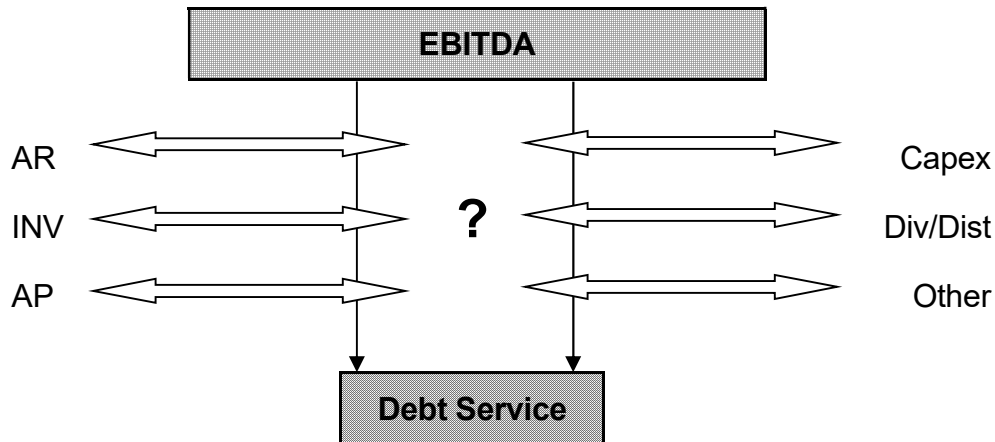


I. Fundamentals of Business Cash Flow (C&I Firms)

- A. More than income statement, especially net income or EBITDA, affects cash flow
1. Changes in balance sheet accounts, and distributions, many times, affect cash flow more significantly than income statement-based items
 2. So, what about CRE? Typical holding company has only the property as the major asset, and then the loan as the major liability. Therefore, changes in other, usually very small balance sheet accounts do not have a significant effect on cash flow. The focus shifts to nuances in rental income and the various operating expenses – such as reserves for replacement and reserves for re-lease and rollover costs. We will be covering C&I businesses in this program, since they tend to have active balance sheet accounts where the changes usually have a significant effect on cash flow.
- B. Purposes of financial statements
1. Balance sheet – reports financial positions of a firm (assets and liabilities) at a point in time (think _____)
 2. Income statement – measures economic performance (revenues and expenses) during an accounting period (month, quarter or year) ending on the balance sheet date (think _____)
 3. Cash flow statement – shows where a firm gets its cash and uses it during the accounting period (think _____)
- C. Cash flow and business firms – “EBITDA does not fully spell *cash flow*”
4. Importance: the cash flow statement is probably the most useful tool to evaluate creditworthiness and repayment ability, since operating cash flow is most frequently cited as our primary source of repayment
 2. However, before we disregard EBITDA (and other income statement-based cash flow measures, let’s look at why EBITDA is important as the starting point or “core” of C&I business cash flow
 - EBITDA is the financial representation of the success or failure of a business model and management’s ability to execute it
 - In accrual-based accounting, EBITDA matches the costs expended over a period of time (to generate revenue) against the revenue earned in the same period; It largely ignores whether the revenue actually was collected or expenses actually paid (essentially a working capital or cash management function) because these can distort the result (sometimes greatly and sometimes intentionally) by a well-timed or unusual cash collection or payment
 - Nevertheless, these distortions are real and can affect timely repayment of loans, or indicate seasonality, or even a need for a larger line of credit
 3. So, cash flow statements and an awareness of the working capital cycle are needed: They improve on the EBITDA-type, traditional debt service coverage ratios to determine ability to repay loans and other obligations, because traditional ratios ignore other activities that affect cash, such as
 - a. Growth in accounts receivable and inventory

- b. Changes in supplier support or timing of payments on accrued expenses
- c. Maintenance capital expenditures that are not individually financed with long-term loans, plus down payments on financed purchases
- d. Additional borrowings creating incremental debt service
- e. Payment of dividends or other distributions to the owners



