WEEK 3: MEASURING CASH CREATION AND FLOW

Working Capital Adjustments

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WORKING CAPITAL

- WC = Current Assets – Current Liabilities
- Operating liquidity
- Opportunity cost
  - WC cannot be deployed elsewhere
- Not included as an expense!

CURRENT LIABILITIES

- Liabilities to be settled < 1 year
- Accounts payable
- Current portion of debt due
- Increase in CL is a cash source
- Decrease in CL is a cash drain

CURRENT ASSETS

- Sold, consumed, or exhausted in 1 year
- Accounts receivable
- Inventory
- Increase in CA is a cash drain
- Decrease in CA is a cash source

WORKING CAPITAL: EXAMPLE

	0	1	2	3
Assets				
Current	100	125	135	100
Long-term Assets	150	150	150	150
Total Assets	250	275	285	250
Liabilities				
Current	75	65	65	100
Long-term Liabilities	80	80	80	80
Total Liabilities	155	145	145	180
Net Worth (Equity)	95	130	140	70
Working Capital	25	60	70	0
Change in WC	25	35	10	-70

FREE CASH FLOW (FCF)

FCF = Operating Profit (after tax)

– Increase in WC

\+ Depreciation

– Capital expenditure

\+ After-tax salvage value

SUMMARY

- Working capital is an opp. cost
- Increases in WC are a cash drain
- Not reflected in earnings
- FCF needs to account for WC changes