Finance Management & Planning

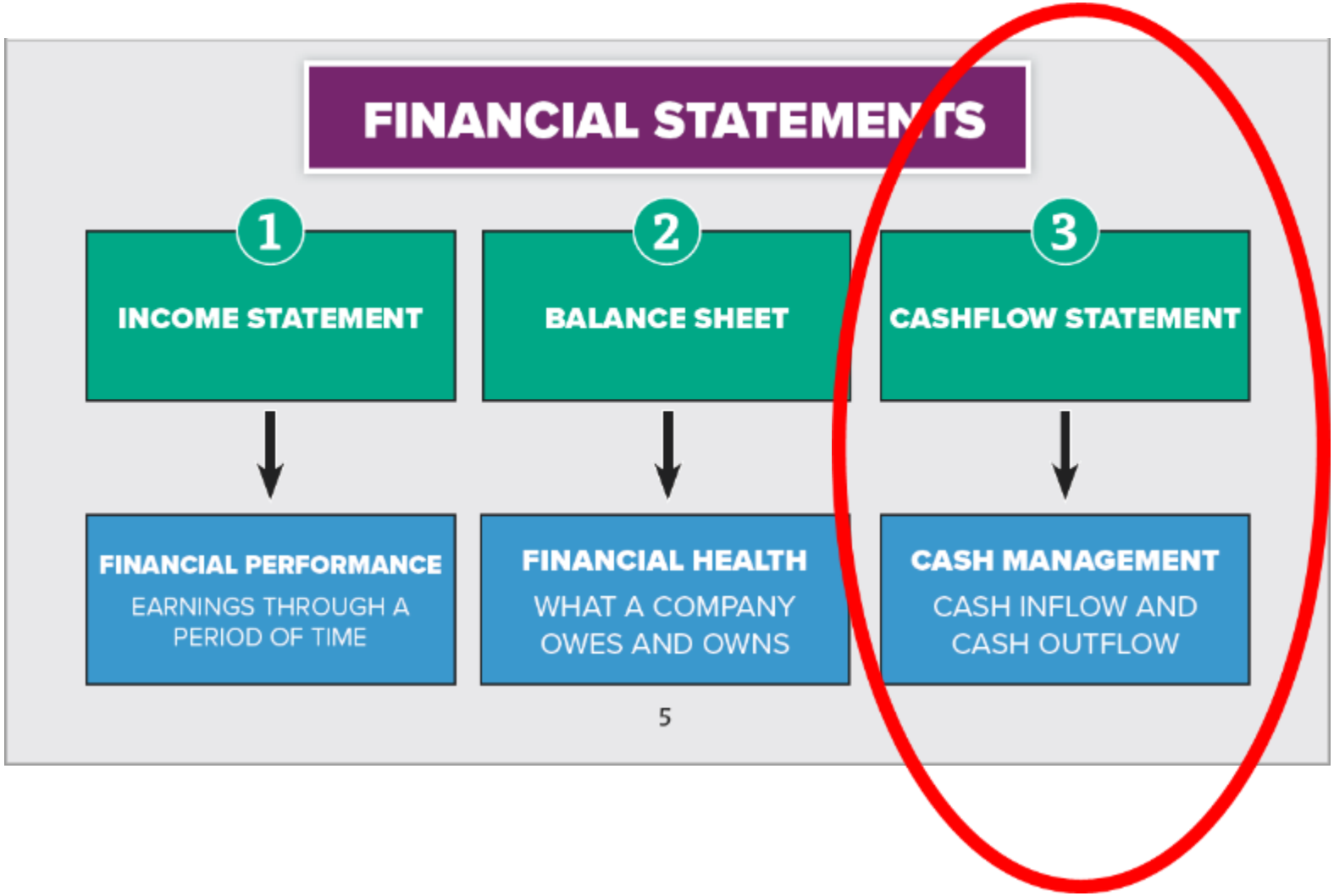
Cashflow and Working Capital

This Week

- How are the assignments progressing ?