- 4. Example where traditional ratios failed: WT Grant bankruptcy in 1974
 - a. Prior to SCF and UCA model development
 - b. Large retail chain had impressive earnings and strong TCF
 - c. All TCF was being absorbed by growth in A/R alone, before debt service
 - d. Could not meet debt payments created by large, leveraged buyout
 - e. Caught many creditors by surprise

- D. Development of the *Statement of Cash Flows (SCF)* Prepared by CPAs
 - 1. Statement of Financial Accounting Standards (SFAS) 95 in early 1990s
 - 2. Replaced the confusing *Statement of Changes in Financial Position*
 - 3. More standardized compilation approaches (indirect and direct)
 - 4. Indirect method dominates (85% usage) due to lower cost to compile
 - 5. We will demonstrate indirect method **SCF** in this session

- E. Bankers developed a similar model a little earlier than the SCF, but the banker model uses direct method only and rearranges a few lines
 - 1. Introduced in Risk Management Association (RMA) training course called Uniform Credit Analysis (UCA), and became known "**UCA Model**"
 - 2. **UCA Model** is now a standard feature of bank software that analyzes business financial statements, we will cover later in this section

- F. Another UCA concept – determining the effects of sales growth and efficiency on working capital and cash flow needs (**Analytical Technique #1**)
 - 1. Example from Anderson Steel in Year 3 for accounts receivable
 - a. What was the effect of the change in A/R turnover from ___d at 12/31/Yr 2 to ___d at 12/31/Yr 3? Just slower in collecting A/R?

- b. A/R at 12/31/Yr 2 = \$945 \cong \$1,000; sales growth for Yr 3 = 19.3% \cong 20%
- c. If level of A/R kept pace with sales growth, A/R at 12/31/Yr 3 = \$_____
- d. Actual A/R at 12/31/Yr 3 = \$_____
- e. Result (unpack \cong \$_____ in A/R growth, use of cash)
 - i. \$_____ of A/R growth due to sales growth
 - ii. \$_____ of A/R growth due to collection slow-down (\$200/13d or \$15/d)
 - iii. \$_____ total in short-term liabilities needed to support A/R increase

2. Example using the Year 3 numbers for inventory

- a. What was the effect of the change in INV turnover from ____d at 12/31/Year 2 to ____d at 12/31/Year 3?
- b. Were they just slower in creating or selling inventory/merchandise?
- c. INV at 12/31/Yr 2 = \$685 \cong \$700; sales growth for Year 3 = 19.3% \cong 20%
- d. If level of INV kept pace with sales growth, INV at 12/31/Yr 3 = \$_____
- e. Actual INV at 12/31/Year 3 = \$_____
- f. Result (unpack \cong \$_____ in INV growth, use of cash)
 - i. \$_____ of INV growth due to sales growth
 - ii. \$_____ of INV growth due to turn-over slow-down (\$_____/28d or \$_____/d)
 - iii. \$_____ total in short-term liabilities needed to support INV increase, from _____

II. Basic Structure of Cash Flow Models, both SCF and UCA

A. Definitions of sources and uses of cash

Sources	Uses	
		in assets other than cash
		in liabilities
		in equity (other than retained earnings)
		in retained earnings

B. Classification of receipts (sources) and payments (uses) into three categories

1. _____, 2. _____, and 3. _____ activities

C. Net Cash Provided by Operating Activities, two methods/formats:

Direct method

- Collections on account
- Cost of goods sold
- Pmts to suppliers of inventory
- Wage payments, etc.

Indirect Method

- Net Income
- Depreciation
- Change in A/R balance
- Change in inventory balance, etc.

