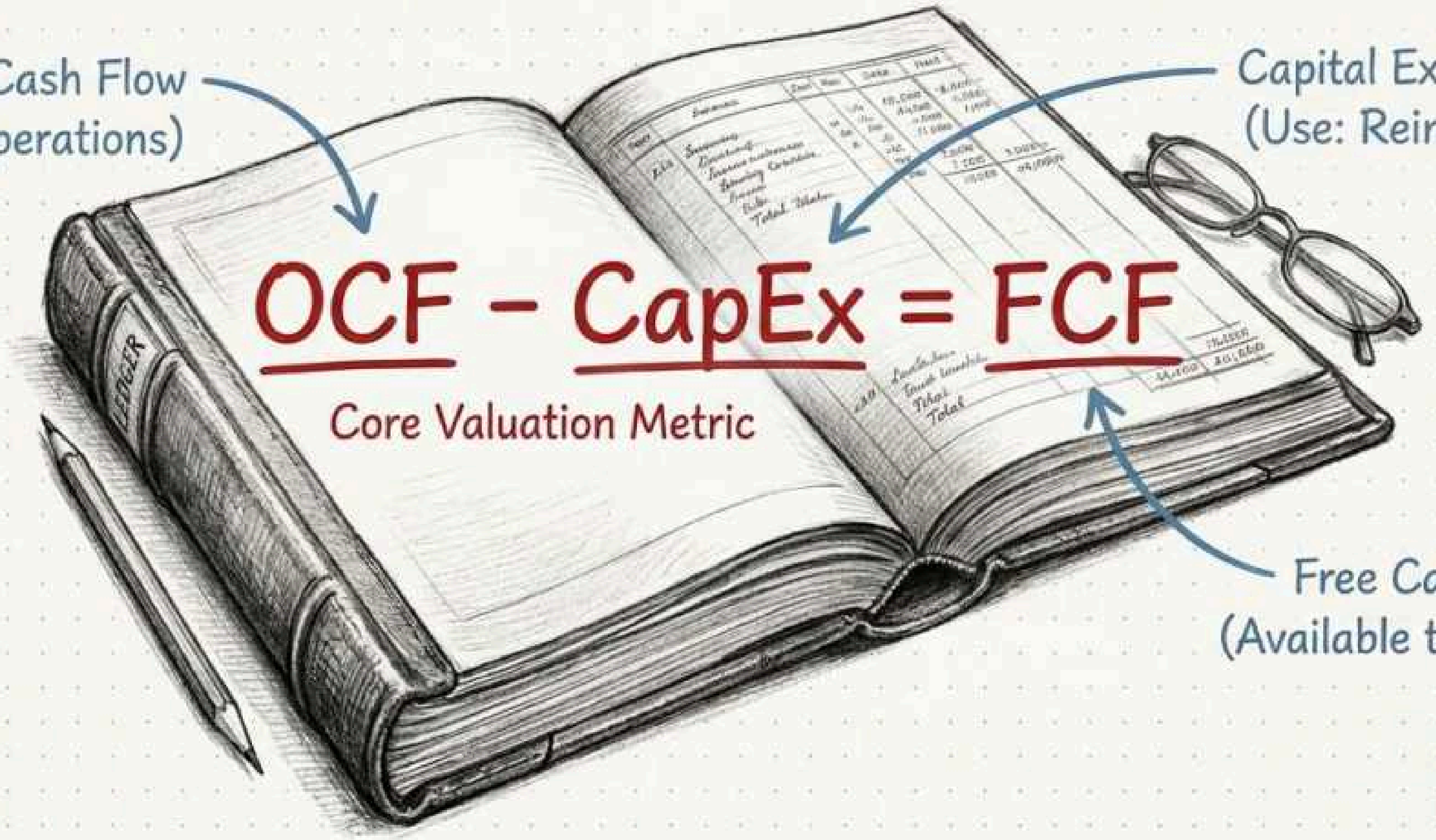
The Cash Flow Statement

ACCT 201 B – Lecture 4

Operating Cash Flow
(Source: Operations)

Capital Expenditures
(Use: Reinvestment)



OCF – CapEx = FCF

Core Valuation Metric

Free Cash Flow
(Available to Investors)

