Discounted Cash Flow Modelling Using Excel

Excel link: case study DCF.xlsx

Q1: What factors can affect the composition of a company's current assets vs. long-term assets?

Several factors can influence the composition of a company's current assets versus long-term assets. Here are some key considerations:

1. Industry Type

- **Manufacturing Companies**: Typically have higher long-term assets due to investments in machinery, equipment, and factories.
- **Service Companies**: Often have more current assets, such as cash and receivables, since they rely less on physical assets.

2. Business Model

- **Capital-Intensive Businesses**: Require significant investments in long-term assets like property, plant, and equipment.
- **Asset-Light Businesses**: Focus more on current assets, such as technology companies that may prioritize software and intellectual property.

3. Growth Stage

- **Startups**: May have more current assets to maintain liquidity and flexibility.
- **Established Companies**: Often have a balanced mix, with significant long-term assets accumulated over time.

4. Financial Strategy

- **Leverage**: Companies with higher debt might invest more in long-term assets to secure loans.
- **Liquidity Management**: Firms focusing on liquidity might maintain higher levels of current assets.

5. Economic Conditions

- **Recession**: Companies might liquidate long-term assets to increase cash reserves.
- **Boom**: Firms may invest more in long-term assets to expand operations.

6. Regulatory Environment

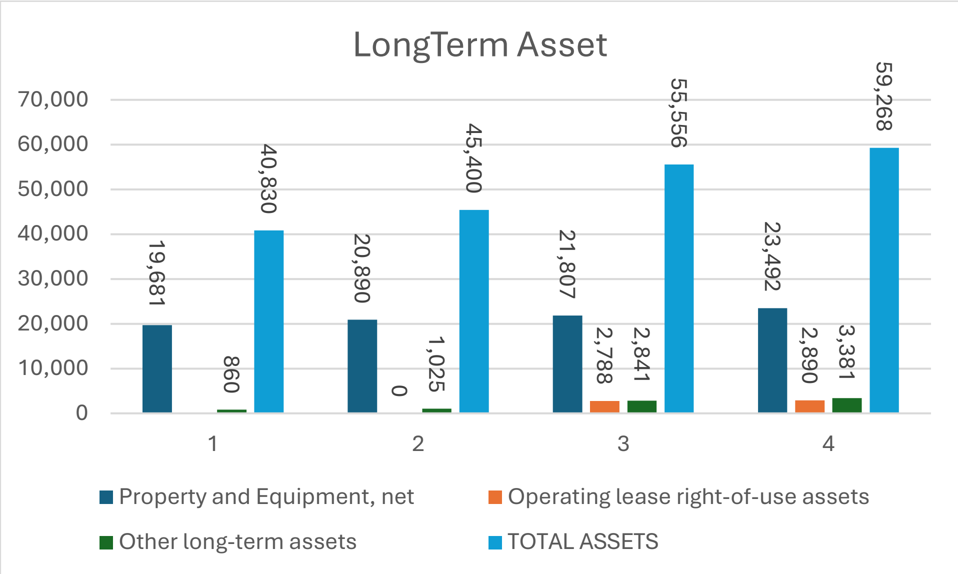
- **Tax Policies**: Depreciation rules and tax incentives can influence investments in long-term assets.
- **Accounting Standards**: Different standards may affect how assets are classified and reported.

