

## **WEATHERING THE PANDEMIC: THREE CORPORATE RESTAURANT CHAINS NAVIGATE THE CHOPPY WATERS OF 2020**

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*Restaurants were some of the businesses hardest hit by the COVID pandemic which began in 2020. For those that were able to survive the loss of customers in the onset of the pandemic, lack of staffing, supply chain issues, mask mandates and further shutdowns cast a cloud on the survivability of many others going forward. This case prompts students to evaluate the financial health of three different restaurant groups heading into the COVID pandemic and consider alternatives for boosting cash reserves in the face of uncertainty.*

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### **FIGHT FOR SURVIVAL!**

“I have been doing this for 30-some years and I’ve never worked so hard for so little in my life. Unfortunately, so much of our overhead is a fixed cost that I can’t get rid of, no matter if I don’t have the business (volume). I’m still paying my self-employment tax and I’ve still got another round of property tax coming up in the next couple of weeks and it’s really scary figuring out how you’re going to manage that.” Springfield, Illinois, August 2020 following weeks of stay at home orders and government mandated shutdowns, restaurateur Hallie Piercall echoed the panic felt by restaurant owners and managers across the US. (Spearie, 2020) Springfield native and 2019 James Beard Award winner Kevin Boehm acknowledged, “We’re on the front lines of a desperate fight to survive. You look across the state and these small and family-owned restaurants and bars are closing for good, leaving behind unpaid bills, empty storefronts and laid off workers.” (Spearie, 2020)

This sentiment was echoed by larger chain restaurants as well. According to Oberon Group owner Henry Rich, “The biggest challenge is adapting to so many shocks while needing to stay nimble on our feet. We abruptly lost our cash flow and our daily work routine, had to lay off our extended work families, while being under personal health and financial risk. In those same moments, we’re retooling

all four of our businesses with new service offerings as fast as we can to keep our heads above water." (Rich, 2020) Frances Allen, stepped into her role as new CEO of Checkers and Rally's, on Feb. 17, 2020. Her first email to the team said, "We need a response plan to this crisis, and we need to look at it on different levels." (Luna, 2020)

Tom Bene, National Restaurant Association President, predicted restaurant industry losses would reach \$240 billion by the end of calendar year 2020. The covid pandemic which began in 2020 wreaked havoc on businesses in the US and abroad. Industries from food service, to transportation, to recreation and hospitality suffered a freefall in sales in a matter of weeks. "After peaking at 29,000 in February, the Dow Jones Industrial Average fell below 21,000 by mid-March – a nearly 30% drop. On March 16, the Dow fell by nearly 3,000 points, the largest single-day drop in history. (Suneson, 2020)." The crisis came on so suddenly that companies had little time to act to prepare their companies to weather the storm. How can these companies prepare, financially, to face pandemic uncertainty in the weeks and months to come?

### **THE RESTAURANT INDUSTRY**

Over the last 30 years, Americans have increasingly turned to restaurants for their meals. According to the USDA, the number of food service establishments increased 77% between 1977 and 2012 while spending on food away from home in the US increased from 44% in 1987 to over 50% in 2010. (USDA, 2000) Firms in this industry may be classified as fast food operations, fast-casual, casual dining, and fine dining establishments and range from corporate giants to small mom and pops. The restaurant industry can be described as highly competitive with razor thin margins. "The statistics aren't pretty: 60 percent of restaurants don't make it past their first year and 80 percent go out of business within five years." (Crawford, 2022) As the pandemic swept upon us rapidly in the spring of 2020, businesses had to adjust quickly to stay afloat.

### **BLOOMIN BRANDS**

The first Outback Steakhouse opened in Tampa, Florida in 1988 with a new, fun theme inspired by the Australian outback. The company went public in 1991 followed by the addition of three other restaurant concepts. As of December 29, 2019, Bloomin' Brands was one of the largest casual dining restaurant companies in the world, with 1,045 company operated restaurants and 173 franchised restaurants across the US and internationally (Bloomin Brands, 2019). The

company operated four different restaurant concepts that ranged in price point and degree of formality from casual (Outback Steakhouse and Carrabba's Italian Grill) to upscale casual (Bonefish Grill) and fine dining (Fleming's Prime Steakhouse & Wine Bar), (Bloomin Brands). All four concepts, however, were primarily dine-in facilities with limited take-out capabilities.