CASH FROM OPERATING ACTIVITIES

Then derive cash from investing and financing activities (no major differences between indirect and direct methods)

III. Case Exercise Part B – SCF Indirect Format Illustrated

Statement of Cash Flows – Indirect Method	Year 3	Calculation Notes	Year 4	Calculation Notes
Net Income				
+ Depreciation				
Gross Cash Flow				
Accounts Receivable (Increase) Decrease				
Inventory (Increase) Decrease				
Prepaid Assets (Increase) Decrease				
Misc. Current Assets (Increase) Decrease				
Accounts Payable Increase (Decrease)				
Accrued Expenses Increase (Decrease)				
Income Taxes Payable & Deferred Taxes Increase (Decrease)				
Misc. Current Liabilities Increase (Decrease)				
OPERATING CASH FLOW				
Fixed Assets (Increase) Decrease				
Intangible Assets (Increase) Decrease				
Misc. Non-Current Assets (Increase) Decrease				
INVESTING CASH FLOW				
Short-Term Debt Increase (Decrease)				
Payments on Long-Term Debt Increase (Decrease)				
Incremental or New Long-Term Debt Increase (Decrease)				
Capital Stock Increase (Decrease)				
Dividends Paid				
FINANCING CASH FLOW				
TOTAL CASH FLOW				

A. Analytical Technique #2 (from Year 3 SCF)

- | | | | |
|--|---------------------|---------|------|
| 1. Notice the “blend” of cash needs compared to the “blend” of financing employed -- more “balance” or similarity of these blends generally is desirable | Operating Cash Flow | (\$426) | ~40% |
| | Investing Cash Flow | (\$615) | ~60% |
| | Financing Cash Flow | \$1,045 | |
| | Total Cash Change | \$ 4 | |
| 2. Recognizing financing imbalances (mix of short and/or long-term) versus mix of causes (short and/or long-term) and how they occur | | | |
| | Short-Term Debt | \$ 186 | ~20% |
| | Net Long-Term Debt | \$ 782 | ~80% |
- a. Lender preference for type of debt, based on comfort or experience level, collateral comfort, preference or value
 - b. Customer preference for type of debt based on goal of flexibility (line of credit) or certainty (monthly payments on long-term debt) or even interest rate differences
 - c. These imbalances are not necessarily good or bad, but important to recognize
2. If any new or incremental long-term debt, compare to the “new” fixed asset collateral based on the SCF calculation of fixed asset expenditures (for Anderson Steel in Years 3, \$_____ to collateralize \$_____ of new debt)
 - a. Even if you could re-appraise the almost-fully-depreciated fixed assets, probably does not support ~\$_____ of new debt
 - b. Likely that “outside” fixed assets pledged, not primary reliance on AR & INV

IV. SCF Direct Method Illustrated, operating cash flow section only

Statement of Cash Flows – Direct Method	Year 3	Year 4
Collections on Account	\$7,396	\$10,111
Cash Paid to Suppliers	(5,600)	
Cash Paid for Operating Expenses	(2,049)	
Income Taxes Paid	(69)	
Interest Costs Paid	(108)	
Misc. Income (Expense) and Asset/Liab. Chngs.	4	(66)
OPERATING CASH FLOW	\$426	

V. Usefulness of Cash Flow Statements

- A. Cash flow vs. traditional ratios
 1. Example with Anderson Steel in Year 3
 - a. Traditional ratios showed
 - i.
 - ii.
 - iii. Good conventional debt coverage ratios, due to favorable EBITDA

2. SCF cash flow reveals
 - a. Adverse cash impact of slowdown in A/R, also in inventory, but inventory change mostly offset by payables
 - b. Operating cash flow deficit, despite strong EBITDA
 - c. True financing need, including fixed asset purchases

B. Identifying and assessing risk (Analytical Technique #3)

1. Insights into _____ of future cash flows
2. Quality of “income” or EBITDA
3. _____
4. True “liquidity” of working assets
5. Results or causes of
 - a. Investing activities
 - b. Financing activities

C. Anderson Steel’s Financing Blend for Year 4: cash sources/needs through investing section compared to financing employed and paid down

1. More “balance” in aggregate dollars, ignoring source or (use)
2. Financing of fixed assets allowed paydown of line of credit

Operating Cash Flow	\$ 338	~ 60%
Investing Cash Flow	(\$212)	~ (40%)
Financing Cash Flow	(\$107)	
Total Cash Change	\$ 19	
Short-Term Debt	(\$58)	~ (55%)
Net Long-Term Debt	\$49	~ 45%

(Analytical Technique #4): Four Key Relationships/Issues to Track from a Cash Flow Statement or Model (UCA or SCF)

- I. Relationship of INV (increase) decrease to AP increase (decrease)
 - Target: Similar size of opposing sources and uses; that is, if inventory increases (use of cash), we should see a similar increase [source of cash] from accounts payable or vendors.
 - Similarly, when inventory decreases [source of cash], we should see a similar decrease (use of cash) from accounts payable or vendors.

