What do you mean by Cash Flow?

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- This is probably a good point in the course to review the differences between earnings and different cash flow metrics

What do you mean by Cash Flow?

- EBITDA represents earnings after all operating expenses but before Depreciation, Amortisation, Interest and Tax
- EBIT includes the Depreciation and Amortisation
- Net Income or PAT is profit after Interest and Tax
- Net Income divided by the (weighted) number of shares in issued equals Earnings Per Share

What do you mean by Cash Flow?

- Note that EBITDA is often used as a proxy for cash flow. In practice the two are seldom the same and when you conduct your own valuations you should check to see what the differences are.
- Cash flow can be a little more confusing which is why I want to walk through it here…

What do you mean by Cash Flow?

- Cash Flow (CF)
- Free Cash Flow (FCF)
- Free Cash Flow to Equity (FCFE)
- Free Cash Flow to the Firm (FCFF) (unlevered Free Cash Flow)

What do you mean by Cash Flow?

- Cash Flow (CF) or Cash Flow from Operations
- This is measure of cash flow from normal operations
- Depreciation and Amortisation are added back to Net Income
- All other non cash items such as stock based compensation are also added back
- This also includes changes in net working capital between the two balance sheet dates
- Operating Cash Flow does NOT include capital expenditure

What do you mean by Cash Flow?

- Free Cash Flow (FCF)
- Having calculated Cash Flow From Operations, if you then deduct Capital Expenditure you arrive at Free Cash Flow
- This is the cash flow that Management can now use for discretionary spending from acquisitions to paying dividends

What do you mean by Cash Flow?

- Free Cash Flow to Equity (FCFE) is also called Levered Cash Flow
- Take Operating Cash Flow, deduct Capex
- Add net debt issued, deduct net debt repayment, includes interest on debt
- Represents the cash flow available to Equity investors, taking into account the leverage in the company - hence Levered Cash Flow

What do you mean by Cash Flow?

- Free Cash Flow to the Firm (FCFF) or Unlevered Cash Flow
- This is the cash flow used in Discounted Cash Flow calculations
- It requires calculating…

What do you mean by Cash Flow?

- Start with EBIT - Earnings before Interest and Tax
- Calculate the hypothetical tax based on EBIT
- Add back Depreciation and Amortisation
- Deduct any increases in non cash working capital
- Deduct Capex

- EBIT
- - Tax
- + Depreciation and Amortisation
- - Changes in NWC
- - Capex
- = FCFF

What do you mean by Cash Flow?

- The main lesson from this is that you need to understand the metrics you are working with when preparing your ratios
- EBITDA is easy but the least accurate
- FCFF - Unlevered Cash Flow - is the most complicated to calculate but is the most accurate

What do you mean by Cash Flow?

- On balance these ratio metrics provide us with easy to calculate ratios which we can apply to Comparable Company valuations
- In the end are they really a replacement for a DCF?
- I am not sure…

What do you mean by Cash Flow?