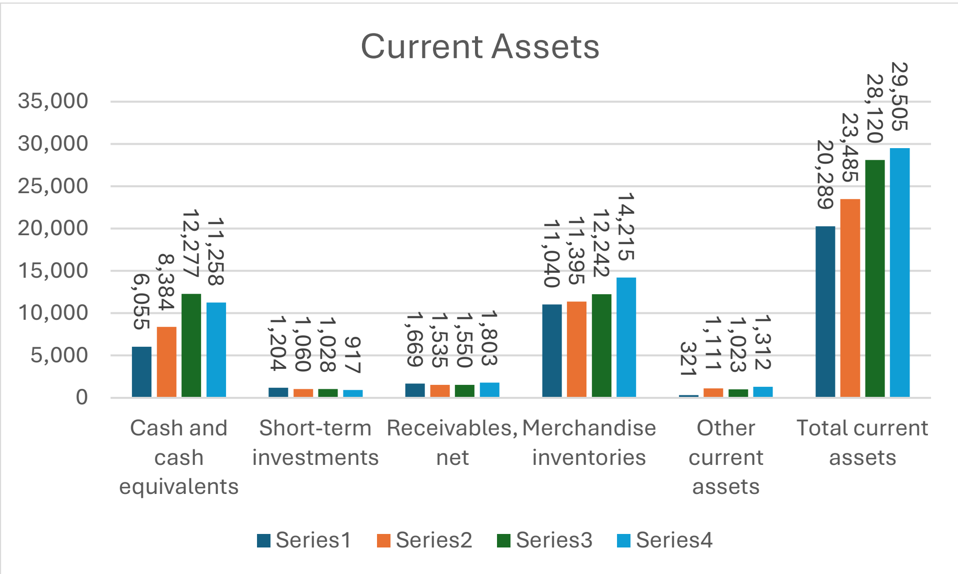
7. Technological Advancements

- **Innovation**: Rapid technological changes can lead to higher investments in new long-term assets or the obsolescence of existing ones.

8. Market Demand

- **Consumer Preferences**: Shifts in demand can affect inventory levels, a component of current assets.
- **Supply Chain Dynamics**: Efficient supply chains can reduce the need for high inventory levels.



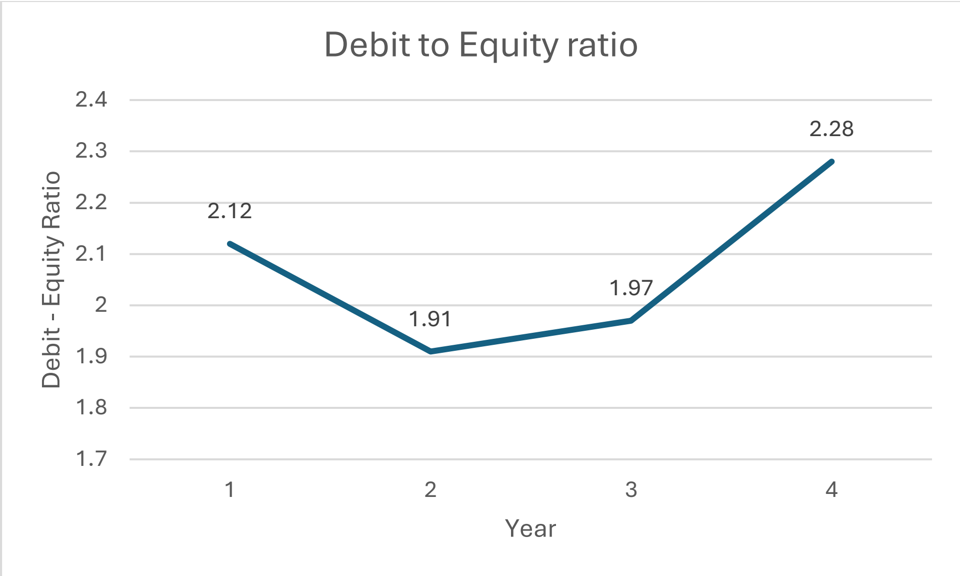


Q2: How can a company's debt-to-equity ratio impact its creditworthiness and access to capital?

