What is Global Cash Flow and Why is it Important?

Wynn Richardson
Center for Farm Financial Management
University of Minnesota
wynn@umn.edu

Michael Bonnett
Vice President, Sr. Manager Ag Credit Center
BMO Harris Bank
michael.bonnett@bmo.com

“Traditional” Ag Credit Analysis Tools

- Balance sheet
- Collateral analysis
- Schedule F (cash to accrual)
- Annual / Monthly Cash Flow Projections
“Traditional” Ag Credit Analysis Tools

• Business financial performance measures
  – Liquidity
  – Solvency
  – Profitability
  – Repayment Capacity
  – Efficiency

Global Cash Flow…

A New Old Tool?
Global Cash Flow…

Does Not Measure Business Financial Performance

A New / Old Tool

• Global Cash Flow Analysis
  – Analyze debt repayment from multiple sources
  – Mix of business and personal
**Old-School Example**

- Family with farm income, custom hire income, non-farm W-2 income
- Use your favorite tool to project “can they pay their bills?”

---

**What’s Wrong With This Old-School Picture?**

Minnesota Vikings
“Wilfs own complex web of holdings in 37 states”

• 21-year civil trial in NJ between Wilfs and partners in 764-unit apartment complex

Highlights and Quotes

• Ownership stake in 460 separate entities
• Roughly 700 separate tax returns
Highlights and Quotes

• “Judge Deanne Wilson complained of how difficult it has been to unravel the Wilfs’ many interrelated companies because of a lack of records and the Wilfs’ own confusing testimony.”

Source: StarTribune, September 21, 2013

Highlights and Quotes

• “Once again, I have no idea what the witness’ answer actually was, or what he was doing, or why he did what he did,” said the judge.

Source: StarTribune, September 21, 2013
A New / Old Tool

• Global Cash Flow Analysis
  – Analyze debt repayment from multiple sources
  – Mix of business and personal
  – Multiple entities
  – Multiple guarantors

This is unusual, right?

Let’s ask the IRS…
Partnership Returns, 2010

For 2010, the number of partnerships increased 2.5 percent, from 3,168,728 for 2009 to 3,248,481. The number of partners increased by 6.1 percent, from 21,141,979 for 2009 to 22,428,047 for 2010. Partnerships in the real estate and rental and leasing sector accounts for 47.9 percent of all partnerships and 32.9 percent of all partners, the largest share reported among all sectors.

The finance and insurance sectors reported the largest share of total net income (loss), 48.3 percent, and total assets, 55.4 percent, for all partnerships in 2010.

Total net income (loss), or profit, increased by 44.9 percent $409.9 billion for 2009 to $593.7 billion for 2010. In 2010, only 2 sectors (information and education) reported a decline in profits down from 13 in 2009.

Total receipts in 2010 were $5.5 trillion, a 14.3-percent increase from 2009. Business receipts, the largest component of total receipts, increased between 2009 and 2010. Business receipts increased by $384.1 billion to $3.9 trillion for 2010.

Total assets of partnerships reporting balance sheet information increased 5.4 percent, from $18.8 trillion for 2009 to $19.8 trillion for 2010.

Total income (loss) minus total deductions available for allocation increased significantly from $391.3 billion for 2009 to $976.6 billion for 2010.

In 2010, partners classified as corporations received the largest share of income (loss) allocated to partners, $294.2 billion.

A partnership is an unincorporated organization formed by two or more entities or persons that join to carry on a trade or business. Each partner contributes money, property, labor, or skill, and each expects to share in the profits and losses. Every partnership that engages in a trade or business, or has income from sources in the United States, must file an annual information return, Form 1065, U.S. Partnership Return of Income, or Form 1065-B, U.S. Return of Income for Electing Large Partnerships, with the Internal Revenue Service. A partnership does not pay tax on its income but “passes through” any profits and losses to its partners, who must include those profits and losses on their income tax returns.