	Year 2	Year 3	Year 4
Inventory (Incr.) Decr.	(\$325)	(\$583)	\$ 71
Acc. Payable Incr. (Decr.)	\$214	\$638	(\$119)

II. Relationship of operating cash flow surplus (deficit) [or NCAO] to notes payable [short-term debt or line of credit] increase (decrease)

- Target: Similar size of opposing sources and uses; that is, if operating cash flow is a deficit (use of cash), we should see a similar increase [source of cash] from notes payable or the operating line of credit.
- Similarly, when operating cash flow is a surplus [source of cash], we should see a similar decrease (use of cash) in notes payable or the operating line of credit.
- In reality, cash absorbed by net growth in current assets, as shown by an operating cash flow deficit, is often funded by a secured line of credit provided by a bank
- Offering such a line of credit may be the reason for the credit analysis in the first place

	Year 2	Year 3	Year 4
SCF Operating Cash Flow	\$245	(\$426)	\$338
Short-Term Notes Pay. Incr. (Decr.)	\$ 0	\$186	(\$ 58)

III. Level of maintenance capital expenditures and trend

- Maintenance capex is somewhat of a misnomer; as used by most bankers, it is the ongoing minimum level of all capital expenditures (not just for maintenance and repairs, but including purchases) being made annually

	Year 2	Year 3	Year 4
Fixed Assets (Incr.) Decr.	(\$191)	(\$575)	(\$213)

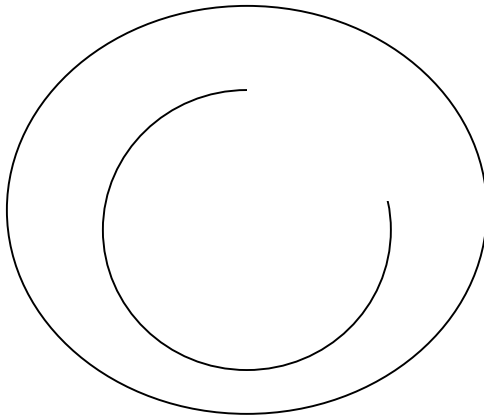
IV. Relationship of capital expenditures to incremental/additional long-term debt

- Any shortfall where *capital expenditures* > *incremental LTD* will create amounts that most likely become elements of permanent working capital
- Even small shortfalls over time can add up [this instructor calls it the “nickel and dime effect”], contributing to permanent working capital, creating what is often called an evergreen, frozen or non-revolving operating line of credit

	Year 2	Year 3	Year 4
Fixed Assets (Incr.) Decr.	(\$191)	(\$575)	(\$213)
Incremental LTD	<u>\$181</u>	<u>\$1,034</u>	<u>\$139</u>
WC Used for Fixed Assets	(\$10)	n/a	(\$74)

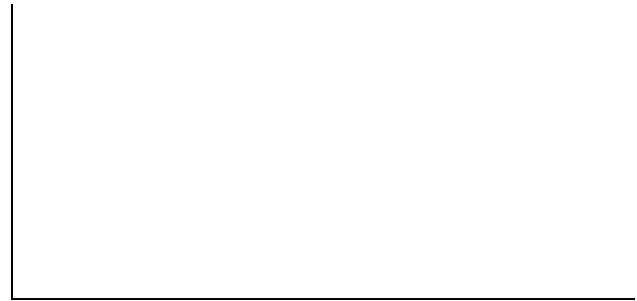
- In addition to the “nickels and dimes,” another key contributor to permanent working capital is the firm’s trade cycle or working capital cycle, then consider graphing the weekly average line of credit balance over a one-year period to better gauge the ongoing level or permanent working capital, and, perhaps, its build up over time

