Discounted Cash Flow Modelling

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Factors that can affect the composition of a company's current assets vs. long-term assets

Internal Factors:

i. **Business Model and Industry:**
- Companies in different industries have varying asset needs. For example, manufacturing companies might have significant investments in machinery and equipment (long-term assets), while retail businesses might hold more inventory and receivables (current assets).
- Companies with long sales cycles, such as construction firms, may have more significant investments in work-in-progress and long-term contracts, affecting their long-term assets.

ii. **Growth Stage:**
- Typically, startups invest heavily in long-term assets like property, plant, and equipment as they build their infrastructure and expand.
- More established companies might focus on maintaining or upgrading existing assets and managing working capital, which could shift the focus more towards current assets.

iii. **Capital Expenditure Plans:**
- Significant capital expenditures on new projects or expansion can increase long-term assets.
- Decisions about maintaining current assets versus investing in new long-term assets will impact the balance.

iv. **Financial Management and Strategy:**
- How a company manages its current assets (e.g., inventory management, receivables collection) and its investment strategy in long-term assets will affect their composition.
- Companies that prioritize liquidity might hold more current assets like cash and short-term investments.

External Factors:

i. **Economic Conditions:**
- During economic booms, companies might invest more in long-term assets due to optimism about future growth. In downturns, they might reduce such investments and focus on maintaining current assets.
- Low interest rates can encourage investment in long-term assets, as borrowing costs are cheaper. Conversely, high rates might make such investments less attractive.

ii. **Regulatory Environment:**
- Changes in regulations might impact asset composition. For example, stricter environmental regulations might require companies to invest in new, more compliant equipment.
- Government incentives for capital investment can lead companies to increase their long-term asset base.

iii. **Technological Advances:**
- Advances in technology might lead to higher investments in new equipment and technology (long-term assets). Conversely, rapid technological changes can lead companies to frequently update or replace assets.

iv. **Market Demand:**
- Changes in market demand can affect inventory levels (current assets) and investments in long-term production capacity. For instance, a surge in demand might lead to increased investment in long-term production facilities.

v. **Competitive Pressure:**
- Competition can drive companies to invest in new technologies or expand operations (long-term assets) to stay ahead. Conversely, it might also push them to manage current assets more efficiently.

vi. **Strategic Decisions**
- Acquiring another company can significantly alter the balance of current versus long-term assets, depending on the nature of the acquired company's assets.

Impact of company's Debt-to-Equity Ratio on Creditworthiness and Access to Capital

Creditworthiness:

- **Risk Perception:** A higher debt-to-equity ratio indicates that a company relies more on debt financing compared to equity. This can be seen as a higher risk to lenders because the company is more leveraged. Lenders may perceive the company as having a greater risk of default, especially if it faces financial difficulties.
- **Interest Rates:** To compensate for the higher risk, lenders might charge higher interest rates or impose stricter terms on loans. This increased cost of borrowing can affect the company's financial health and its ability to service its debt.

Access to Capital:

- **Borrowing Capacity:** Companies with high debt-to-equity ratios might find it challenging to obtain additional loans or lines of credit. Lenders often have internal thresholds for acceptable leverage levels, and exceeding these thresholds can limit a company's ability to secure more funding.
- **Investment Attractiveness:** Investors may also be cautious about investing in a company with high leverage, as it can lead to greater financial instability and potential returns volatility. This could affect the company's ability to raise equity capital if investors perceive it as too risky.
- **Debt Covenants:** High leverage may trigger restrictive debt covenants in existing agreements, which can limit operational flexibility and strategic options. Breaching these covenants might lead to penalties or forced renegotiation of terms.

Analysis of Debt-to-Equity Ratio over the four years

	2018	2019	2020	2021	Comment
Debt-to-Equity Ratio	2.12	1.91	1.97	2.28	A ratio of approx. 2.0 means: Total Debt=2×Total Equity

Interpretation: Since the ratio remains constant at 2.0 for all four years, this suggests that the proportion of debt relative to equity has remained stable. This indicates a consistent level of leverage relative to the company's equity base.

Debt Financing VS Equity Financing:

The company is consistently relying on debt financing. With a ratio of 2.0, the company has twice as much debt as equity. Specifically, for every dollar of equity, there are two dollars of debt.

- **Stable Leverage:** The consistent ratio suggests that the company's financial strategy and capital structure have been stable over the four years. This might indicate a deliberate choice to maintain a specific level of leverage.
- **Risk Management:** The consistent use of debt might be part of a strategy to benefit from debt financing advantages (such as tax deductibility of interest) while managing the associated risks

Revenue Growth over three years and its segments

The company's total revenue has grown over the three years, segments that are driving this growth are:

	Growth for Year 1 to Year 2	Growth for Year 2 to Year 3	Comments
Merchandise Sales	9.29%	17.66%	Grew by approx. 9% and 18%, indicating strong performance in merchandise.
Membership Fees	5.64%	9.49%	Indicating steady but less aggressive growth compared to merchandise.

Segment revenue contribution for each year:

	2019	2020	2021
Revenue Contribution from Merchandise Sales	97.80%	97.88%	98.02%
Revenue Contribution from Membership fees	2.20%	2.12%	1.98%

Over the three years, the total revenue grows significantly, driven primarily by the growth in merchandise sales due to its larger contribution and higher growth rates.

Gross Margin over the three years

	2019	2020	2021	Comments
Gross Margin %	12.98%	13.09%	12.88%	The Gross Margin % has remained constant at 13% each year
Gross Margin Amounts/Gross Profit	$19,817	$21,822	$25,245	The Gross Profit have increased over the years from $19,817 to $25,245.

The company has been able to increase its gross profit in dollar terms and maintain a consistent gross margin percentage of 13%. This indicates that while the company has not significantly improved its margin percentage, it has been able to grow its total gross profit due to increasing revenues.

The company was not able to improve its margins but managed to maintain them.

Investors can utilize free cash flow analysis to compare different companies in the same industry by focusing on several key factors

- **Unlevered Free Cash Flow (UFCF):** UFCF is a measure of the cash generated by a company's operations, excluding any financing activities such as interest payments. By comparing the UFCF of different companies, investors can assess which company generates more cash from its core operations.
- **Growth in Free Cash Flow:** Investors can look at the growth trajectory of free cash flow over time. Companies with consistently increasing free cash flow are often considered more financially stable and efficient.
- **Capital Expenditures**: The level of capital expenditures (CapEx) relative to UFCF is crucial. A company that generates significant free cash flow but also requires high capital investments might have less flexibility than one with lower CapEx needs.
- **Comparison of Margins:** By comparing operating margins (EBIT) and free cash flow margins, investors can identify companies with better operational efficiency and cash generation capabilities.

- **Working Capital Management:** Changes in Net Working Capital (NWC) can significantly affect free cash flow. Companies with better working capital management (less cash tied up in receivables and inventory) will typically show better free cash flow performance.
- **Industry Benchmarks:** It's also important to compare free cash flow metrics against industry benchmarks to see how a company stacks up relative to its peers. High free cash flow relative to peers might indicate a competitive advantage.
- **Debt Management**: FCF analysis helps investors understand how easily companies can meet their debt obligations. Companies with higher FCF relative to their debt levels have better creditworthiness and are less likely to face financial distress.

By analyzing these factors, investors can determine which companies are likely to deliver more consistent and sustainable returns, making them potentially more attractive investment opportunities.