- This Week
  - Cashflow
  - Working Capital

Income Statement



Cash Flow Statement

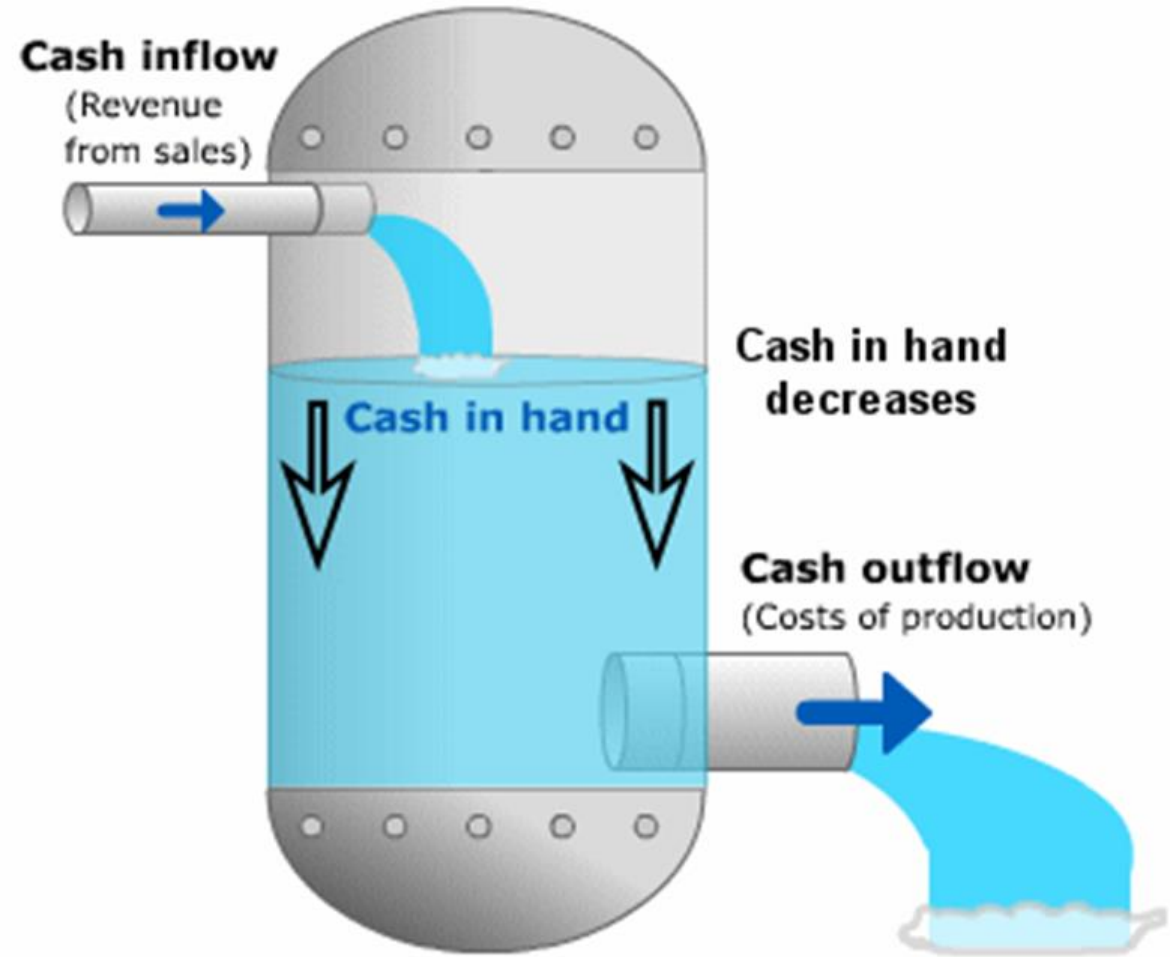
Cash Flow

Definition :

A Cash-flow is a **financial statement** that shows you how cash moves in and out of your business.

