MANUFACTURER

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7 cash flow tips for manufacturers

When times are good, manufacturers tend to focus on sales, profitability and growth. Strong growth can conceal cash flow issues. Cash flow is the lifeblood of a business, so it's critical to develop a strategy for managing and improving it. Every manufacturer is different, so the right cash flow strategies depend on your situation. Here are seven tips to consider.

1. Monitor cash flow

You can't manage cash flow unless you monitor and measure it. In good times, the income statement usually receives top billing. But in uncertain times, the balance sheet should play a more prominent role. While the income statement is a good gauge of past performance, the balance sheet provides a clearer picture of your current assets and liabilities and the amount of cash you'll need in the coming weeks and months.

Project cash flow under best-case, worst-case and most-likely scenarios and have contingency plans in place for each. Monitor your actual results regularly to spot negative cash flow trends early and address them quickly. Talk to your CPA to create a monitoring process.

2. Manage customers

Collecting from customers is key to maintaining strong cash flow, so it's critical to evaluate and manage your customer base. If your business is heavily concentrated in a handful of customers, consider options for growing that base, such as expanding into new markets, developing new products or services, or exploring new marketing techniques. Concentration risks generally happen when one supply chain partner represents more than 10% of your transactions.

Also, be sure to evaluate customers' credit risk. Have their businesses been negatively affected by the COVID-19 pandemic and the resulting economic turmoil? How has this impacted their ability to pay?

3. Manage receivables

Examine ways to convert receivables into cash more quickly. Start by ensuring that invoices are issued on a timely basis and that customers receive regular reminders before payments are due.

Consider offering discounts for early payment. Ask for deposits for custom jobs and milestone payments for long-term projects. Look into factoring your receivables. (See "Pros and cons of factoring receivables" on page 3.)

4. Manage vendors and suppliers

A concentrated supplier base can be just as damaging to your cash flow as a concentrated customer base. Failure of a major supplier can hinder your ability to fulfill orders or meet demand. Consider ways you can build a more diversified supplier base.

Pros and cons of factoring receivables

Uncertainty about collecting accounts receivable is one of the biggest cash flow challenges businesses face. A way to gain some stability in this area is through accounts receivable factoring. Factoring simply means selling receivables to a financial institution or other third party (the "factor") at a discount. You obtain quick access to cash or a line of credit, and the factor takes responsibility for collecting receivables from your customers.

Before you go this route, be sure to consider the pros and cons. Pros include immediate access to cash and avoidance of many of the headaches associated with collecting from customers. Cons include the expense — factoring fees can be higher than interest rates on commercial loans — and potential customer confusion. Despite the expense, for many struggling businesses, factoring is one of the best options available for obtaining cash quickly.

Contact your vendors and suppliers to coordinate the timing of payments. They may be willing to offer extended payment terms or early payment discounts.

5. Manage inventory

Managing inventory can be a delicate balancing act. On one hand, reducing stock levels of raw materials or inventories of finished goods can help boost cash flow. On the other hand, increasing certain inventory levels can help mitigate supply chain risks and avoid raw material shortages.

Focused inventory management can help you strike a balance between conserving cash and meeting customer demand. To free up cash and reduce storage costs, consider liquidating obsolete or slow-moving inventory.

6. Improve efficiency

Don't overlook the potential impact of efficiency improvements on cash flow. Look for opportunities to streamline processes by redesigning the factory layout, optimizing workflows or taking advantage of automation.

Also consider opportunities for cutting or eliminating expenses, either temporarily or permanently. Examples include reducing spending on nonessential travel, meetings, entertainment or training; leasing equipment instead of buying it; reducing work hours; shifting work from temporary to permanent staff; cutting or deferring wages; suspending matching contributions to retirement plans; and delaying capital expenditures.

7. Review your financing

Revisit the status of your outstanding credit lines and other financing arrangements. Have changes to your receivable or inventory levels affected the availability of credit? Have changes to your balance sheet jeopardized your compliance with debt covenants? If so, request a waiver from the lender to avoid being held in default.

During the COVID-19 pandemic, some manufacturers received Paycheck Protection Program (PPP) loans. To the extent that these loans are forgiven, they can provide a major boost to cash flow. In December 2020, a second round of PPP financing was introduced. Check with your CPA to see whether you can benefit from another round of financing.