David Deno was named CEO of Bloomin Brands in April of 2019. Former CEO Elizabeth Smith, with the help of Deno, had turned the company from a \$739.4 Million loss in 2008 to net income of over \$130 million in 2019. During this time, the company completed restaurant makeovers, added pickup options, and partnered with delivery services such as Doordash to improved its customer experience (Lokuwithana, 2019). Despite this success, "the company ... operated amid intense competition from the likes of Darden Restaurants, Inc. and Texas Roadhouse, its peers in the full-service restaurant industry" (Lokuwithana, 2019). In the fall of 2019, Deno was feeling pressure from investor groups to consider selling one or more of its brands (Danielson and DiNatale, 2019). Then in March of 2020, the covid pandemic hit the US full force. Would Bloomin Brands be able to weather the storm? How could they build cash for the uncertain times to come?

### **CHIPOTLE MEXICAN GRILL**

This fast-casual restaurant concept offered a menu of burritos, tacos, salads and burrito bowls. Founder Steve Ellis opened his first burrito shop in Denver, Colorado in 1993. The company focused on fresh, flavorful, and wholesome ingredients. The company went public in 2006. As of December 31, 2019, the company operated 2,580 Chipotle restaurants throughout the United States, 39 international Chipotle restaurants, and three non-Chipotle fast-casual pizza restaurants, all of which are company owned (Chipotle Mexican Grill, 2019). CEO Brian Niccol took the helm in March of 2018, after a string of food borne illnesses between 2015 and 2018 had sickened over 1,000 customers and damaged the company's reputation.

Under the new CEO new strategies were employed to restore customer trust and loyalty. The company instituted paid sick leave for its employees to encourage them to stay home if they were sick. New mandatory training sessions on food safety protocols were instituted. To address former difficulties in enforcing corporate policies in their stores, the company flattened their operating structure to allow field leaders to spend more time in stores and instituted a central training

program in Denver to make store experience more consistent, increase service speeds, and increase hospitality and customer experience. The company launched a customer loyalty program in 2018. They earmarked \$20,000 per store for store makeovers to improve appearance. To improve order speed, the company planned to strengthen its online sales and mobile ordering including adding drive thru windows, second lanes for pick-up orders, shelves for pickup and a separate prep line in-store for pickup orders, improvements estimated to run the company \$45 million (Whitten, 2018). Company initiatives in 2018 also included improving delivery times, and partnering with third party delivery service Doordash (Lucas, 2019). Then in March of 2020, the covid pandemic hit the US full force. Would Chipotle be able to weather the storm? How could they build cash for the uncertain times to come?

### **POTBELLY CORPORATION**

Potbelly sandwich shop, which became public in 2013, got its start 45 years ago in a Chicago antique store that sold refurbished potbelly stoves. The proprietors served sandwiches to keep the customers in the store. "Known for their nostalgic ambiance, wood fixtures and sandwiches such as "A Wreck." The chain became publicly traded in 2013" (Lalley, 2022). As of December 2019 the company had the company had 474 shops in 32 states and the District of Columbia, 428 of which were company operated and 46 franchised (Potbelly, 2019).

After going public in 2013, the company faced "a number of challenges, including an intensely competitive sandwich category. According to Technomic, the number of fast casual sandwich chains with more than \$50 million in annual sales increased 70% to over 7,500 in the past five years"(Kelso, 2018). Slowing sales growth prompted, then-CEO Aylwin Lewis to step down in May 2017 and he was replaced by Alan Johnson. (Jargon, 2018) The firm was pressured by activist shareholders to make changes or sell. The firm did not receive a viable offer, so it began to try correct its issues on its own with a number of initiatives including simplifying the menu from 115 items to only 66, and improving its customer facing technology and its marketing"(Kelso, 2018). Then in March of 2020, the covid pandemic hit the US full force. Would Potbelly be able to weather the storm? How could they build cash for the uncertain times to come?