Purpose :
The cash flow statement is believed to be the most intuitive of all the financial statements because it follows the cash made by the business in three main ways—through operations, investment, and financing. The sum of these three segments is called net cash flow

Cash Flow Statements



How does a cashflow work ?

A simple example

	CASH FLOWS	
		£
Monday	Opening balance (cash introduced)	40
	Cash from sales of widgets for Monday	45
	Cash paid out to buy widgets	-40
	Closing balance of cash	45
Tuesday	Opening balance (from previous day)	45
	Cash from sales of widgets for Tuesday	48
	Cash paid out to buy widgets	-20
	Closing balance of cash	73
Wednesday	Opening balance (from previous day)	73
	Cash from sales of widgets for Wednesday	32
	Cash paid out to buy widgets	-46
	Closing balance of cash	59

Cash Flow Statements

ABC Company Inc

Cash Flow Statement

	£
Cash at Beginning of Year	14,300
Cash In	781,100
Cash Out	(763,000)
Cash at End of Year	32,400

Initial Thoughts on the Cash Flow of the business ?

As the owner of the business what additional information would you like to know?

Cash Flow Statement

- The Cash-flow Statement
- Highlights the movements in Cash during a specific period
  - Published Statements are usually 12 months.
  - Although internal can be 1 Month , Quarterly or half yearly.

The information is presented in three sections:

- Cash flows provided by/used for operations
- Cash flows provided by/used for investments
- Cash flows provided by/used for financing?

Cash Flow Statements

ABC Company Inc.

Cash Flow Statement

For the Year Ending: 31/12/201X
Cash at Beginning of Year: **14,300**

Operating Activities	
Cash receipts from customers	741,000
Cash paid for	
Inventory purchases	(310,500)
General operating and administrative expenses	(100,000)
Wage expenses	(135,000)
Interest	(15,000)
Income taxes	(38,500)
Net Cash Flow from Operations	**142,000**
Investing Activities	
Cash receipts from	
Sale of property and equipment	40,100
Collection of principal on loans	
Sale of investment securities	
Cash paid for	
Purchase of property and equipment	(81,000)
Making loans to other entities	
Purchase of investment securities	
Net Cash Flow from Investing Activities	**(40,900)**
Financing Activities	
Cash receipts from	
Issuance of stock	
Borrowing	
Cash paid for	
Repurchase of stock (treasury stock)	
Repayment of loans	(38,000)
Dividends	(45,000)
Net Cash Flow from Financing Activities	**(83,000)**
Net Increase in Cash	**18,100**

Cash at End of Year: **32,400**

Same Cashflow , now split into sections

How does this inform you as :-

a) Owner / Leader of the business
b) Shareholder
c) Interested party – Bank , Supplier etc.

Why are Cash Flow statements important?

- The P&L does not illustrate movements of cash

- The cash flow forecast is a cash flow statement that predicts net cash flows of the business over a future period. It shows when surpluses and deficits of cash are likely to occur to allow the taking of appropriate action, for example:

  - Cash surpluses may be re-invested
  - Cash deficits may be mitigated

- They can aid planning and decision-making for a business

- Prospective investors (banks etc.) may want to know how well cash is managed for the business before investing

- Remember “Cash is King” – it is the lifeblood of the business and a business cannot survive without it!!

Cash Flow Statements

Groups

From a business perspective ? Think of your business ?

1) What is more important Cashflow or Profitability ?
2) What reasons could make a businesses change its view on the above ?

Think about this from a perspective of a

a) Start up business
b) High Growth business
c) Established business plc
d) Shareholder

Cash Flow Statements

A business may see a profit every month, but its money is tied up in assets or accounts receivable, and there is no cash to pay employees.

The absence of a profit eventually has a declining effect on the cash flow.

Another thing to remember when determining whether to focus on cash flow or profit is cash flow can be bought.

- A business owner can put up his or her personal assets as capital into the business
- Alternatively, they can get a small business loan from a bank to keep the business running until it starts seeing cash flow again.