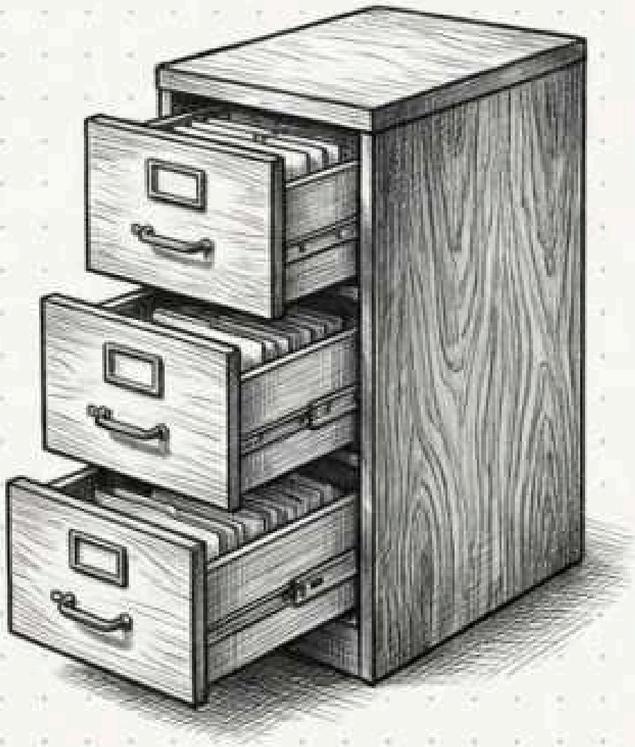
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Framing the Cash Flow Statement

¶ 4.1



Why are profit and cash not the same?



How does the statement organize cash?



Why do profitable companies run out of money?

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Profit is an Opinion. Cash is a Fact.

¶ 4.2



≠



Records revenue when earned & expenses when incurred. (Profit)

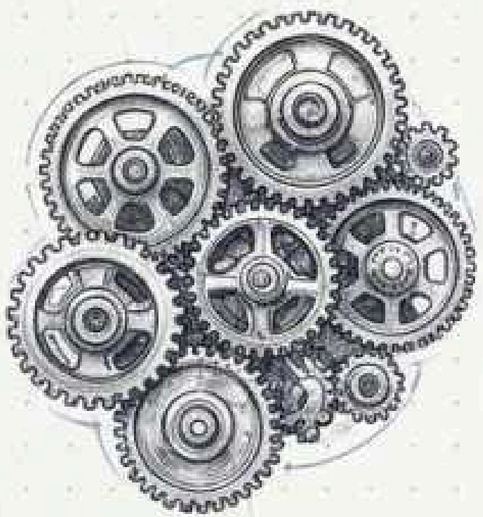
The actual movement of cash during the period. (Fact)

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Organizing Cash Movements

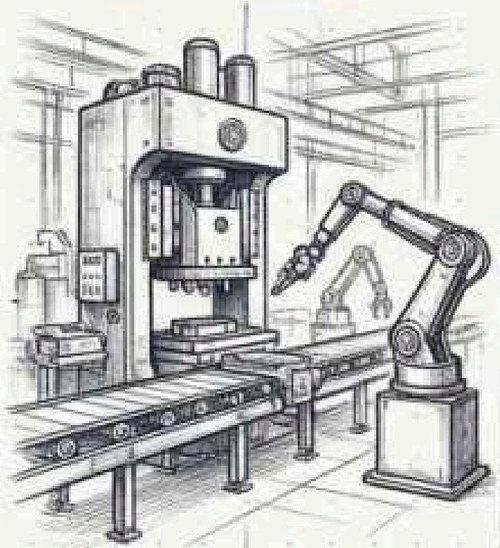
¶ 4.3

Operating



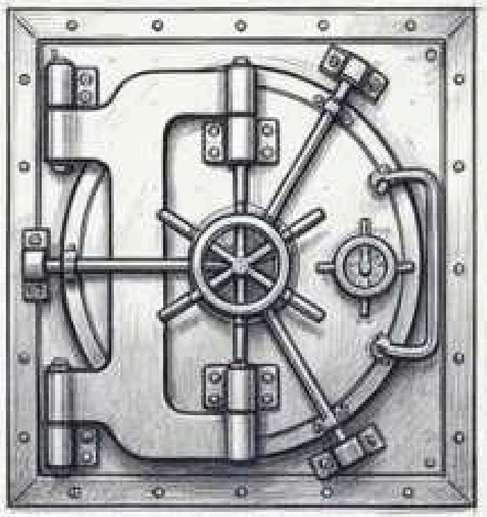
Running the business.

Investing



Buying & selling long-term assets.