**TABLE 1**  
**BLMN Balance Sheet**

BLMN Balance Sheet			
\$ in Thousands	Dec. 2017	Dec. 2018	Dec. 2019
Cash and cash equivalents	128,263	71,823	67,145
Current portion of restricted cash	1,280	0	0
Inventories	51,264	72,812	86,861
Other current assets, net	179,402	190,848	186,462
Total current assets	360,209	335,483	340,468
Property, fixtures and equipment	1,173,414	1,115,929	1,036,077
Operating Lease Right of Use			1,266,548
Goodwill	310,234	295,427	288,439
Intangible assets, net	522,290	503,972	470,615
Deferred income tax assets, net	60,486	92,990	73,426
Other assets, net	135,261	120,973	117,110
Total assets	2,561,894	2,464,774	3,592,683
Accounts payable	185,461	174,488	174,877
Accrued and other current liabilities	270,840	246,653	391,451
Unearned revenue	330,756	342,708	369,282
Current portion of long-term debt	26,335	27,190	26,411
Total current liabilities	813,392	791,039	962,021
Deferred rent	160,047	167,027	1,279,051
Deferred income tax liabilities	16,926	14,790	13,777
Long-term debt, net	1,091,769	1,067,585	1,022,293
Net LT deferred gain sale-leaseback	188,086	177,983	
Other long-term liabilities, net	210,443	191,533	138,060
Total liabilities	2,480,663	2,409,957	3,415,202
Common stock	919	913	869
Additional paid-in capital	1,081,813	1,107,582	1,094,338
Retained Earnings (Deficit)	-913,191	-920,010	-755,089
Accumulated other comp. loss	-99,199	-142,755	-169,776
Total BB stockholders' equity	70,342	45,730	170,342
Noncontrolling interests	10,889	9,087	7,139
Total stockholders' equity	81,231	54,817	177,481
Total liabilities and equity	2,561,894	2,464,774	3,592,683

**TABLE 2**

**BLMN Statement of Cash Flows (Selected Entries)**

BLMN Statement of Cash Flows			
\$ in Thousands	Dec. 2017	Dec. 2018	Dec. 2019
Net cash provided by operating activities	409,002	288,074	317,603
Net cash used in investing activities	-123,115	-177,296	-131,291
Proceeds from issuance of long-term debt	621,603	1,637	0
Repayments of long-term debt	-75,528	-26,686	-27,259
Extinguishment of debt	-1,193,719		
Borrowings on revolving credit facilities	1,345,761	476,829	670,800
Repayments of revolving credit facilities	-676,500	-478,500	-671,300
Proceeds from failed sale-leaseback	5,942		
Financing fees	10,439	0	0
share-based compensation, net		36,612	2,707
Distributions to noncontrolling interests	-5,973	-6,943	-7,214
Contributions from noncontrolling int.	873	2,037	1,349
Purchase of noncontrolling interests	-5,713	-2,112	-41
Payments for partner equity plan	-16,786	-19,947	-15,675
Repurchase of common stock	-272,916	-113,967	-106,992
Cash dividends paid on common stock	-30,988	-33,312	-35,734
Net cash used in financing activities	-293,505	-164,352	-189,359
Effect of exchange rate changes on cash	975	-4,146	-1,631
Net increase (decrease) in cash	-6,643	-57,720	-4,678
Cash as of the beginning of the period	136,186	129,543	71,823
Cash as of the end of the period	129,543	71,823	67,145

**TABLE 3**

**CMG Balance Sheet**

CMG Balance Sheet		12 Months Ended	
\$ in Thousands	Dec. 2017	Dec. 2018	Dec. 2019
Cash and cash equivalents	184,569	249,953	480,626
Accounts receivable, net	40,453	62,312	80,545
Inventory	19,860	21,555	26,096
Other current assets	50,918	54,129	57,076