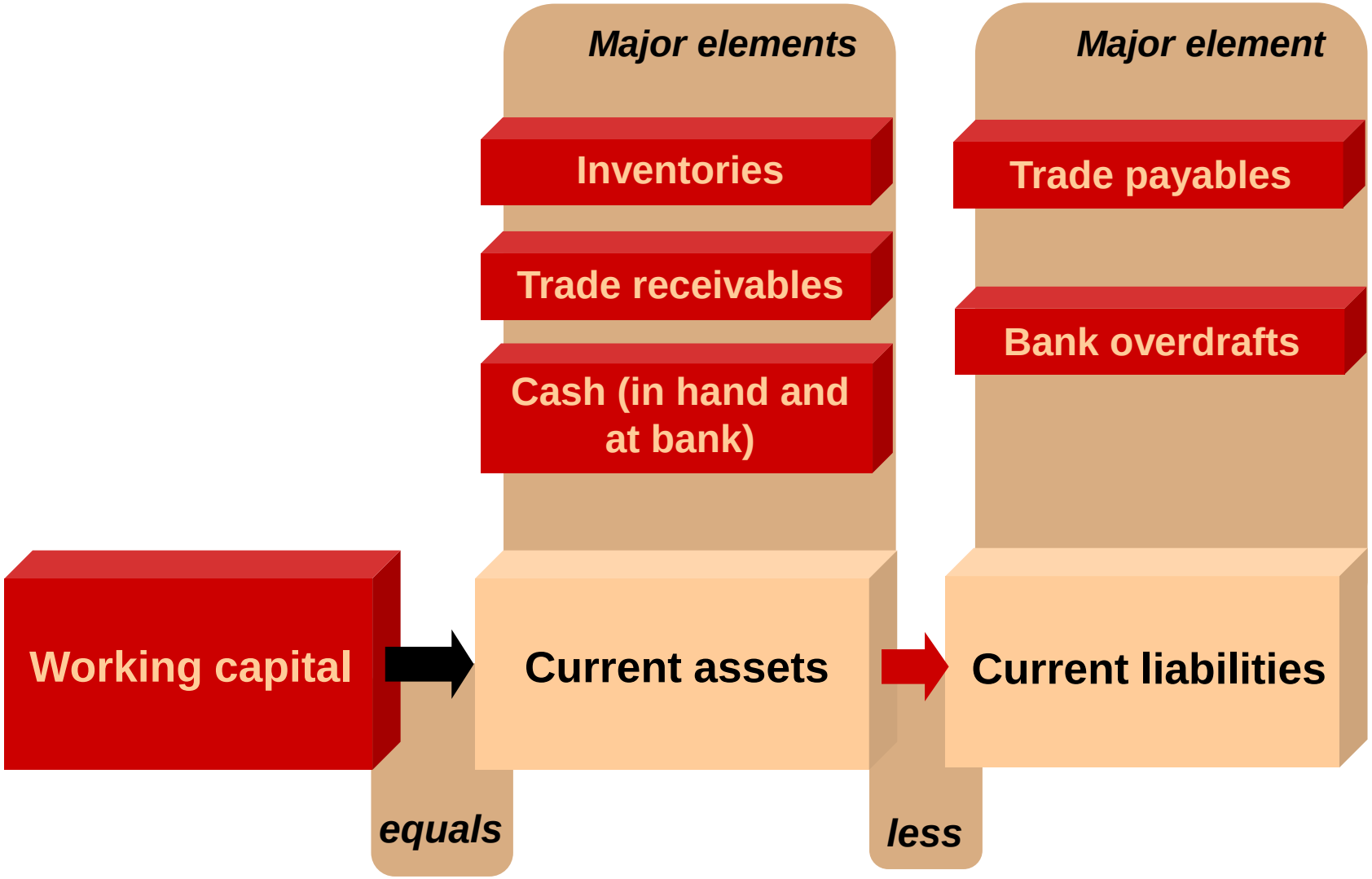
Within a business we need to understand our working capital cycle?