The Working Capital Cycle



or

Graphing Line of Credit Usage



Using the “big three” efficiency ratios in days, this time with Anderson Steel

Year	Year 2	Year 3	Year 4
Accounts Receivable	52d	65d	
Inventory	54d	82d	
Accounts Payable	(49d)	(81d)	
Working Capital Days	57d	66d	
x Revenue per Day (000s)	\$18/d	\$21/d	
Working Capt. Financing Needed (000s)	\$1,026	\$1,386	

Also recommended, but not really an analytical step, is to create an **SCF** surplus (deficit) position after operating cash flow and investing cash flow [already provided to you from **UCA** model] to better anticipate what will occur in financing section

	Year 2	Year 3	Year 4
SCF Operating Cash Flow	\$245	(\$426)	\$338
SCF Investing Cash Flow	<u>(\$191)</u>	<u>(\$615)</u>	<u>(\$212)</u>
Calculated Financing Surplus (Req.)	\$ 54	(\$1,041)	\$126
<i>CMLTD Previous Year-End</i>	<u>(\$234)</u>	<u>(\$252)</u>	<u>(\$188)</u>
<i>UCA Financing Surplus (Req.)</i>	(\$180)	(\$1,293)	(\$ 62)

Key point: Don't get locked into a single measure of cash flow for usage in a debt service coverage (DSC) ratio – multiple measures may be important to assess

- In most cases, EBITDA as the starting point or core element of cash flow, is critical for long-term relationships and payback periods
- Businesses with a strong growth pace usually will put pressure on operating cash flow, so having a secured line of credit in place becomes important, along with a strong underlying EBITDA
- To explain incidences of cash flow problems, and perhaps occasional visits to your past due list, the **SCF** operating cash flow and/or **UCA** NCAO can be very helpful and relevant

Analytical Technique #1 Re-Visited (Bonus, Time Permitting): Year 4 and the Effect of Sales Growth and Working Capital Management on the Operating Cash Flow

- A. What was the effect of the change in A/R turnover from ____d at 12/31/Year 3 to ____d at 12/31/Year 4? Were they just faster in collecting A/R?
1. A/R at 12/31/Yr 3 = \$ ____ \cong \$ ____; sales growth for Yr 4 = ____% \cong ____%
 3. If level of A/R kept pace with sales growth, A/R at 12/31/Yr 4 = \$ ____
 4. Actual A/R at 12/31/Year 4 = \$ ____
 5. Result [unpack \cong \$ ____ in A/R decrease and source of cash]
 - a. (\$ ____ of A/R growth due to sales growth)
 - b. \$ ____ of A/R decrease due to collection speed-up (\$ ____ / ____d or \$ ____/d)
 - c. \$ ____ total in short-term liabilities not needed due to A/R increase
- B. What was effect of change in INV turnover from ____d at 12/31/Year 3 to ____d at 12/31/Year 4? Were they just quicker in handling inventory?
1. Was the firm just ____ in creating or selling inventory/merchandise?
 2. INV at 12/31/Year 3 = \$ ____ \cong \$ ____; sales growth for Year 4 = ____%
 3. If level of INV kept pace with sales growth, INV at 12/31/Year 4 \cong \$ ____
 4. Actual INV at 12/31/Year 4 \cong \$ ____
 5. Result [unpack \cong \$ ____ in INV decrease and source of cash]
 - a. (\$ ____ of INV growth due to sales growth)
 - b. \$ ____ of INV growth due to turn-over speed-up (\$ ____ / ____d or \$ ____/d)
 - c. \$ ____ total in short-term liabilities not needed due to INV increase
 - How did AP change?

APPENDIX UCA Format Cash Flow Model Overview

A. Overview of structure

1. Three key sections
 - a. Operating
 - b. Investing
 - c. Financing
2. Three key items that are isolated/moved
 - a. Interest expense
 - b. CMLTD (previous year-end)
 - c. Dividends
3. Special issues with dividends

Dividends in the UCA model standard format are positioned as a **financing cost**, which is appropriate for **C corporations, larger businesses with many owners, and public companies**, because these firms have the option of borrowing money and/or issuing bonds (paying interest to the lender or bondholder) or issuing common stock (paying a dividend to the shareholder). In these situations, dividends are a financing cost.