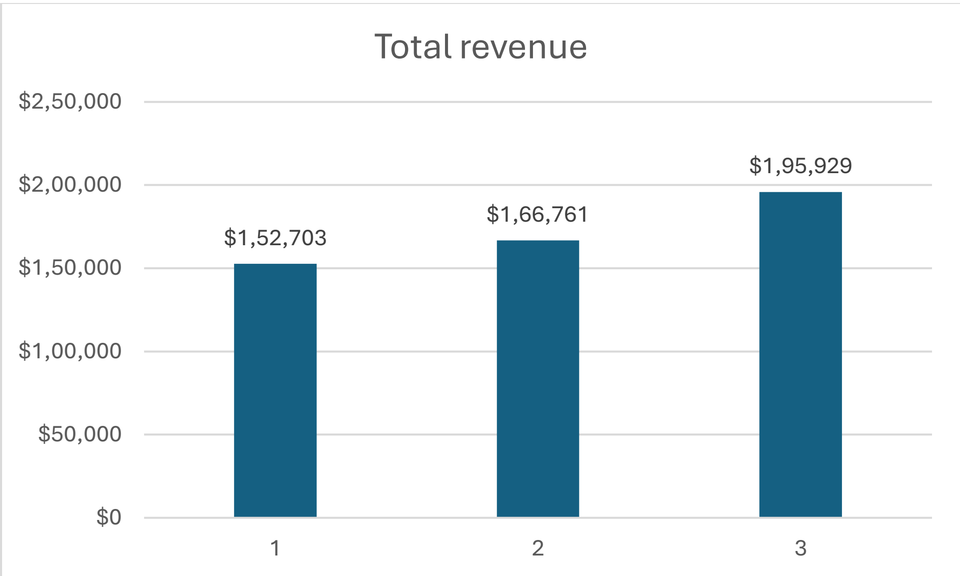
1. **Creditworthiness**: Lenders use the D/E ratio to evaluate a company's creditworthiness. A lower ratio indicates a healthier capital structure, reducing the risk of default and increasing the likelihood of obtaining favorable financing terms.
2. **Risk**: A high D/E ratio increases the risk of default and liquidation, which is not favorable for investors and lenders.
3. **Capital Access**: Companies with high D/E ratios may struggle to attract additional capital (equity) or take on more debt.
4. **Cost of Capital**: As the D/E ratio rises, so does the company's risk, impacting the cost of capital.
5. **Growth**: A high D/E ratio can be beneficial for rapidly expanding companies needing additional capital.

Q3: Debt-to-Equity Ratio: How has the debt-to-equity ratio changed over the four years? (take in considereation total liabilities and total equity)Is the company relying more on debt financing or equity financing?

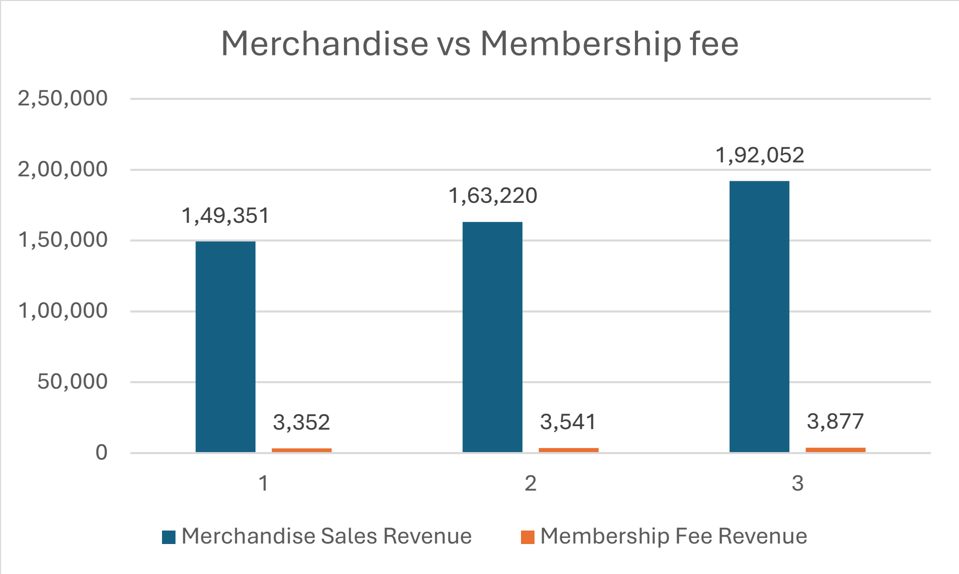
- The debt-to-equity (D/E) ratio compares a company’s total liabilities with its shareholder equity and can be used to assess the extent of its reliance on debt.
- D/E ratios vary by industry and are best used to compare direct competitors or to measure change in the company’s reliance on debt over time.
- Among similar companies, a higher D/E ratio suggests more risk, while a particularly low one may indicate that a business is not taking advantage of debt financing to expand.
- Investors will often modify the D/E ratio to consider only long-term debt because it carries more risk than short-term obligations.



