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FINANCIAL RATIO ANALYSIS

THE COMPLETE FINANCIAL STATMEENT ANALYSIS

MODULE 4: THE CASH FLOW RATIOS

LEARNING MATERIAL – TAKEAWAY NOTE

DISCLAIMER

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THANK YOU!

Hello friends,

Congratulations! You’ve completed the Module 4 – The Cash Flow Ratios. This is a learning note that we’ve prepared for you. It includes all key information in the lectures. You can take it away and revise the course from anywhere, on any device and at anytime you want.

If you have any concern about the lectures, feel free to send us a message, we are always here to help you!

Best regards,
Wealthy Education Team.

HOW THE CASH FLOW STATEMENT WORKS

CASH FLOW STATEMENT EXAMPLE (AAPL) – TTM

CASH FLOW FROM OPERATING ACTIVITIES	
Net Income (after taxes)	50,678
Depreciation and Amortization	11,634
Deferred Taxes	2,595
Stock Based Compensation	3,897
Accounts Receivable	(1,324)
Inventories	115
Accounts Payable	1,353
Other Working Capital	(1,421)
Net Cash from Operating Activities [a]	**67,527**

CASH FLOW FROM INVESTING ACTIVITIES	
Investments in Property, Plant & Equipment	(11,609)
Purchase of Investments	(160,121)
Other Investing Cash Flow	124,842
Net Cash from Investing Activities [b]	**(46,888)**

CASH FLOW FROM FINANCING ACTIVITIES	
Common Stock Issued	481
Dividend Paid	(11,888)
Other Financing Cash Flow	(2,207)
Net Cash from Financing Activities [c]	(13,614)
Net Change in Cash and Cash Equivalents	**$7,025**
(Net Change = [a] + [b] + [c])	
Cash at beginning of period	$14,489
Cash at end of period	$21,514

Free Cash Flow = Net Cash from Operating Activities
– Capital Expenditures
= 67,527 – 12,352
= $55,175

OPERATING CASH FLOW (OCF)

- Often known as **Net Cash Provided by Operating Activities** or **Cash Flows from Operations**
- Operating cash flow is a measure of how much money your company is generating from its regular business operations
- It reveals whether your business is generating enough cash flows to support its operations, without taking on unnecessary debt

OPERATING CASH FLOW (OCF)

- **Operating cash flow should correlate to the firm's revenue and net income.**
- For example:
  - If your business reports an increase in revenue and net income, the OCF should increase as well (at least remain stable)

  → If the OCF has declined, this indicates a potential problem

OPERATING CASH FLOW (OCF)

- Remained Stable or Growing OCF
- Avoid Negative OCF

FREE CASH FLOW (FCF)

Capital Expenditure

Free Cash Flow (FCF) = Operating Cash Flow - CAPEX

- Free Cash Flow reveals how much money is available to support such business activities as growth, acquisition, debt reduction, and dividend payments.

FREE CASH FLOW CAN BE NEGATIVE!

- Unlike OCF, when a company shows a negative free cash flow value, it's **not necessarily a bad sign** since it could mean:
  - It's using its FCF to invest in high-return projects
  - It's expanding, and is using its FCF to hire more staff or purchase new equipment
- Only avoid companies that demonstrate ongoing negative results

FREE CASH FLOW vs LONG-TERM DEBT

- Free cash flow can be used to evaluate your company's long-term debt situation
- We'll consider investing in businesses that can easily pay off its long-term debts within 3 years by using its Free Cash Flow

➔ **Investment criterion:**

- ❑ **3 x Free Cash Flow > Long-term Debt**

WHY YOU SHOULD EVALUATE DIVIDENDS

- **Dividends cannot be hidden or exaggerated**
- Dividend create “value” in a business

➔ Value is created by:

- ❑ The dividend payments themselves
- ❑ The stock price increases that usually accompany these regular cash payments

POTENTIAL RISK OF HIGH DIVIDEND PAYOUTS

- **Pay out too much of its earnings in dividends?**
  - The more of its profit a business pays out to investors, the less cash it has to support its own expansion.
- **Dividends represent a delicate balancing act between:**
  - Rewarding shareholders with cash payments
  - Increasing stock value through company growth

DIVIDEND PAYOUT RATIO

$$\text{Dividend Payout Ratio} = \frac{\text{Dividend Per Share}}{\text{Earnings Per Share}}$$

- Dividend Payout Ratio measures a firm's dividends as a percentage of its net income
- The lower the ratio is, the less cash it's paying out to shareholders as dividends

DIVIDEND PAYOUT RATIO

20% – 60%

- ❑ An ideal company should have a dividend payout ratio of less than 60%
- ❑ If a company pays out 60%, it can retain the remaining 40% for future growth

➔ **Too High Ratio = Less Growth**

➔ **Too Low Ratio = Not Worth Investing in**

DIVIDEND CUTS

Be aware when dividends are suddenly cut

without any acceptable reasons

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THANK YOU!

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