Similarly, dividends in the SCF formats are in the **financing activities** section, because for many larger firms, paying a dividend and its size are somewhat optional, after other cash flow needs are met.

(Interestingly, both the SCF and UCA emerged while S corporations were still a new, somewhat untested- in-court option as a legal entity. Also, at that time, LLCs did not exist.)

For bankers that encounter **private firms that are pass-through entities, primarily limited liability companies (LLCs) and S corporations**, dividends and distributions play a different role, either as (1) a reimbursement to the owners for the personal income taxes paid on any profits passed through to them, or (2) a tax-effective way to compensate the owners after a minimum amount of salary (required by IRS) has been paid. Dividends are not equivalent to a financing cost for these firms.

Suggestion: Use the features of your software to re-allocate pass-through dividends into the proper role. That is, spread the amount as an income tax expense of the firm. Any amount over or above what you can reasonably relate to personal income taxes (say, more than 40% of the total profits passed through to the owners) spread as either salary or other compensation to owners.

4. Bonus: How distributions primarily are a tax adjustment, and your focus remains on profit retention. What if Anderson Steel was an S. corporation, LLC or partnership?

Anderson Steel for Year 4		C Corp.	[S or LLC]
Pretax Income	[Ordinary Income]	\$166	[~ \$166]
Federal Income Taxes		(\$37)	
Net Income	[Ordinary Income]	\$129	[~ \$166]
Dividend [Distribution] to Owners			[~ \$37]
Profit Retention		\$129	\$129

5. Comparing the SCF Format to the UCA Format

SCF Indirect Method (Usually)	UCA Direct Method (Always)
Operating <i>[Interest Exp. incl. in Net Income]</i>	Operating <i>(Interest Exp.)</i> <i>[If pass-through, Div./Dist. Here]</i>
	Interest Exp. and Dividends
	CMLTD Previous Year
Investing	Investing
Financing <i>[Incl. CMLTD Prev. Yr.]</i> <i>[Incl. Div./Dist.]</i>	Financing <i>(CMLTD Prev. Yr.)</i> <i>(Dividends)</i>

6. UCA terminology/definitions

- a. Cash from Sales is that portion of present year's sales collected in present year, plus any amounts from previous years' sales collected during the present year.
- b. Cash Production Costs are cash expended during present year to produce goods for sale (manufacturer) or to acquire merchandise (wholesaler or retailer).
- c. Gross Cash Profit is difference between cash from sales and cash production costs.
- d. Gross Cash Margin (%) is computed by dividing the gross cash profit by cash from sales. The result is an indication of the percentage of each cash dollar of sales that remains after payment of cash production costs.
- e. Cash Operating Expenses is actual cash spent during the year for selling, general and administrative expenses. This figure is adjusted for depreciation as well as for changes in prepaid and accrued expenses.
- f. Cash Operating Profit is result of subtracting cash operating expenses from gross cash profit.
- g. Net Cash After Operations (NCAO) is cash remaining after adjusting cash operating profit for net cash inflow (or outlay) from changes in income taxes and in miscellaneous assets and liabilities. It is the amount available for covering debt service.
- h. Net Cash Income is result of subtracting financing costs (interest as the cost of debt and dividends/withdrawals as the cost of equity) from NCAO.

On a cash basis, this number is comparable to the amount of net income (on an accrual basis) that is retained after dividends. To this end, consider spreading as “income taxes” the portion of pass-through entity dividends that equate to the owners’ personal income tax on the entity’s net income.