Q4: Revenue Growth: How has the company total revenue grown over the three years? What segments are driving this growth (merchandise sales, membership fees)?

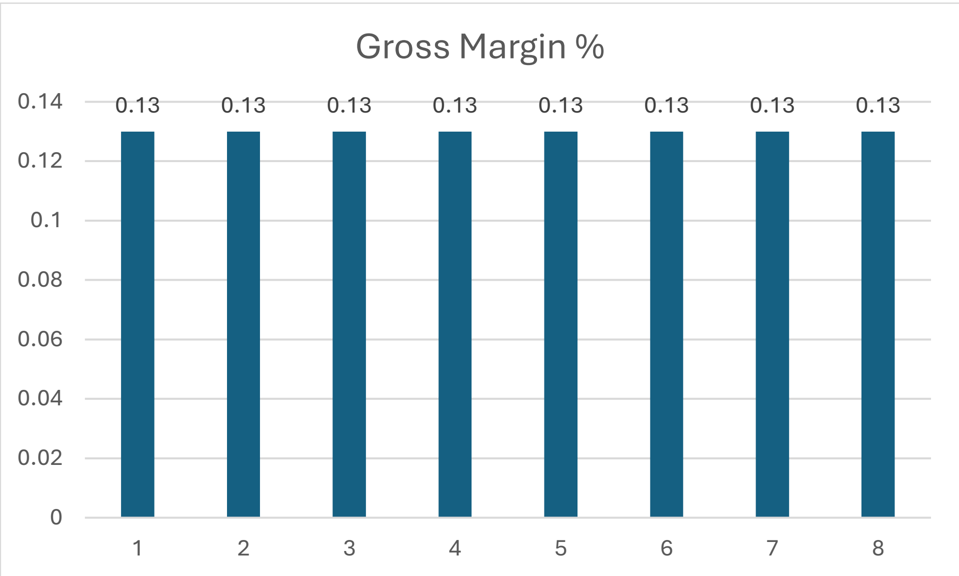


- We can see that company has seen growth in its revenue each year.



- Merchandise sales seems to give growth to the company than the membership fee.

Q5: Gross Margin: Calculate and compare the gross margin (consider total revenue and total expense) across the three years. Is the company able to maintain or improve its margins?



From the above analysis we can see that company can maintain its margins every year.

Q6: How can investors utilize free cash flow analysis to compare different companies in the same industry?

Cash flow analysis can lend insight into the financial vibrancy or financial instability of a company and its prospect as a good investment. Bear in mind these points when analyzing cash flow:

Positive Cash Flow

Positive cash flow is always the goal. When it continues over a number of consecutive periods, it demonstrates that a company is capable of healthy operations and can grow successfully.

However, keep an eye out for positive investing cash flow and negative operating cash flow. This could mean trouble ahead if, for instance, cash flowing from the sale of investments is being used to pay operating expenses.

Negative Cash Flow

Negative cash flow may indicate something other than financial trouble. For instance, investing cash flow might be negative because a company is spending money on assets that improve operations and the products it sells.

Free Cash Flow

Having free cash flow is a great advantage. It's the cash flow available after paying operating expenses and purchasing needed capital assets. A company can use its free cash flow to pay off debt, pay dividends and interest to investors, and more.

Operating Cash Flow Margin

The operating cash flow margin ratio compares cash from operating activities to sales revenue in a particular period. A positive margin shows that a company is able to convert sales to cash and can indicate profitability and earnings quality.

Limitations of Cash Flow Analysis

- The cash flow statement presents past data. It might not be a big help on its own to analysts and investors who want to properly size up a company as an investment. For example, cash flow data that shows investments made point to an outflow (that could contribute to a negative cash flow). But those investments may result in future positive cash flow, profits, and major growth.
- It doesn't depict a company's net income because it doesn't include non-cash items. The income statement must be examined to determine these.
- It doesn't present a full picture of a company's liquidity, just the cash available at the end of one period.