STATEMENT OF CASH FLOW CHEAT SHEET

By Flavio Macorig:
flavio.macorig@gmail.com
www.flaviomacorig.ch

The **Statement of Cash Flow** stands as a cornerstone financial statement that traces the **movement of cash** as it flows in and out. This statement reveals the story of a company's cash over a specific period (month, quarter, year-to-date. full year,...) broken into three pivotal sectors: **Operating**, **Investing**, and **Financing Activities.** Unlike other financial statements that might focus on accrued revenues or expenses, the Statement of Cash Flows gives a straightforward view of the **actual cash activities**. Its purpose is simple yet vital: to provide stakeholders an holistic view and clarity on a company's ability to generate and use cash, offering insights into its **liquidity**, **solvency**, and **financial health**. Alongside the **Income Statement** and the **Balance Sheet**, it forms the trifecta of critical financial statements issued by businesses.

Cash Flow General Structure

Descriptions and Main Formulas

	Full Year 2023	Explanations
Operating Activities		**This section reflects the cash effects of transactions involved in determining net income**
Cash Receipts from Customers	*40'000*	*Indicates the cash collected from sales of goods or services*
Cash Payments to Suppliers	*-15'000*	*Represents cash paid to suppliers for inventory or other goods*
Cash Payments for Salaries and Wages	*-12'000*	*Cash paid to employees*
Interest Paid	*-1'000*	*Cash payments made for interest on borrowed funds*
Taxes Paid	*-2'000*	*Cash payments for taxes*
Other Operating Cash Inflows/Outflows	-	*Other miscellaneous cash transactions related to operations*
Net Cash Provided by (Used in) Operating Activities	**10'000**	**Formula = Sum of the above elements, indicating the net cash from core business operations**
Investing Activities		**Reflects the cash effects of acquiring and disposing of investments and long-lived assets**
Cash Receipts from Sale of PP&E	5'000	*Indicates cash inflow from selling long-term assets (Property, Plant, and Equipment or PP&E)*
Cash Payments to Acquire PP&E	-8'000	*Cash outflow for purchasing long-term assets (Property, Plant, and Equipment or PP&E)*
Cash Receipts from Sale or Redemption of Investment	500	*Cash inflows from selling investments*
Cash Payments to Acquire Investments	-200	*Cash spent on purchasing investments*
Net Cash Provided by (Used in) Investing Activities	**-2'700**	**Formula = Sum of the above elements, showing the net cash from investing decisions**
Financing Activities		**Portrays the cash effects of transactions with creditors and owners**
Cash Receipts from Issuance of Stock	-	*Indicates cash inflow from issuing shares*
Cash Payments to Repurchase Stock	-	*Cash outflows used to buy back company shares*
Cash Receipts from Issuance of Debt	2'000	*Cash obtained through borrowing*
Cash Repayments of Debt	-1'000	*Cash paid to repay borrowed funds*
Dividends Paid	-3'500	*Cash outflows to shareholders as dividends*
Net Cash Provided by (Used in) Financing Activities	**-2'500**	**Formula = Sum of the above elements, illustrating the net cash from financing activities**
Beginning Cash Balance	12'000	**The cash balance at the start of the period**
Net Increase (Decrease) in Cash	4'800	**The sum of the net cash from the three activities (i.e. the overall change in cash for the period)**
Ending Cash Balance	16'800	**Formula = Beginning Cash Balance + Net Increase (Decrease) in Cash over the period**

Note: Certain transactions don't involve cash but are disclosed separately, often in footnotes. Examples: Issuance of stock to purchase assets / Conversion of bonds to equity / Leasing of assets.

Cash from Operating Activities: Direct vs Indirect Method

There are two different options used to list Cash Flows from Operating activities:

- The **Direct Method** lists major classes of gross cash receipts/payments. This option is less used due to the difficulty in gathering all the data;
- The **Indirect Method** takes the Net income and adjusts for non-cash items and changes in working capital. This one is most commonly used.

