Strategies for Generating Cash Flow

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- When creating a DCF valuation model, we have already seen that the model is very sensitive to the input assumptions
- Given that the valuation is driven by free cash flow, this means that anything that can impact cash generation or cash consumption is critical to the outcome of the model

Strategies for Generating Cash Flow

- It is therefore worth considering a framework to understand the inputs to our model that can impact cash generation

Strategies for Generating Cash Flow

- There are three ways to generate cash in a business
  - Grow Revenues
  - Improve Margin
  - Improve Capital Efficiency

Strategies for Generating Cash Flow

- Lets consider each one of these in turn…

Strategies for Generating Cash Flow

- Revenue Growth
  - Increase sales
    - New customers
    - Sell more to existing customers
    - Create new products and services
  - Increase Prices charged on existing and new products and services

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- Margin Improvement
  - Optimise the costs of goods sold by improving terms with suppliers, improving quality, reducing returns and making production improvements to achieve greater efficiencies
  - Below the Operating Margin, there is scope for making cost savings to the SG&A, staffing costs and other overheads

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- Improving Capital Efficiency
  - The fixed assets, property, plant and equipment can require capital investment and maintenance, improvements here can free up cash for new investments
  - Inventory can be a huge consumer of working capital so improvements in managing inventory can reduce working capital requirements and generate extra cash

Strategies for Generating Cash Flow

- When constructing a DCF model, these levers of Cash Flow generation should form specific input areas so that you can test different scenarios
- In reality, this means that the model can lead to management developing new business strategies once they realise the potential improvements to be made in these areas.

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