Financing



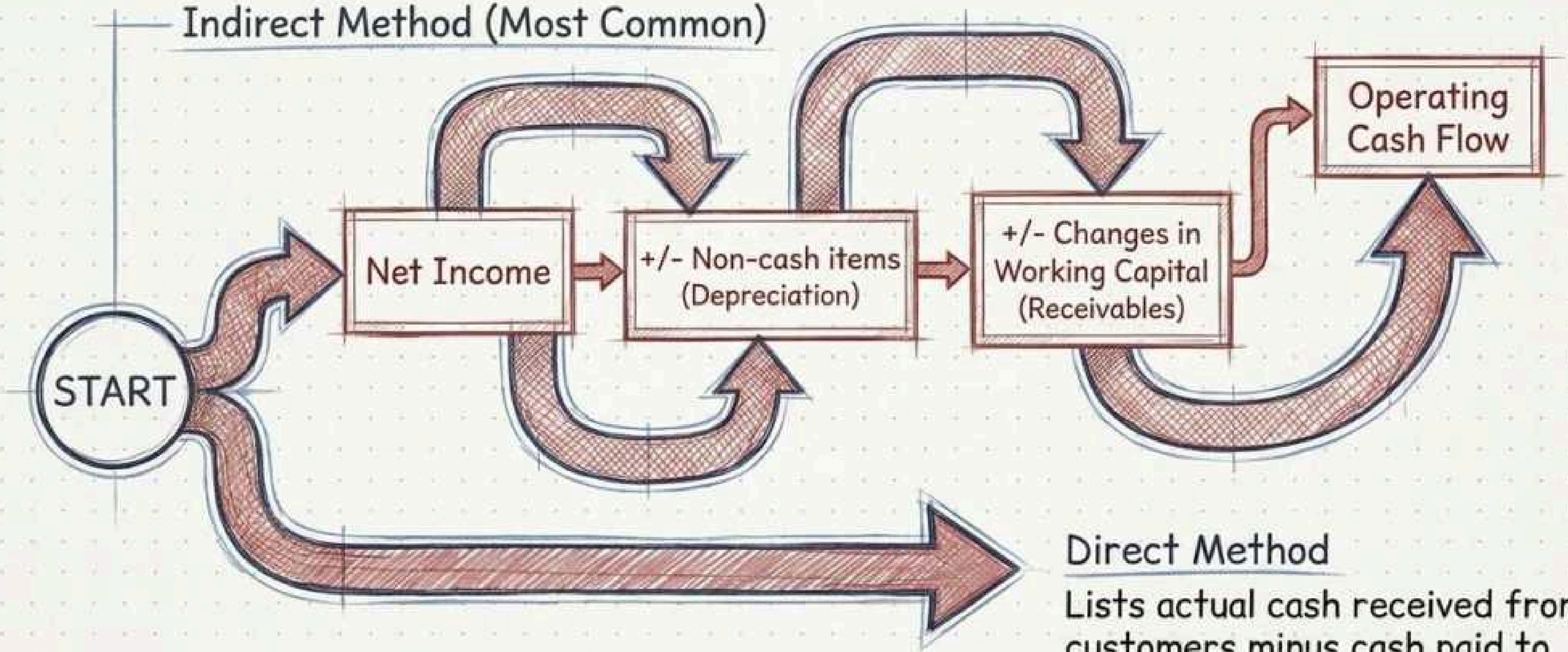
Raising & repaying money / dividends.

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Preparing the Operating Section

¶ 4.4

Indirect Method (Most Common)



Direct Method

Lists actual cash received from customers minus cash paid to suppliers and staff.

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Case Study: The Bicycle Shop (Operating)

¶ 4.5



+ $2,000 [Net Income]

- $1,000 [Receivables rose: Customers still owe money]

- $2,000 [Inventory rose: Bought more bicycles than sold]

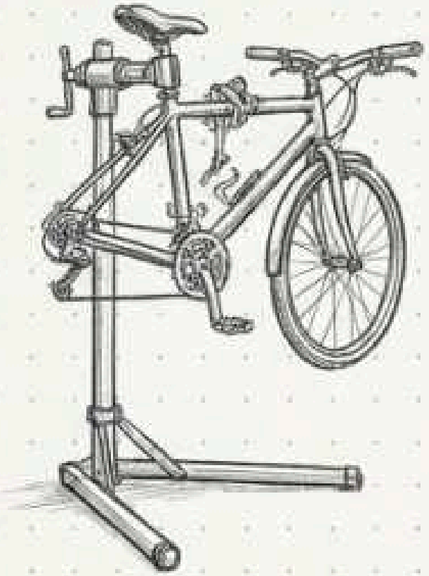
+ $ 500 [Depreciation: Add back non-cash expense]

= -$ 500 [Operating Cash Flow]

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Case Study: The Bicycle Shop (Total Cash)

¶ 4.6





- $ 500 [Operating Cash Flow, carried over]
- $1,000 [Investing Outflow: New repair stand]
- $1,000 [Financing Outflow: Loan repayment]

= - $2,500 [Total Cash Change]

Reported a profit, but cash fell by $2,500.
This is not unusual for a growing business.