Section	Formula Relationships for the Indirect Method	Explanation
Operating Activities	Cash from Operations = Net Income + Non-cash Adjustments + ΔWorking Capital	Converts net income to cash basis by adjusting for non-cash expenses and working capital changes.

Comments:

- **Non-Cash Adjustments**: These adjustments are crucial in converting accrual-based net income (where revenues are recognized when earned and expenses when incurred) to a cash basis. Indeed, some income statement items do not affect cash during the period, even though they impact reported net income. The purpose of non-cash adjustments is to remove the effect of these items to arrive at cash generated from operations. Examples: Depreciation & Amortization, Stock-Based Compensation, or Deferred Taxes.
- **Δ (Delta) in Working Capital:** Working capital represents the difference between current assets and current liabilities. Changes in working capital reflect the timing differences between the recognition of revenues and expenses. If current assets (excluding cash) increase during a period, it implies cash has been used up (e.g., buying more inventory or accounts receivables increasing because sales were made on credit). Conversely, an increase in current liabilities indicates a source of cash (e.g., purchasing on credit, which means not paying cash immediately).

Major Cash Flow Ratios and Their Interpretations

General Comments on the Statement of Cash Flow:

- A positive cash flow from operating activities indicates the company is generating sufficient cash from its core business.
- High positive cash flow from investing activities might mean the company is selling off assets – consider why.
- High negative cash flow from investing activities might indicate expansion or long-term investment.
- High borrowings in financing activities could mean the company is heavily reliant on debt.
- The net increase or decrease in cash and cash equivalents should reconcile to the change in the cash balance year-over-year.

Let's have a look now on the major Cash Flow ratios:

Ratio Name	Formula	Interpretation
Operating Cash Flow Ratio	Operating Cash Flow / Current Liabilities	Measures a company's ability to cover its current liabilities from its operations.
Free Cash Flow	Operating Cash Flow - Capital Expenditures	Indicates cash available to the company after maintaining and expanding assets.
Cash Flow Margin	Operating Cash Flow / Net Sales	Shows the operating cash generated per dollar of sales.
Cash Flow to Debt Ratio	Operating Cash Flow / Total Debt	Assesses a company's ability to repay its debt from operational cash flows.
Dividend Payout Ratio	Dividends Paid / Net Income	Reveals the proportion of earnings paid out as dividends.
Cash Flow Adequacy Ratio	Operating Cash Flow / Fixed Asset Acquisitions	Evaluates a company's ability to finance asset purchases from operational cash.
Investment Quality Ratio	(Operating Cash Flow - Dividends) / Capital Expenditures	Shows if a company can fund capital expenditures without relying on external financing or dividends.

Interpreting these ratios:

- **Operating Cash Flow Ratio**: A higher ratio indicates that a company is in a better position to cover its short-term liabilities. A ratio below 1 may suggest liquidity problems.
- **Free Cash Flow (FCF)**: Positive FCF indicates a company can sustain itself without external financing or investing. Negative FCF might imply a need for external capital.
- **Cash Flow Margin**: A higher percentage means the company is more efficient at converting sales into cash.
- **Cash Flow to Debt Ratio**: A higher ratio suggests the company is in a good position to cover its total debt with its annual operating cash flow.
- **Dividend Payout Ratio:** A higher ratio indicates that the company returns more of its profits to shareholders. However, a very high ratio might imply the company is not reinvesting enough into its business.
- **Cash Flow Adequacy Ratio**: A value over 1 indicates that a company can fund its fixed asset purchases from its operational cash flow.
- **Investment Quality Ratio**: A higher value suggests the company is able to finance its capital expenditures without cutting dividends or resorting to external financing.

***Note**: Ratios always need to be interpreted in the context of the specific industry, the overall economy, and the company's previous financial performance. Comparing them to industry benchmarks or competitors can provide a clearer picture of a company's performance. Always use financial ratios as tools in conjunction with other analyses.*