

Understanding Cash Flow is Key to Growing or Selling a Business!

The cash flow and performance of your business should be measured by your Profit and Loss (P&L) Statement in conjunction with your Balance Sheet (B/S). It is very possible for a highly profitable company to be in critical need of cash. Cash is King!

As a business owner, understanding your P&L is essential to increasing your profitability and growing your business. Your P&L will identify your successes and where there is room for improvement. A P&L statement tracks performance and detects drops in sales, income and margins or spikes in expenses. Monthly review of your P&L ensures that the causes of these drops and spikes are identified so adjustments can be made immediately and better preparation for future months is implemented to bring growth and top performance.

The P&L Statement also can be used to compare your company's actual performance with industry benchmarks, as well as show the business growth and financial strength over time. Past performance trends will help in formulating reasonable forecasts.

Most importantly, as Lenders, we use the P&L in conjunction with the B/S (i.e. asset and liability changes) to calculate a borrower's operating ability to support respective debt service. Lenders typically calculate cash flow as shown:

$$\begin{aligned} &\text{Net Income} \\ &+ \text{Interest} \\ &+ \text{Depreciation} \\ &+ \text{Amortization} \\ &= \text{Cash Flow} \end{aligned}$$

We can also include non-recurring expenses as long as those items can be documented.

Careful analysis of the P&L in conjunction with the B/S is necessary to determine all sources and uses of cash, and the ongoing cash flow ability of the borrower to repay existing debt, finance additional debt (for business expansion), or to reinvest in the company.

Analyzing a P&L in conjunction with the B/S is traditionally recognized as a UCA Cash Flow Analysis. Investors also use this type of analysis to gauge the financial strength and viability of considering a potential investment or to evaluate their current return on an existing investment.

Having a good understanding of your cash flow requires understanding components in both your P&L and B/S. This concept makes a big difference in managing your business and making better decisions to increase cash flow, grow your business and/or get the most out of your business.



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