An ongoing priority

Managing cash flow is critical during tough times, but it should be an ongoing business activity. Paying attention to cash flow when times are good can enhance your business's performance and better position it to weather the storm when the next economic downturn comes along. ■

COVID-19 relief legislation offers significant benefits for manufacturers

The Consolidated Appropriations Act (CAA), signed into law in December 2020, is known for authorizing a second round of direct stimulus payments to individuals and extending enhanced unemployment benefits. But the law also provides tax relief and new financing opportunities for businesses affected by the COVID-19 pandemic. Following are highlights of key provisions most relevant to manufacturers.

New PPP financing available

Eligible small businesses that previously received forgivable Paycheck Protection Program (PPP) loans may apply for a "second draw," provided they've used or will use all of the proceeds of their original loans by the time a second draw is disbursed. Generally, to qualify for an additional loan, you must have 300 employees or fewer and demonstrate a 25%-or-more decline in gross receipts in any quarter of 2020 compared to the same quarter in 2019. (Special eligibility rules apply to businesses that didn't exist during some or all of 2019.)

Like the first round of PPP loans, you may receive up to 2½ times your average monthly payroll costs in 2019 (or in the one-year period preceding the date of the loan), but new loans are capped at $2 million. Businesses that are ineligible for a second draw may be able to increase the amount of their *original* PPP loans. Also, the CAA permits certain businesses that didn't previously receive PPP loans to apply for them. But you'll have to act quickly: Applications are due by March 31, 2021.

PPP expenses deductible

The CARES Act, which established the PPP program, provided that the amount of PPP loan forgiveness isn't included in a borrower's gross income

for tax purposes. But last year, the IRS essentially erased this tax benefit by ruling that borrowers may not deduct expenses paid with the proceeds of loans that have been (or likely will be) forgiven.

The CAA restores the tax advantages of loan forgiveness by overruling the IRS and providing that otherwise deductible expenses remain deductible regardless of whether a loan is forgiven.

Allowable loan uses expanded

As before, to qualify for forgiveness, applicants must use at least 60% of a PPP loan's proceeds for payroll. But the CAA expands the allowable nonpayroll uses beyond mortgage, rent and utility expenses, to include:

- "Covered operations expenditures" for software or cloud computing services that facilitate business operations,
- "Covered property damage costs" related to vandalism or looting due to public disturbances in 2020 and not covered by insurance or otherwise reimbursed,

- "Covered supplier costs" for goods that are essential to business operations and meet certain requirements, and

- "Covered worker protection expenditures" to comply with health guidelines, such as expenses for creating drive-through window facilities or air filtration systems.

The CAA also clarifies that payroll costs, for PPP purposes, include employer-provided group life, dental, vision or disability insurance.

More CAA provisions

Other PPP updates of interest include:

Modified covered period. The "covered period" is the one during which PPP loan proceeds must be spent on eligible expenses in order to qualify for forgiveness. Originally, the covered period was eight weeks from the time the loan is made. Later, it was extended to 24 weeks, although borrowers that received loans before June 5, 2020, could choose either an eight-week or 24-week period. Now, borrowers can choose a covered period of any length between eight and 24 weeks.

Simplified forgiveness application procedures. The CAA allows businesses that borrow less than $150,000 to simply certify that they meet the 25% revenue loss requirement. However, they must substantiate compliance with this requirement when (or before) they submit a forgiveness application. Finally, the CAA simplifies the forgiveness application for PPP loans under $150,000.

That's not all

In addition to the above, the CAA contains several other changes of interest to manufacturers: It makes the Section 179D commercial buildings energy-efficiency tax deduction permanent, extends the time for repaying deferred employee payroll taxes through the end of 2021, expands the employee retention credit, and extends the work opportunity credit and empowerment zone incentives through 2025. To ensure that you're making the most of these and other benefits, please contact us. ■

Why a cost segregation study is a good idea

Accelerate depreciation deductions to reduce taxes and boost cash flow

The COVID-19 pandemic has resulted in many companies conserving cash and not buying much equipment during the past year. An unintended downside is that you may not be able to claim the same amount of depreciation tax deductions as you have in past years.

What can you do? A cost segregation study may allow you to accelerate depreciation deductions on certain items, thereby reducing taxes and boosting cash flow. And, thanks to the Tax Cuts and Jobs Act, the potential benefits of a cost segregation study are now even greater than they were a few years ago because of enhancements to certain depreciation-related tax breaks.

