BALANCE BUSINESS SOLUTIONS INC
YOUR BUSINESS, YOUR FUTURE, YOUR WAY

Earnings Stream

Net Cash Flow to Equity

In the last piece, we discussed Discretionary Owner's Income. The next two issues we will discuss net cash flow. For appraisal purposes, net cash flow differs from the accounting definition of cash flow as described in FASB's Statement of Financial Accounting Standards No. 95. Below is the basic formula for the Net Cash Flow to Equity:

	Normalized net income (need to determine if this is before or after tax)
+	Normalized noncash charges (depreciation and amortization)
=	Gross cash flow
-	Anticipated capital expenditures
- or +	Changes in working capital necessary to support growth
- or +	Changes in long-term debt
	Net Cash Flow to Equity

If you are familiar with FASB No. 95 at all, you will see the difference between the accounting definition and the appraisal definition of cash flow.

We should point out some important aspects of the appraisal definition that you may have already noted. The first is the fact that we are using "normalized" figures. As mentioned in past issues, normalize means to adjust the accounting financial statements to the economic financial statements. A second aspect is that we account for the change in debt but not interest as we did on the Owner's Discretionary Income. This formula is for net cash flow to equity and not invested capital. You will notice the difference between the two net cash flow formulas in the December educational issue when we discuss Net Cash Flow to Invested Capital.

One other adjustment that you may make to the above formula, if it pertains to the business, is a deduction for preferred stock dividends. Look at net cash flow to equity as what is available for distribution to common stock holders or the dividend-paying capacity of the business. A third way to look at net cash flow is the amount that is left over after reinvesting back into the company to allow for growth.

Why not use this cash flow for all businesses? A primary reason not to use this for small businesses is that they typically are not run as a business. The products and services that a small owner operated business sells generally are not priced to provide a particular return on investment. The business tends to be run as a job and not a business.