- i. Cash After Debt Amortization (CADA) is computed by subtracting the CMLTD at the end of the previous year from net cash income. If, after this step, there is still a positive figure, it means the company has been able to generate sufficient cash from its operations to meet all its obligations to bank lenders, including interest and principal. If, on the other hand, this figure is negative, the firm must resort to additional sources of financing to meet these obligations as well as to make any capital expenditures.
- j. Cash Coverage Ratio (x) is calculated by dividing NCAO by the sum of interest expense and the previous year-end CMLTD. Just like a positive figure for CADA, a cash coverage ratio $\geq 1.0x$ means the company has been able to generate sufficient cash from its operations to meet all its obligations to bank lenders, including interest and principal.
- k. Financing Surplus (Requirement) is result of subtracting fixed asset expenditures and other long-term investments from CADA. This measures either the magnitude of excess cash generated beyond all needs of the business, or the amount of external financing needed.
- l. Cash After External Financing – “External financing” refers to the provision of additional cash to the company from new loans (short-term and/or long-term) or equity capital (from shareholders). The cash after external financing is the excess or shortfall of cash after adjusting for the amount of external financing or lump-sum repayments (excluding scheduled CMLTD from the previous year-end).
- m. Actual Change in Cash is the year-to-year change as shown on the company’s balance sheet. If the cash flow statement has been calculated correctly, this will be the same as cash after external financing.

Analytical Technique #4: Three basic cash flow questions from UCA model format

- A. Can the firm pay its debt service with net cash after operations?

[Note that the UCA model covers interest first, just like bank loan systems]

- B. After operations, debt service and investing activities, does the firm have financing surplus or (financing requirement)?

- C. How did the firm (use the surplus) or cover the requirement?

[Note that the change in cash can be one of the (uses) or sources of financing]

Charts Reconciling Key UCA Subtotals to the SCF

Operating Cash Flow	Year 3	Year 4
UCA NCAO	(\$ 345)	\$ 502
Interest Expense	(108)	(157)
Δ Other Non-Curr. Asset	<u>27</u>	<u>(7)</u>
SCF Operating Cash Flow	(\$ 426)	\$ 338

The UCA model does not use interest expense to calculate NCAO, where as the SCF starts with net income, which includes interest expense. Also, the models handle certain miscellaneous accounts differently.

Financing Surplus/Requirement	Year 3	Year 4
SCF Operating Cash Flow	(\$426)	\$ 338
SCF Investing Cash Flow	<u>(575)</u>	<u>(212)</u>
Self-Calculated Subtotal	(\$1,041)	\$ 126
CMLTD (Prev. FYE)	<u>(252)</u>	<u>(188)</u>
UCA Fin. Surplus/Requirement	(\$1,293)	(\$ 62)

The UCA financing surplus (requirement) includes the results of the earlier, debt service payments section that uses the principal amounts paid in the current year (CMLTD at previous FYE). In the SCF, principal amounts paid in the current year are included later, in the financing cash flow section.

Financing Cash Flow	Year 3	Year 4
UCA Total External Financing	\$1,297	\$ 81
CMLTD (Prev. FYE)	<u>(252)</u>	<u>(188)</u>
SCF Financing Cash Flow	(\$1,045)	(\$ 107)

The UCA total external financing subtotal does not include the principal amounts paid in the current year (CMLTD at previous FYE). In the SCF, principal amounts paid in the current year are included in the financing cash flow section.

ANDERSON STEEL, INC.
Uniform Credit Analysis Model, Summary Version (\$000s omitted)
For the Year Ended December 31