Working Capital

- Why is this important to understand ?

	Note	As at 27 March 2021 £m	As at 28 March 2020 £m
ASSETS			
Non-current assets			
Intangible assets	12	**237.0**	247.0
Property, plant and equipment	13	**280.4**	294.9
Right-of-use assets	14	**818.1**	834.0
Investment properties		**2.4**	2.5
Deferred tax assets	15	**137.1**	171.5
Trade and other receivables	16	**45.0**	53.7
		1,520.0	1,603.6
Current assets			
Inventories	17	**402.1**	450.5
Trade and other receivables	16	**276.9**	252.1
Derivative financial assets	18	**2.2**	6.7
Income tax receivables		**39.7**	50.4
Cash and cash equivalents	19	**1,261.3**	928.9
		1,982.2	1,688.6
Total assets		**3,502.2**	3,292.2
LIABILITIES			
Non-current liabilities			
Trade and other payables	20	**(99.4)**	(102.3)
Lease liabilities	21	**(809.6)**	(910.0)
Borrowings	24	**(297.1)**	(300.0)
Deferred tax liabilities	15	**(0.8)**	(0.1)
Retirement benefit obligations		**(1.0)**	(1.9)
Provisions for other liabilities and charges	22	**(31.8)**	(28.6)
		(1,239.7)	(1,342.9)
Current liabilities			
Trade and other payables	20	**(392.9)**	(447.5)
Bank overdrafts	23	**(45.4)**	(41.6)
Lease liabilities	21	**(210.0)**	(215.5)
Derivative financial liabilities	18	**(2.6)**	(4.8)
Income tax liabilities		**(27.9)**	(7.9)
Provisions for other liabilities and charges	22	**(24.0)**	(13.2)
		(702.8)	(730.5)
Total liabilities		**(1,942.5)**	(2,073.4)
Net assets		**1,559.7**	1,218.8