Income tax receivable	9,353		27,705
Investments	324,382	426,845	400,156
Total current assets	629,535	814,794	1,072,204
Property and equipment	1,338,366	1,379,254	1,458,690
Restricted cash	29,601	30,199	27,855
Operating lease assets			2,505,466
Other assets	26,251	19,332	18,450
Goodwill	21,939	21,939	21,939
Total assets	2,045,692	2,265,518	5,104,604
Accounts payable	82,028	113,071	115,816
Accrued payroll and benefits	82,541	113,467	126,600
Accrued liabilities	95,679	147,849	155,843
Unearned revenue	63,645	70,474	95,195
Current operating lease liabilities		5,129	173,139
Total current liabilities	323,893	449,990	666,593
Long-term operating lease liabilities	316,498	330,985	2,678,374
Deferred income tax liabilities	814	11,566	37,814
Other liabilities	40,042	31,638	38,797
Total liabilities	681,247	824,179	3,421,578
Common stock	359	360	363
Additional paid-in capital	1,305,090	1,374,154	1,465,697
Treasury stock	-2,334,409	-2,500,556	-2,699,119
Accumulated other comp. loss	-3,659	-6,236	-5,363
Retained earnings (deficit)	2,397,064	2,573,617	2,921,448
Total shareholders' equity	1,364,445	1,441,339	1,683,026
Total liabilities and equity	2,045,692	2,265,518	5,104,604

**TABLE 4**

**CMG Statement of Cash Flows (Selected Entries)**

CMG Statement of Cash Flows		12 Months Ended		
		Dec. 2017	Dec. 2018	Dec. 2019
\$ in Thousands				
Net cash provided by operating activities		468,216	621,552	721,632
Net cash used in investing activities		-86,578	-387,578	-291,974

Acquisition of treasury stock	-285,218	-160,937	-190,617
Tax withholding on stock-based comp. awards	-702	-5,411	-10,420
Other financing activities	26	-187	-698
Net cash used in financing activities	-285,894	-166,535	-201,735
Effect of exchange rate changes on cash	2,056	-1,457	406
Net change in cash	97,800	65,982	228,329
Cash at beginning of year	116,370	214,170	280,152
Cash at end of year	214,170	280,152	508,481

**TABLE 5**  
**PBPB Balance Sheet**

PBPB Balance Sheet	12 Months Ended		
\$ in Thousands	Dec. 2017	Dec. 2018	Dec. 2019
Cash and cash equivalents	25,530	19,775	18,806
Accounts receivable	5,087	4,737	4,257
Inventories	3,525	3,482	3,473
Other current assets	11,061	11,426	5,687
Total current assets	45,203	39,420	32,223
Property and equipment, net	103,859	87,782	79,032
Right-of-use assets for operating leases			211,988
Indefinite-lived intangible assets	3,404	3,404	3,404
Goodwill	2,222	2,222	2,222
Deferred income taxes, non-current	11,202	13,385	
Deferred expenses, net and other assets	4,840	7,002	4,010
Total assets	170,730	153,215	332,879
Current liabilities			
Accounts payable	3,903	3,835	3,886
Accrued expenses	23,449	25,029	20,569
Current portion of long-term debt			
Total current liabilities	27,352	29,026	53,774
Deferred rent and landlord allowances	22,987	23,067	29,319
Long-term debt, net of current portion			
Long-term operating lease liabilities			206,726



Other long-term liabilities	3,153	5,751	3,210
Total liabilities	53,492	57,682	263,710
Common stock	318	330	331
Warrants			
Additional paid-in-capital	421,657	432,771	435,278
Treasury stock	-85,262	-108,372	-112,680
Retained Earnings (Deficit)	-219,990	-229,558	-254,081
Total stockholders' equity	116,723	95,171	68,848
Non-controlling interest	515	362	321
Total stockholders' equity	117,238	95,533	69,169
Total liabilities and equity	170,730	153,215	332,879