	Year 2	Year 3	Year 4
Net Sales	\$ 6,586	\$ 7,859	\$ 9,980
Change in Accounts Receivable	(285)	(463)	131
Cash Collected from Sales	\$ 6,301	\$ 7,396	\$10,111
Cost of Goods Sold (less Deprec. in CofGS)	(4,615)	(5,655)	(7,248)
Change in Inventory	(325)	(583)	71
Change in Accounts Payable	214	638	(119)
Cash Production Costs	(\$4,726)	(\$5,600)	(\$7,296)
Gross Cash Profit	\$ 1,575	\$ 1,796	\$ 2,815
Operating Expenses (less Deprec. in Op. Exp.)	(1,312)	(1,662)	(2,191)
Change in Prepaids	(38)	(133)	(7)
Change in Accruals	195	(254)	(41)
Cash Operating Costs	(\$1,155)	(\$2,049)	(\$2,239)
Cash After Operations	\$ 420	(\$ 253)	\$ 576
Misc. Cash Income	5	(23)	(59)
Income Taxes Paid	(115)	(69)	(15)
Net Cash After Operations [NCAO]	\$ 310	(\$ 345)	\$ 502
Interest Costs Paid	(65)	(108)	(157)
Dividends Paid	0	0	0
Financing Costs	(\$ 65)	(\$ 108)	(\$ 157)
Net Cash Income	\$ 245	(\$ 453)	\$ 345
Current Maturities of LTD, Previous FYE	(234)	(252)	(188)
Cash After Debt Amortization	\$ 11	(\$ 705)	\$ 157
Capital Expenditures*	(191)	(575)	(213)
Change in Intangibles	0	(13)	(6)
Change in Long-Term Investments/Assets	0	0	0
Financing Surplus (Requirement)	\$ 180	(\$1,293)	(\$ 62)
Change in Short-Term Debt	0	186	(58)
Proceeds from Long-Term Borrowing	181	1,034	139
Change in Equity (excluding Retained Earnings)	29	77	0
Total External Financing	\$ 210	\$1,297	\$ 81
Cash After Financing	\$ 30	\$ 4	\$ 19
Actual Change in Cash	\$ 30	\$ 4	\$ 19
 Earnings Before Interest, Taxes & Deprec.	 \$ 659	 \$ 583	 \$ 492

ANDERSON STEEL, INC.
Statement of Cash Flows (\$000s omitted)
For the Year Ended December 31

	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>
Net Income	\$ 261	\$ 254	\$ 129
Plus: Depreciation	128	125	169
Accounts Receivable (Increase) Decrease	(285)	(463)	131
Inventory (Increase) Decrease	(325)	(583)	71
Misc. Current Assets (Increase) Decrease	(43)	(160)	(24)
Accounts Payable Increase (Decrease)	214	638	(119)
Accrued Expenses Increase (Decrease)	195	(254)	(41)
Income Taxes & Deferred Taxes Increase (Decrease)	90	27	22
Misc. Non-Current Liabilities Increase (Decrease)	10	(10)	0
Operating Cash Flow	<u>\$ 245</u>	<u>(\$ 426)</u>	<u>\$ 338</u>
Fixed Assets (Increase) Decrease	(\$ 191)	(\$ 575)	(\$ 213)
Long-Term Investments (Increase) Decrease	0	0	0
Intangibles & Misc. Non-Current Assets (Incr.) Decr.	0	(40)	1
Investing Cash Flow	<u>(\$ 191)</u>	<u>(\$ 615)</u>	<u>(\$ 212)</u>
Net Borrowings on Revolving Line of Credit	\$ 0	\$ 186	(\$ 58)
Principal Payments on Long-Term Debt	(234)	(252)	(188)
Proceeds from Long-Term Borrowing	181	1,034	139
Capital Stock Increase (Decrease)	29	77	0
Dividends Paid	0	0	0
Financing Cash Flow	<u>(\$24)</u>	<u>\$1,045</u>	<u>(\$107)</u>
NET CASH FLOW	<u>\$ 30</u>	<u>\$ 4</u>	<u>\$ 19</u>

The SCF normally will be part of a reviewed financial statement, as we have with Anderson Steel. It was not provided as part of the case initially because part of our program involved building the SCF after analyzing the various ratios.

Summary and Key Point:

Don't get locked into a single measure of cash flow for usage in a debt service coverage (DSC) ratio – multiple measures may be important to assess

- In most cases, EBITDA as the starting point or core element of cash flow, is critical for long-term relationships and payback periods
 - In some cases (example: sole proprietorships) you may not have enough balance sheet information to create a full statement of cash flows
 - In other cases, global cash flow may be your primary decision tool, especially for a very small business
- Businesses with a strong growth pace usually will put pressure on operating cash flow, so having a secured line of credit in place becomes important, along with a strong underlying EBITDA
- To explain incidences of cash flow problems, and perhaps occasional visits to your past due list, the **SCF** operating cash flow and/or **UCA** NCAO can be very helpful and relevant, especially for larger firms with significant balance sheet accounts in relation to revenues.