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Why Profitable Companies Fail

¶ 4.7





The Growth Trap.

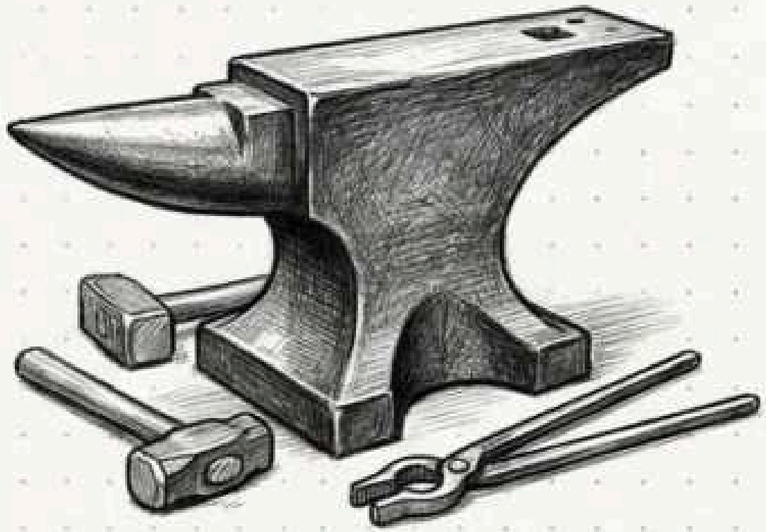
Pay for materials & staff. — [TIME GAP] → Customers finally pay.

Fast-growing firms run out of cash before the revenue arrives.

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Unprofitable but Cash-Rich

¶ 4.8



Heavy depreciation charges on old equipment drag down net income, but no actual cash is lost today.



Customers pay in advance. Cash is collected a full year ahead of the service being provided.

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Free Cash Flow (FCF)