Depreciating property

Business buildings generally have a 39-year depreciation period (27½ years for residential

rental properties). Typically, companies depreciate a building's structural components — including walls, windows, HVAC systems, plumbing and wiring — along with the building. Personal property (such as equipment, machinery, furniture and fixtures) is eligible for accelerated depreciation, usually over five or seven years. And land improvements, such as fences, outdoor lighting and parking lots, are depreciable over 15 years.

Often, businesses allocate all or most of their buildings' acquisition or construction costs to real property, overlooking opportunities to allocate costs to shorter-lived personal property or land improvements. Items that appear to be "part of a building" may in fact be personal property. Examples include:

- Removable wall and floor coverings,
- Removable partitions,
- Awnings and canopies,
- Window treatments,
- Signs, and
- Decorative lighting.

In addition, certain items that otherwise would be treated as real property may qualify as personal property if they serve more of a business function than a structural purpose. Examples include reinforced flooring to support heavy manufacturing equipment, electrical or plumbing installations, and dedicated cooling systems for server rooms.

Calculating costs

Under the right circumstances, a cost segregation study can yield substantial tax benefits. A cost segregation study identifies real estate components that are properly treated as personal property depreciable over, say, five or seven years, or land improvements depreciable over 15 years. By allocating a portion of your costs to these shorter-lived assets, you can accelerate depreciation deductions and substantially reduce your tax bill.

And don't overlook bonus depreciation. If these assets qualify, the tax savings can be even greater.

Bear in mind that tax law changes may occur this year that could affect current depreciation and expensing rules. This in turn could alter the outcome and importance of a cost segregation study.

Conducting the study

A cost segregation study should be performed by an outside, independent firm. According to the IRS *Cost Segregation Audit Techniques Guide*, there are no prescribed qualifications for cost segregation preparers. The guide, however, states that a study conducted by a construction engineer would, all else being equal, be considered more reliable than one by someone without a construction background.

The guide further states that other important criteria include "experience in cost estimating and allocation, as well as knowledge of the applicable law." It adds: "A quality study identifies the preparer and always references their credentials, experience and expertise in the cost segregation area."

Rewarding tax benefits

Though the relative costs and benefits of a cost segregation study will depend on your particular facts and circumstances, it can be a valuable investment. Cost segregation studies have costs all their own, but the potential long-term tax benefits may make it worth your while to undertake the process. Contact your CPA for further details. ■

Manufacturing after COVID-19

As we begin to see some light at the end of the COVID-19 tunnel, many manufacturers are turning their attention to the future. While the pandemic's effects on manufacturing will, in some respects, be temporary, it could have the following lasting impacts on global manufacturing.

Greater reliance on domestic manufacturing

There has long been concern about U.S. reliance on foreign manufacturing, particularly in China. The pandemic's impact on production in China and elsewhere, and its disruption of the global supply chain, put a spotlight on these concerns, particularly when it comes to medical equipment and supplies. Expect a push to produce more of these items in the United States to reduce reliance on overseas supply chain partners when facing future health care crises.

President Biden has made several proposals designed to encourage relocation of manufacturing facilities and jobs to the United States. For example, in the run-up to last fall's election, Biden called for:

- Leveraging federal buying power and the Defense Production Act to manufacture more critical products domestically,
- Using tax penalties and tax incentives to discourage offshoring and encourage "reshoring" of manufacturing businesses, and
- Offering a 10% tax credit to companies that revitalize, renovate and modernize existing or recently closed manufacturing facilities.

How much of this moves forward through Congress remains to be seen. Manufacturers should stay on top of these proposals.

Focus on digitization

Post-pandemic manufacturing will see an increased emphasis on digitization for two reasons:

1. Manufacturers will need to rely on the efficiencies offered by automation, artificial intelligence and Internet-of-things technology to maintain a competitive advantage in light of cheaper labor costs overseas, and
2. Post-pandemic, there will likely be continued interest in remote working arrangements.

As a result, manufacturers will need to rely on Internet-based diagnostic and management tools that allow devices on the shop floor to be monitored and operated remotely, as well as online communication and collaboration tools.

Be prepared

With greater reliance on domestic manufacturing, questions remain: How long is the lead time to get the country up and running for a surge in manufacturing coming back? Do we have enough buildings, facilities and equipment? If not, how long will it take to build, renovate, and/or purchase and deliver them?

It's not entirely clear what the future has in store for manufacturers once the pandemic is behind us. One thing is certain, though: The new normal will likely be different than the old one, and manufacturers that are prepared for change will have a competitive edge. ■

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