**TABLE 6**  
**PBPB Statement of Cash Flows**

Consolidated Statements of Cash Flows \$ in Thousands	12 Months Ended		
	Dec. 31, 2017	Dec. 30, 2018	Dec. 29, 2019
Net cash provided by operating activities	41,819	30,988	18,168
Net cash used in investing activities	(34,684)	(21,395)	(14,365)
Treasury stock repurchase	(12,941)	(22,916)	(4,217)
Debt issuance costs			(189)
Proceeds from exercise of stock options	6,487	8,244	173
Proceeds from exercise of stock warrants	1,972		
Employee taxes on stock-based comp.		(194)	(91)
Contributions- non-controlling interest	11	98	75
Distributions to non-controlling interest	(513)	(580)	(523)
Net cash used in financing activities	(4,984)	(15,348)	(4,772)
Net increase (decrease) in cash	2,151	(5,755)	(969)
Cash at beginning of period	23,379	25,530	19,775
Cash at end of period	25,530	19,775	18,806

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## **APPENDIX A: THINGS TO LOOK FOR IN A HEALTHY BALANCE SHEET**

***High Cash/Total Assets*** - Cash is king when it comes to liquid assets. Having plenty of cash on hand gives a firm cushion to pay its bills when sales drop during an economic downturn. Some students may focus entirely on the dollar amount of cash on the firm's balance sheet. However, that makes comparison across firms of different sizes impossible.

***High Current Ratio (Current Assets/Current Liabilities)*** - This basic liquidity ratio tells us how much cushion of liquid assets we have to be able to pay our upcoming liabilities. Students may point to the quick ratio as well [(Current Assets - Inventories)/Current Liabilities]. While that is not an incorrect answer to this question, for these restaurant companies, the main inventory item is food stocks which are highly perishable and purchased on a just in time basis. Therefore, inventories for these firms at any given time makes up a small portion of total assets and comparison would not be meaningful.

***Low Intangible Assets and Goodwill /Total Assets***- Intangible assets represent the value of things like patents, trademarks, and licenses while Goodwill on a company's balance sheet reflect the value paid for an acquisition over its book value. Unlike physical assets which can be used as collateral on a loan, the value of these assets, particularly goodwill, could be called into question or dissipate altogether in hard economic times. Again, rather than measure this as a dollar amount, the level of these intangible assets relative to total assets would be more appropriate.

***Low Total Liabilities/Total Assets*** (High Shareholders' Equity/Total Assets) - While having zero debt is not optimal for most firms, the greater level of debt a company has, the greater risk that the company will not be able to pay its interest expense in a downturn leading to bankruptcy. Students should recognize that a debt ratio near (or over) 100% is a very risky proposition.

***Positive, High, Increasing Net Worth*** -Net worth is defined as Total Assets - Total Liabilities. This is the shareholder's equity in the firm. The higher this number is, the stronger balance sheet the firm has, as it means the firm is less reliant on debt to fund firm assets. Declining, small, or negative shareholders' equity on the

balance sheet means that debt is growing or large. In the event that the total shareholders' equity on the balance sheet is negative, that means the company owes more than the book value of the firm's assets. It would be equivalent to being upside down on your car note.

***High Tangible Net Worth*** - This calculation is a combination of the two previous metrics. Net worth is defined as Total Assets - Total Liabilities. This is the shareholder's equity in the firm. To account for the fact that the intangible assets may not have a market value equal to their value on the balance sheet, we subtract the intangibles (including goodwill) from total assets and then subtract total liabilities. The higher this number is, the stronger balance sheet the firm has because the shareholder's net worth is relying on tangible assets as opposed to assets whose value could disappear into thin air.

