided by Financing Activities	310,055.74
				Net cash increase for period	148,573.83
				Cash at beginning of period	478,373.38
				Cash at end of period	626,947.21