¶ 4.9

Operating Cash Flow - Capital Expenditure = Free Cash Flow



Repay Debt



Pay Dividends



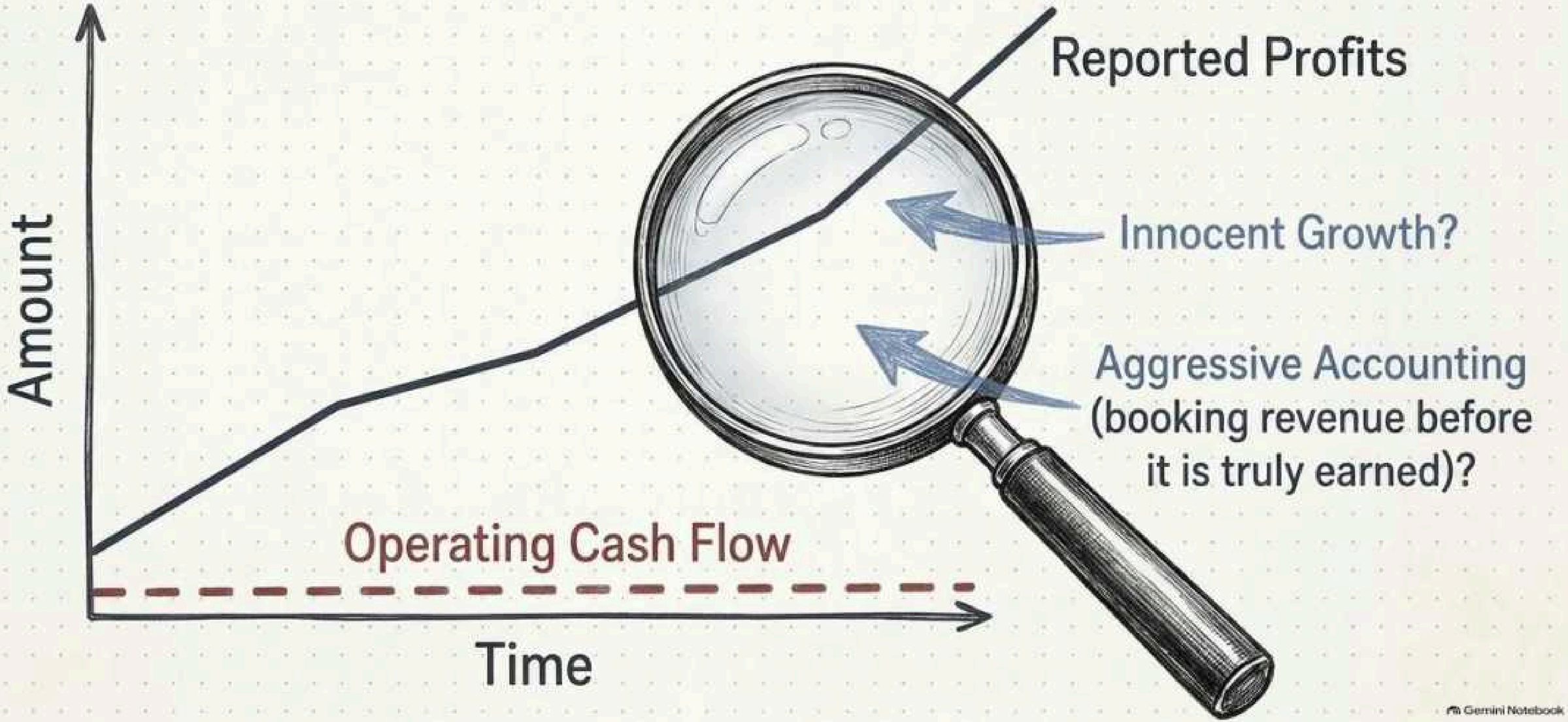
Invest in New Opportunities

A better guide to a company's strength than reported profit.

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Checking the Quality of Earnings

¶ 4.10

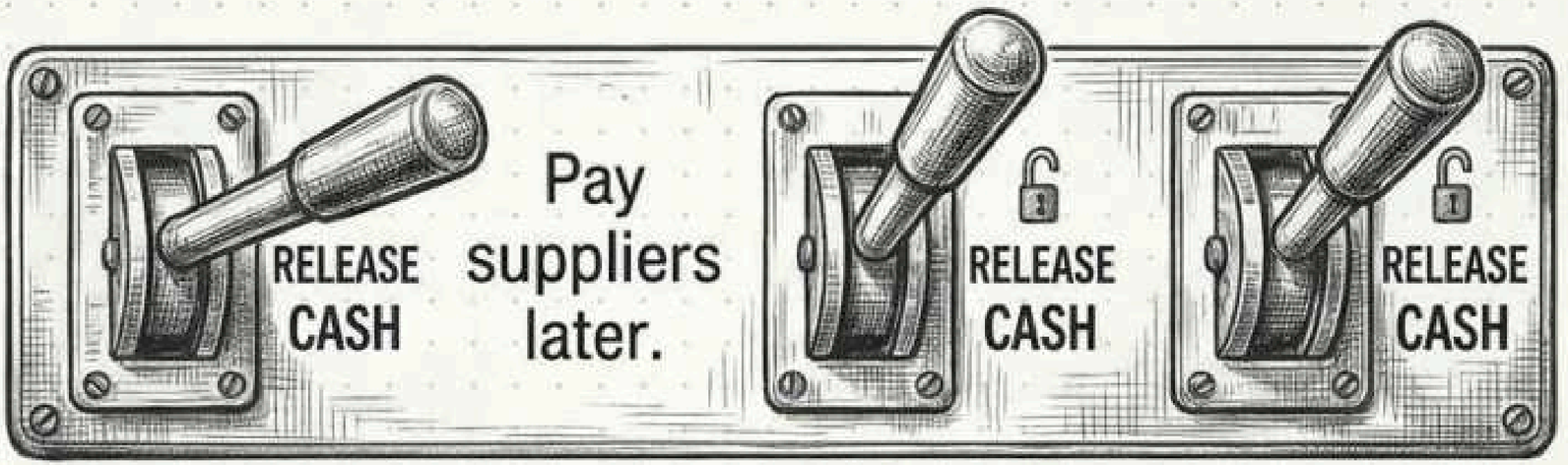


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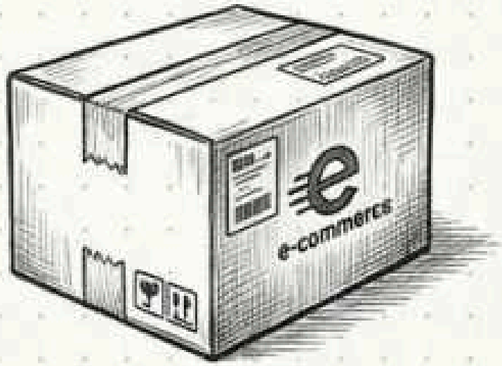
Working Capital Management

¶ 4.11

Collect from customers faster.



