

## What Is “Cash Flow”?

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What is “Cash Flow”? Is Cash Flow the cash left over after “Operational, Financial, and Investment activities? Is it the same thing as “Net Income”? Or maybe Cash Flow is the cash left over after all expenses are deducted including a fair amount for owner’s salary? How about “Seller’s Discretionary Cash Flow”? And, what about “Free Cash Flow”? What is the difference? Of course, we do not want to forget the “Discounted Cash Flow”. Can we make it more confusing?

Most business and real estate buyers are confronted with this dilemma as they analyze proposed investment options. Even sellers must prepare statements (or have prepared) reflecting the cash flow of their business or real estate they propose to market.

So how do we deal with the multitude of definitions of cash flow proliferating throughout the investment scene? Simple—just keep in-mind you always want to compare apples to apples and ask for more information on how the cash flow is determined for the particular investment you are considering. Never take for granted whoever prepared the financial figures will use the same definition of cash flow.

Some definitions to consider:

1. “In [finance](#), **cash flow** refers to the amounts of [cash](#) being received and spent by a business during a defined period of time, sometimes tied to a specific project.”
2. **Net income** is equal to the [income](#) that a firm has after subtracting costs and [expenses](#) from the total [revenue](#).”
3. **Sellers Discretionary Cash Flow:** Many brokers use general rules of thumb for valuing businesses. Most of these rules are multiples of Sellers Discretionary Cashflow (SDC). SDC includes net income plus owner’s salary and perks, and non-cash expenses such as depreciation = the cash

the seller receives from the business. Most small businesses sell for somewhere between 1.5 and 2.5 times SDC.

**4. Free cash flow** measures a firm's cash flow remaining after all expenditures required to maintain or expand the business have been paid off. It represents the net cash produced by a firm during a given period on behalf of stakeholders (e.g. shareholders, debt holders, preferred shareholders).”

“Some investors prefer using free cash flow instead of net income to measure a company's financial performance, because free cash flow is more difficult to manipulate than net income.”

**5. In finance**, the **discounted cash flow** (or DCF) approach describes a method to value a project or an entire company. The DCF methods determine the present value of future cash flows by discounting them using the appropriate cost of capital.

How do we decipher all of this information and apply it towards our goal of acquiring a profitable investment? Consequently, how do we use this information to effectively market our existing investment to potential buyers? Welcome “on-board” yet another investment term: The “ProForma Statement”.

*Pro forma*, a Latin term meaning "as a matter of form," is applied to the process of presenting financial projections for a specific time period in a standardized format. Businesses use pro forma statements for decision-making in planning and control, and for external reporting to owners, investors, and creditors. Pro forma statements can be used as the basis of comparison and analysis to provide management, investment analysts, and credit officers with a feel for the particular nature of a business's financial structure under various conditions.

A Proforma statement is used to align our investment goals with the investment being considered. Not all Proforma statements will be alike because not all investors have the same investment goals. Nonetheless, we need some sort of tool to be able to keep investment options organized in a systematic way. By using a Proforma statement designed with your goals in-mind you can analyze several investments using the same criteria for each. Of course, you will still have to “plug” the same numbers derived from the cash flow sheets, profit and loss statements and/or balance sheets. Actually, Proforma

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statements can be created for each of the financial statements. However, for the most part, it is the operational performance of the investment which deserves more attention.

As a prospective buyer or seller of investments, it will be in your best interest to become familiar with these financial terms and how they are used. Consequently, obtaining standardized forms to use for cash flow projections and proforma's may be your best bet because creating them from scratch can become a time consuming task. Another option, of course, is to enlist the assistance of a business and/or real estate broker who is knowledgeable with financial investments and can produce the information necessary to guide your decision making process.

Works Cited

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