***Positive and Increasing Retained Earnings*** - This is a reflection of continued profitability which boosts the shareholders' relative claim on firm assets. When firms have profits that exceed their dividend payout, the retained funds are reinvested in assets to help the firm grow. Dwindling or deficits (negative) retained earnings indicates the firm has experienced losses as this is absorbed by the owners' investment. Students will many times overlook the trend in this balance sheet item.

## **APPENDIX B: HOW TO EVALUATE A STATEMENT OF CASH FLOWS**

***Net Income*** - Profits that the firm has generated are the first source of funds for the company to use. It is the first item at the top of the cash flow statement. A healthy firm will have positive and increasing net income over time.

***Net Cash Provided by Operating Activities*** - Operating cash flow is the cash flowing into or out of the firm from the actual day to day operations of the business. A positive sign indicates money flowing into the firm. A healthy firm will have positive and increasing operating cash flows over time. Smaller, younger firms may experience negative operating cash flow in the start-up phase of the life cycle. Also, firms can experience a negative operating cash flow during a restructuring or merger. That is not necessarily bad. However, consistently declining or negative operating cash flow is unhealthy and could indicate that the firm is experiencing difficulties.

***Net cash Used in Investing Activities*** - Investing cash flow is the cash flowing into or out of the firm primarily due to the firm investing in new fixed assets and acquisitions. A negative sign indicates money flowing out of the firm. A negative

cash flow from investing activities is a sign of a healthy firm. That means the company is spending money on new assets to help the firm grow. An acquisition will typically show up as a large negative in this section. A steady decline in the amount of money spent on growth could be a sign that the company is having trouble. Likewise, a positive sign in this category means the company sold off assets. While it is common for companies to spin off parts of their firm occasionally, selling off assets would be grounds for further investigation into what prompted the sale. Several years of positives in this category

***Free Cash Flow*** - Free cash flow is the cash flow generated by a firm's operations after taking into account the capital spending (investment) necessary to maintain planned company growth but before any distributions to creditors or shareholders. On a basic level, the free cash flow is the Cash Flow Provided by Operating Activities + the Cash Flow from Investing Activities. The cash flow from investing activities is typically negative in a health firm so this is subtracted from the Operating Cash Flow. A positive and increasing free cash flow would be a healthy sign for a company. That means that it is bringing in more than enough money from its day to day operations to pay for the investments needed to maintain its growth. Firms in the start-up phase of the life cycle will often exhibit a negative free cash flow as the investment needed to fuel growth of a start-up is often higher than the operating cash flows for the first few years of operations.

***Cash Flows from Financing Activities*** - Cash flow from financing activities explain how the company deals with the positive or negative free cash flow. For example, if the cash flow from operations is \$10 Million, but the investing cash flows are \$12 Million, the firm must finance that shortcoming by either issuing debt, issuing new shares of stock, cutting the dividend, or decreasing the cash balance. If the free cash flow is positive, the firm can pay off debt, buy back stock, pay a larger dividend, or build up its cash. A positive sign in this section means there is money flowing in (from borrowing more money or issuing more stock for example). A negative sign in the financing cash flow means there is money flowing out (paying a dividend, paying off debt, repurchasing stock for example). One cannot make a blanket statement about what looks healthy or unhealthy about items in this section. However, a firm that must stop paying a dividend or a firm that suddenly issues a large amount of debt may be in financial trouble.

***Net Increase (Decrease) in Cash*** - The cash flow statement explains why the cash on the balance sheet went up or down during the year. This is the bottom line which shows whether the company's cash on its balance sheet went up or down.

Obviously, higher cash levels give the firm more cushion to weather a downturn or economic shock. Increasing cash levels indicate higher liquidity and lower risk. However, it is not necessarily bad to see a company's cash balance decline occasionally. Many firms build up their cash and then use the funds for an acquisition. However, several years of negative or declining cash flows would be reason for concern. Also, the magnitude of a drop in cash is important. If the cash declined only a small percentage from the previous year's cash at the beginning of the year, there is not a lot of cause for worry. If a decline in the firm's cash wipes out almost the entire cash balance, that could be a very bad sign.