

Preparing a Cash Flow Projection - by Dan Sautner

Throughout your business career, you are continually asked to predict the future. Your banker wants to know how you will repay loans. You hire new employees with the expectation that the volume of future work will support them. You purchase a new delivery truck because you expect the future to require it.

We often predict the future by relying on our intuition or gut feel about the business that we are in. We consider the past, make adjustments for the new environment the future always brings, and then take a stand on where sales will be. This is how this has been done since the days of trading ships.

The concept of a cash flow statement is also not new. It has been around at least as long. Even prior to sending out a trading ship, someone had to determine if it was going to be a profitable adventure. They did this by estimating what the flow of cash would be and how much eventually would be left over. This exercise also allowed the traders to determine how much up-front capital was required.

In your business you also have to guess about the future. One major tool for this is the cash flow projection. This is not a cash flow statement (sometimes called sources and applications of funds) which shows how and why the current assets changed, but rather the estimation of where the cash will come from and where it will go.

These projections take a number of forms and have a number of uses. There are projections that are broken down into three month periods and cover up to five years. These are often used in major capital acquisitions (such as a new building) when an existing company is heading off into an entirely new venture or in the acquisition of a new business. These activities often will take some time to resolve.

Projections can also be by the month for periods of two or three years. These are most often used when raising debt at a bank. The primary focus of these projections are on when and how much excess cash will be generated. The lender will use these projections to assist in the determination of ability to repay.

The simplest forms are the projections related to a single project, event or season. Here the time frames are contracted and often the information is restricted to only those elements affected. An easy example might be the decision to go to a trade fair and purchase a display booth. Here the event and the costs have a limited, easily-definable life.

In order to demonstrate the development of a projection, let us use the example of going to a trade show. It has a limited life, affects very few of our other resources and probably can be done on the back of a large envelope.

First, determine what type of cost categories will be required to undertake this project. List these down the left hand side, about a third of the way down the page, and label this "Uses". Next set up columns on the page. The number of columns will be based upon the time frames you wish to study. These could be quarters or months, but these are too long. The trade show is in eight weeks. We

might choose days, but that is too narrow of a focus. In fact, while the word projection sounds scientific, it really means "best guess." In our example, set up nine columns, label them weeks "one" to "eight" and then "total". We will reserve the top third of the paper for sources of cash, but we will get to this later.

Using the list of expenses, work out first how much total money will be needed and record this in the total column. We allocate this to the week columns later. This gives you the total size of the project. Is this total in the realm of possibility? I have thrown my scratch work envelope away at this point because there was no possible way we could afford that much cash in that time period. If the total does not surprise, you go onto the next step, which is the inflows, or sources of cash.

On the top third of the envelope on the far left, list the sources of cash for this project. This may include immediate sales at the trade show or costs avoided while at the trade show. Again, once you have the types of sources, determine the amount to be placed in the total column. Now add a final line in the sources, called contributions. Use this line to balance the sources of cash to the uses of cash. In a perfect world, sources will be higher than uses and no amount will be required here. In many cases, you will have to put cash into the venture. Again, determine if this type of contribution is possible.

Now is the time to break the total sources and uses of funds up among the eight weekly columns. Remember to figure when the cash will actually move as opposed to when you incur the liability. Once these have been distributed, determine the totals for each weekly column.

You will now be able to schedule your contributions so each week is balanced in its source in use of cash. In all likelihood, you will find that your contributions reach a high water mark early in the project. This amount may even exceed the total requirement. The accumulated contribution is the most cash you will require to undertake this project.

Now you have the numbers. Things can be juggled, and you may have to do some rearranging. Many projects in of themselves are not positive cash-flow generators. The reason that they are undertaken is that they assist the company in its total operation, and this venture represents an investment in the company.

Using cash flow projections is the beginning and end of your decision-making process. It can be valuable to you in that it does highlight the financial aspects of a new idea or venture. You must balance this investment with the intangible benefits. You may determine that the investment is worth it.

Once the project is underway, track the actual against this projection. It can help you budget, or at the very least, help you understand the effect of cost overruns. If nothing else, it helps you prepare a better projection for the next project.

For the larger projects, you may want to get the help of your accountant. As the time frame and number of variables increase, the complexity increases. Very quickly, you are out of the back of an envelope and onto a computer model. These projections take time, but they will allow you to go into

new ventures with your eyes open.

Start with an easy, simple project. Test some assumptions and train yourself in what factors are important. This is a skill that will allow you, if not to predict the future, to at least take the surprise out of it.