**Highlights of the Data**

- For 2010, the number of partnerships increased 2.5 percent, from 3,168,728 for 2009 to 3,248,481.
- The number of partners increased by 6.1 percent, from 21,141,979 for 2009 to 22,428,047 for 2010.
- Partnerships in the real estate and rental and leasing sector accounts for 47.9 percent of all partnerships and 32.9 percent of all partners, the largest share reported among all sectors.
- The finance and insurance sectors reported the largest share of total net income (loss), 48.3 percent, and total assets, 55.4 percent, for all partnerships in 2010.
- Total net income (loss), or profit, increased by 44.9 percent $409.9 billion for 2009 to $593.7 billion for 2010.
- In 2010, only 2 sectors (information and education) reported a decline in profits down from 13 in 2009.
- Total receipts in 2010 were $5.5 trillion, a 14.3-percent increase from 2009.
- Business receipts, the largest component of total receipts, increased between 2009 and 2010. Business receipts increased by $384.1 billion to $3.9 trillion for 2010.
- Total assets of partnerships reporting balance sheet information increased 5.4 percent, from $18.8 trillion for 2009 to $19.8 trillion for 2010.
- Total income (loss) minus total deductions available for allocation increased significantly from $391.3 billion for 2009 to $976.6 billion for 2010.
- In 2010, partners classified as corporations received the largest share of income (loss) allocated to partners, $294.2 billion.

**Tax Stats**  >  **Business Tax Statistics**  >  **Partnership Statistics**
Number of Partnerships by Type of Entity, 2001-2010

Number of Partnerships by Industry

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total number of partnerships</td>
<td>3,168,728</td>
<td>3,248,481</td>
<td>3,285,177</td>
</tr>
<tr>
<td>Total number of partners</td>
<td>21,141,979</td>
<td>22,428,047</td>
<td>24,389,807</td>
</tr>
</tbody>
</table>

**Number of Partnerships by Industry**

<table>
<thead>
<tr>
<th>Industry</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>RANK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry, fishing &amp; hunting</td>
<td>129,889</td>
<td>121,401</td>
<td>121,192</td>
<td>7</td>
</tr>
<tr>
<td>Mining</td>
<td>31,922</td>
<td>41,731</td>
<td>34,522</td>
<td>16</td>
</tr>
<tr>
<td>Utilities</td>
<td>6,052</td>
<td>6,761</td>
<td>3,349</td>
<td>19</td>
</tr>
<tr>
<td>Construction</td>
<td>181,295</td>
<td>167,576</td>
<td>157,333</td>
<td>5</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>44,698</td>
<td>60,192</td>
<td>64,418</td>
<td>13</td>
</tr>
<tr>
<td>Wholesale trade</td>
<td>54,540</td>
<td>59,803</td>
<td>73,201</td>
<td>10</td>
</tr>
<tr>
<td>Retail trade</td>
<td>176,694</td>
<td>160,359</td>
<td>161,596</td>
<td>4</td>
</tr>
<tr>
<td>Transportation and warehousing</td>
<td>50,551</td>
<td>51,242</td>
<td>40,351</td>
<td>15</td>
</tr>
<tr>
<td>Information</td>
<td>42,846</td>
<td>47,143</td>
<td>44,068</td>
<td>14</td>
</tr>
<tr>
<td>Finance and insurance</td>
<td>313,203</td>
<td>284,487</td>
<td>301,267</td>
<td>2</td>
</tr>
<tr>
<td>Real estate and rental and leasing</td>
<td>1,524,297</td>
<td>1,557,435</td>
<td>1,595,757</td>
<td>1</td>
</tr>
<tr>
<td>Professional, scientific and technical</td>
<td>189,070</td>
<td>227,966</td>
<td>225,785</td>
<td>3</td>
</tr>
<tr>
<td>Holding companies</td>
<td>17,230</td>
<td>25,359</td>
<td>28,578</td>
<td>17</td>
</tr>
<tr>
<td>Administrative, support, etc</td>
<td>74,607</td>
<td>81,773</td>
<td>71,998</td>
<td>11</td>
</tr>
<tr>
<td>Educational services</td>
<td>11,239</td>
<td>12,968</td>
<td>12,968</td>
<td>18</td>
</tr>
<tr>
<td>Health care and social assistance</td>
<td>69,566</td>
<td>73,226</td>
<td>79,803</td>
<td>8</td>
</tr>
<tr>
<td>Arts, entertainment and recreation</td>
<td>58,302</td>
<td>61,534</td>
<td>67,183</td>
<td>12</td>
</tr>
<tr>
<td>Accommodation and food services</td>
<td>113,242</td>
<td>115,676</td>
<td>122,104</td>
<td>6</td>
</tr>
<tr>
<td>Other services</td>
<td>73,772</td>
<td>87,103</td>
<td>77,346</td>
<td>9</td>
</tr>
</tbody>
</table>

