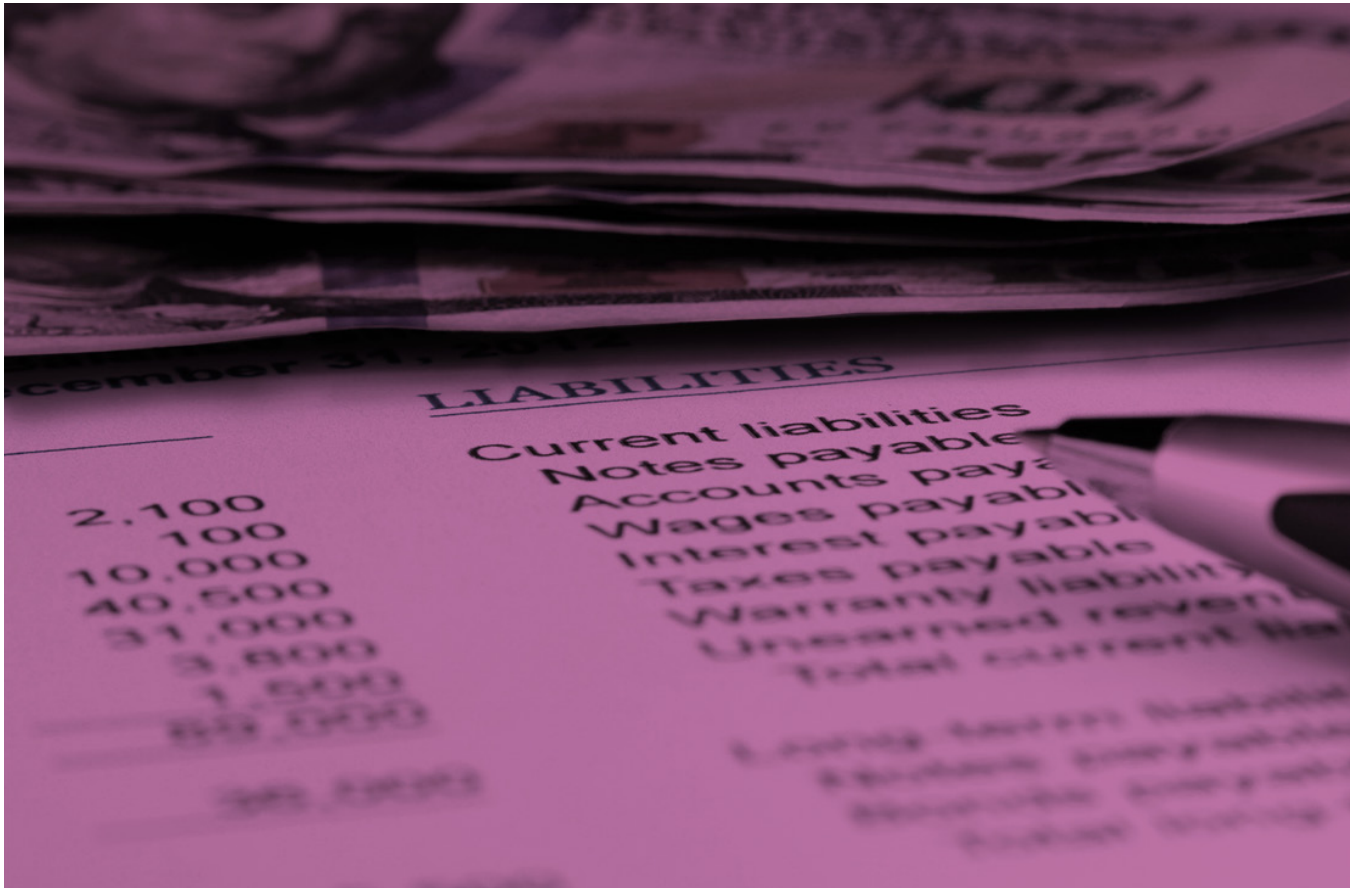


Understanding Cash Flow

Article by Bill Murray, Senior Vice President, National Sales Manager, Bank of America Practice Solutions



Too often we bankers throw around terms such as “cash flow” and “cash flow analysis” as if they were common in everyday conversation. The reality is quite the opposite, and we’re doing our clients a disservice if we don’t take the time to explain what these terms mean and why they are so important to a successful business.

