



# Cash Flow

## At a Glance

The first rule in any business is to stay in business, and the key to staying in business is cash flow. The four major issues affecting cash flow are cash on hand, down payments, monthly payments, and overall cost. Below, we'll offer our insight into each of those issues.

## A Closer Look

### Cash on Hand

Paying cash is certainly one option when you're acquiring equipment, but it isn't really advantageous for most contractors. Many businesses operate with adequate cash flow to survive, but frequently don't have the cash reserves to spend on major equipment purchases.

This is a typical problem for many contractors: You need to acquire new equipment, which will generate additional revenue and make the monthly payments affordable once it's in operation. However, you're also short of immediate capital, and the lender won't finance the equipment without cash up front.

### Down Payments

Now it becomes a matter of how much cash you can afford to put down for your equipment. Installment loans typically require down payments of 10-20% (depending on your credit), which amounts to as much as \$20,000 up front on a \$100,000 machine.

A lease, on the other hand, requires only one or two payments in advance (depending on your credit), which is substantially less outlay and considerably more affordable for most contractors.

### Monthly Payments

Often the acquisition of new equipment becomes feasible only if the monthly payments are manageable. If the size of the monthly payment is a major consideration, leasing will become a more attractive option.

## Overall Cost

Ask yourself two questions while it's still early in the equipment acquisition process:

1. How much am I paying to acquire and use this equipment?
2. What's the best use of my cash and the best way to pay for this equipment?

If you pay cash, you avoid finance charges and have no monthly payments. On the other hand, you've also reduced your cash reserves significantly.

If you use an installment loan or lease, then you have to look at the overall cost of financing. This includes the internal rate of return, the time value of money, and, of course, taxes.

### Trade Value

Before you buy new equipment, you may find yourself making educated guesses on how much your existing equipment is worth in trade. Knowing your trade value can help you plan for future equipment purchases. You can estimate the amount of cash you need and figure monthly payments. If you've owned the equipment for a few years, it gets more difficult to determine what the dealer will allow for trade.

A lease eliminates the guessing game. At the end of a lease, you know your options. You can turn in the equipment and walk into a new lease or you can purchase the equipment with a stated purchase option. You always know (years in advance) what you'll be paying and your options at the end of your contract.

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## Overall Cost *(continued)*

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### Time Value of Money

Time Value of Money (TVM) calculations compensate for future value. The future value method adds investment earnings to cash flow. This allows you to see what the value of today's money would be worth if you received a specific investment return, and helps determine what your money is worth now, compared to what it will be worth as it's paid back. When calculating TVM, you must use the current Internal Rate of Return (IRR) of your business as the future value factor.

### Taxes

Did you know that the way you acquire equipment can make a significant difference in your tax liability and can help you avoid common tax consequences?

When you do a thorough analysis of the cost of paying cash, the cost of an installment loan, and the cost of leasing, you will often find that a lease can have the lowest overall cost—sometimes by a wide margin.

Naturally, this isn't true 100% of the time. There will be occasions when your best bet is an installment loan. Remember: Rarely, if ever, will paying cash be your best option.

## Find the right solution when you're looking for equipment.

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Before you make your next equipment acquisition decision, we recommend that you:

1. Talk to your local John Deere dealer, a great source for both equipment and financing answers.
2. Always consult your accountant and/or tax advisor.

## Always discuss your equipment acquisition plans with a qualified accountant.

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