Working Capital



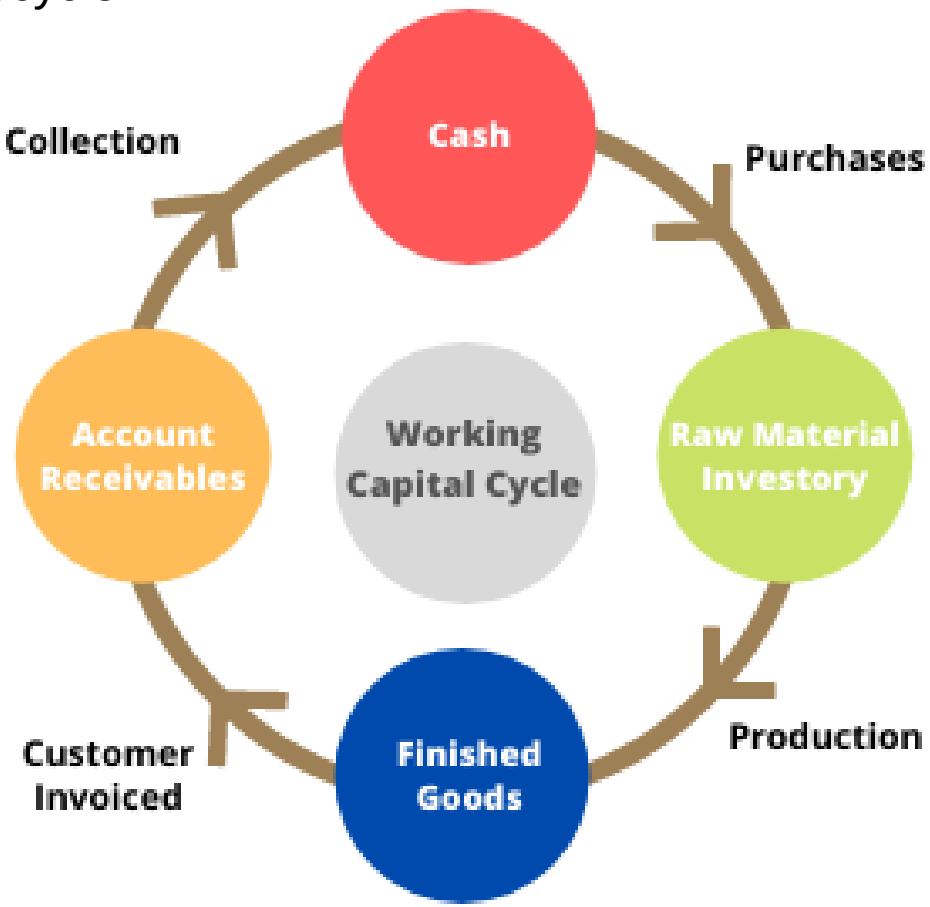
Source: Atrill & McLaney

Working Capital Explained

https://youtu.be/XvHAlui-Bno

Working Capital

Working Capital Lifecycle



Working Capital

What Ratios support our understanding of Working Capital lifecycles?

Liquidity Ratios

Current Ratio $= \dfrac{\text{Current Assets}}{\text{Current Liabilities}}$

Quick Ratios (or Acid Test Ratio) $= \dfrac{\text{Current Assets Less Stock}}{\text{Current Liabilities}}$

Cash Ratio $= \dfrac{\text{Cash and Cash Equivalents}}{\text{Current Liabilities}}$

Consider :-

Current Ratio – Low Test Level
Quick Ratio – Medium Test Level
Cash Ratio – High Test Level

Activity Ratios

Days Sales Outstanding (DSO) $= \dfrac{\text{Trade and other receivables}}{\text{Average Revenue per Day}}$

Inventory Turnover $= \dfrac{\text{Cost of Goods Sold}}{\text{Average Inventory / Stock}}$

Days Payable Outstanding (DPO) $= \dfrac{\text{Trade and other payables}}{\text{Average COGS per day}}$

Where **Average Revenue per Day** $= \dfrac{\text{Annual Revenue}}{365}$

Where **Average COGS per Day** $= \dfrac{\text{Annual COGS}}{365}$

Working Capital

How can we reduce the Working Capital Lifecycle

- Reduce the need for stock or stockholding time – Just in Time Methodology ?
- Negotiate quicker payments from our customers – Incentives ?
- Negotiate longer payment times to suppliers – Reputation risk if seen as a slow payer

Why is it important?

- Business requires sufficient working capital to meet its day to day running costs
- Working capital is ‘dead’ money because :
  - it earns no interest
  - it is high risk (e.g. debtors not paying, stock becoming obsolete)
- The objective is for the business to operate with as little working capital as possible, and to therefore make what they have work as hard as possible.
- Working Capital Cycle should be as short as possible……

Cash Flow v. Profit

Turnover is Vanity

Profit is Sanity

Cash is Reality

What are your thoughts on this statement ?

Next week

- 1:1's for the next 2 weeks
- Slots will be made available for you to book 15 min slots , turn up at your allotted time to discuss you assignments.
- 27th will be a final open session for a recap of the course and a general open group discussion on the assignment.

What is the effect on profit and cash?