At its core, cash flow is the difference between the money generated by a business (cash inflow) and the cost to run the business (cash outflow). When considering a small business loan, banks commonly go one step further by incorporating personal obligations as part of the cash outflow. A cash flow analysis measures a company’s financial health and a borrower’s ability to meet his/her business and personal obligations. It provides the information upon which lending decisions are based.

To better illustrate why it’s important to understand cash flow, let’s review an example that shows how a minor change in a borrower’s obligations can make the difference between a loan being approved or declined.

CONTINUED ON NEXT PAGE

"Once we've determined the amount of money a borrower can expect to generate from the clinic, we factor in the payments on the loan needed to purchase the clinic as well as the borrower's personal obligations."

For this example, we'll assume that a borrower is purchasing a veterinary clinic that collected \$1 million in 2014. These collections (not production) represent the cash inflow in our cash flow analysis. After deducting all business expenses that will be assumed by the buyer (business cash outflow), the clinic showed an operating profit of \$247,500 for the year. Business expenses, such as interest payments and auto expenses, are not assumed by the buyer and are, therefore, not included in the cash flow analysis. This \$247,500 is also referred to as the clinic's operating cash flow.

Once we've determined the amount of money a borrower can expect to generate from the clinic, we factor in the payments on the loan needed to purchase the clinic as well as the borrower's personal obligations. These obligations may include payments for mortgages, student loans, autos, credit cards and taxes, as well as a cost of living estimate. In our example, the borrower has total obligations of \$200,000 (personal cash outflow).

Now that we've accounted for all of the cash inflows and outflows, our cash flow analysis shows that the borrower will have \$47,500 in excess of his/her business and personal obligations. To put it another way: for every \$1 in business and personal obligations, the borrower will generate \$1.24 from the clinic. To approve a loan, many banks require that borrowers generate no less than \$1.20 for every \$1 in expenses. This borrower was close, but at \$1.24, the cash flow analysis resulted in an approval!

But what if the borrower's expenses were slightly higher? Today, almost all veterinary students graduate from veterinary school with a sizeable amount of debt and most are anxious to pay it off. The borrower in the example above chose to pay his/her loans off over 30 years and made annual payments of \$48,000. At the time the borrower started repayment, there was a 15-year option at

a slightly lower interest rate that required annual payments totaling \$72,000. While this alternate option would have saved the borrower some interest, the required larger payment would have reduced the borrower's excess cash flow by \$24,000. This minor change would have resulted in the borrower generating only \$1.08 for every dollar of expenses and the loan request would be declined.

When making financial decisions, it is important to think of what you are trying to accomplish in the next few years and not just satisfy an immediate need or want. Potential buyers who overextend themselves with high credit-card debt, large home mortgage payments and large expensive car payments will potentially miss out on an opportunity to purchase a veterinary clinic because of the amount of income they require to satisfy their monthly credit obligations.

Bank of America is a registered trademark of Bank of America Corporation.
©2016 Bank of America Corporation

Bank of America, N.A. provides informational reading materials for your discussion or review purposes only. Please consult with your financial or tax advisor, as neither Bank of America, its affiliates, nor their employees provide legal, accounting and tax advice.

AR# ARXC6M4J

Bank of America Practice Solutions is an MWI Animal Health Distinct Advantage™ program partner. To discuss how your practice can qualify for a free Distinct Advantage program membership, contact your MWI Territory Manager.

Distinct Advantage™
AmerisourceBergen