**Number of Partners by Industry**

<table>
<thead>
<tr>
<th>Industry</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>RANK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry, fishing &amp; hunting</td>
<td>424,032</td>
<td>401,045</td>
<td>393,200</td>
<td>12</td>
</tr>
<tr>
<td>Mining</td>
<td>978,314</td>
<td>1,352,731</td>
<td>1,367,314</td>
<td>4</td>
</tr>
<tr>
<td>Utilities</td>
<td>152,179</td>
<td>169,072</td>
<td>113,472</td>
<td>18</td>
</tr>
<tr>
<td>Construction</td>
<td>521,851</td>
<td>446,521</td>
<td>404,683</td>
<td>11</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>574,758</td>
<td>516,074</td>
<td>682,535</td>
<td>7</td>
</tr>
<tr>
<td>Wholesale trade</td>
<td>371,496</td>
<td>425,981</td>
<td>538,253</td>
<td>9</td>
</tr>
<tr>
<td>Retail trade</td>
<td>613,579</td>
<td>434,660</td>
<td>647,523</td>
<td>8</td>
</tr>
<tr>
<td>Transportation and warehousing</td>
<td>1,258,967</td>
<td>1,906,832</td>
<td>2,445,371</td>
<td>3</td>
</tr>
<tr>
<td>Information</td>
<td>182,752</td>
<td>192,452</td>
<td>215,393</td>
<td>15</td>
</tr>
<tr>
<td>Finance and insurance</td>
<td>5,647,231</td>
<td>5,872,248</td>
<td>6,597,560</td>
<td>2</td>
</tr>
<tr>
<td>Real estate and rental and leasing</td>
<td>7,052,342</td>
<td>7,381,816</td>
<td>7,654,683</td>
<td>1</td>
</tr>
<tr>
<td>Professional, scientific and technical</td>
<td>675,316</td>
<td>753,404</td>
<td>753,583</td>
<td>6</td>
</tr>
<tr>
<td>Holding companies</td>
<td>932,091</td>
<td>950,456</td>
<td>1,027,254</td>
<td>5</td>
</tr>
<tr>
<td>Administrative, support, etc</td>
<td>201,645</td>
<td>190,540</td>
<td>173,707</td>
<td>16</td>
</tr>
<tr>
<td>Educational services</td>
<td>26,642</td>
<td>30,930</td>
<td>33,200</td>
<td>19</td>
</tr>
<tr>
<td>Health care and social assistance</td>
<td>314,117</td>
<td>339,600</td>
<td>347,280</td>
<td>14</td>
</tr>
<tr>
<td>Arts, entertainment and recreation</td>
<td>598,375</td>
<td>401,445</td>
<td>369,166</td>
<td>13</td>
</tr>
<tr>
<td>Accommodation and food services</td>
<td>418,215</td>
<td>454,842</td>
<td>450,271</td>
<td>10</td>
</tr>
<tr>
<td>Other services</td>
<td>184,239</td>
<td>195,481</td>
<td>170,711</td>
<td>17</td>
</tr>
</tbody>
</table>

2011 Partners by Industry

1. Real estate, rental and leasing
2. Finance and insurance
3. Transportation and warehousing
4. Mining
5. Holding companies

Know Thy Borrower

Global Cash Flow ≠ Business Financial Performance
Global Cash Flow

Where Is the Cash?

Why?

• “Because the examiner told me to…”
• Find the weak thread(s)
• How do they impact the stronger threads?
Why?

• Turn over all the rocks
• Due diligence
• Are you approving a loan or approving the risk?

Do You Have an Approach?

• Art vs. Science? Luck vs. Skill?
• Can it be explained?
• No auto-pilot
“Perfect” Global Cash Flow

• Considers all existing and potential sources of income
• Analyzes all asset holdings and balance sheet cash flow

“Perfect” Global Cash Flow

• Personal income
• Business income, assets & inventories
• Real estate holdings
• Direct liabilities and debt service
• Contingent liabilities
Steps to Consider

• Full tax return to identify “activities”
  – 1040 and supporting schedules
  – K-1’s
• Personal balance sheet
  – Equity in other entities?
• Does it fit the “old-school” example?

Challenges

• $1 + 1 \neq 2$
  – Don’t double-count cash
  – Earnings vs. Distributions
Challenges

• How many entities to include in the analysis?
  – As many as you can stand?
  – Where is the risk?

Challenges

• Difficult to compare global cash flow between different customers
• Monitor changes over time
Challenges

• Balancing consistency in approach vs. one-size-fits-all results

Challenges

• If the approach leads to more questions, you are probably on the right track
Questions?

Thank You!