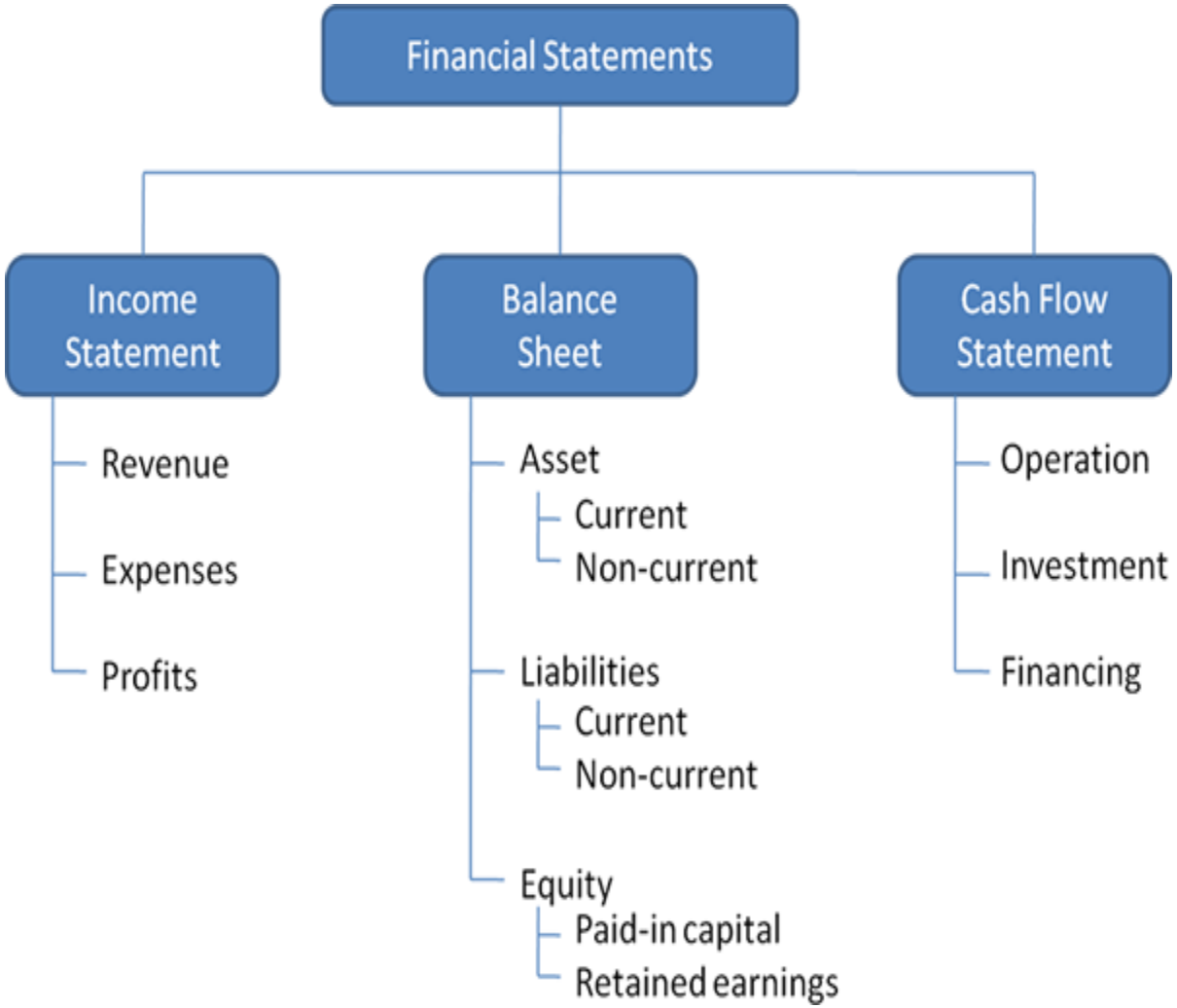
	Effect on Profit	Effect on Cash
1. Repayment of borrowings	none	decrease
2. Making a profitable sale on credit	increase	none
3. Buying a non-current asset on credit	none	none
4. Receiving cash from a credit customer	none	increase
5. Depreciating a non-current asset	decrease	none
6. Buying some inventories for cash	none	decrease
7. Making a share issue for cash	none	increase

Cash Flow v. Profit

Cash flow and profit are different

Cash flow is the money that flows in and out of the business activities, whereas profit is what remains from revenue after all business expenses have been deducted.

A business may be profitable, but it needs cash to survive in order to pay its short-term liabilities

While profitability usually implies good cash flow in the long term, it may not hold true in the short to medium term.

Summary of Financial Statements