Hold less inventory.

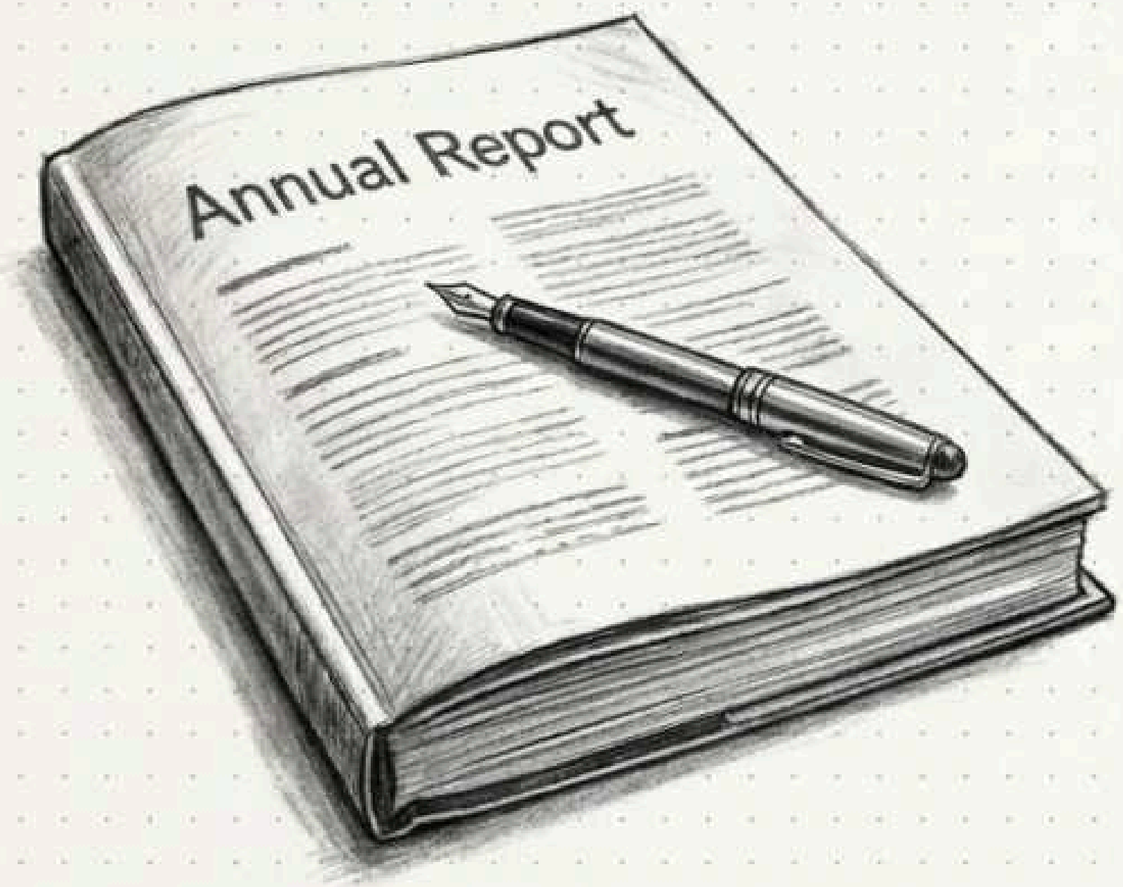


Cash received from customer → (Time passes) → Supplier is paid

Funds growth without external financing.

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Apply the Concepts



- [ ] Find the Cash Flow Statement.
- [ ] Compare Operating Cash Flow vs. Net Income over several years.
- [ ] Calculate Free Cash Flow (OCF – CapEx).
- [ ] Read the Notes
- [ ] Read the Notes for explanations of big differences.

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Exercise: Calculate Operating Cash Flow

¶ 4.13

$5,000 [Net Income]
+ $1,000 [Depreciation]
− $3,000 [Increase in Receivables]
+ $1,000 [Decrease in Inventory]

= $? 4,000

Next Lecture: Inventory, Depreciation, and Accounting Rules.

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