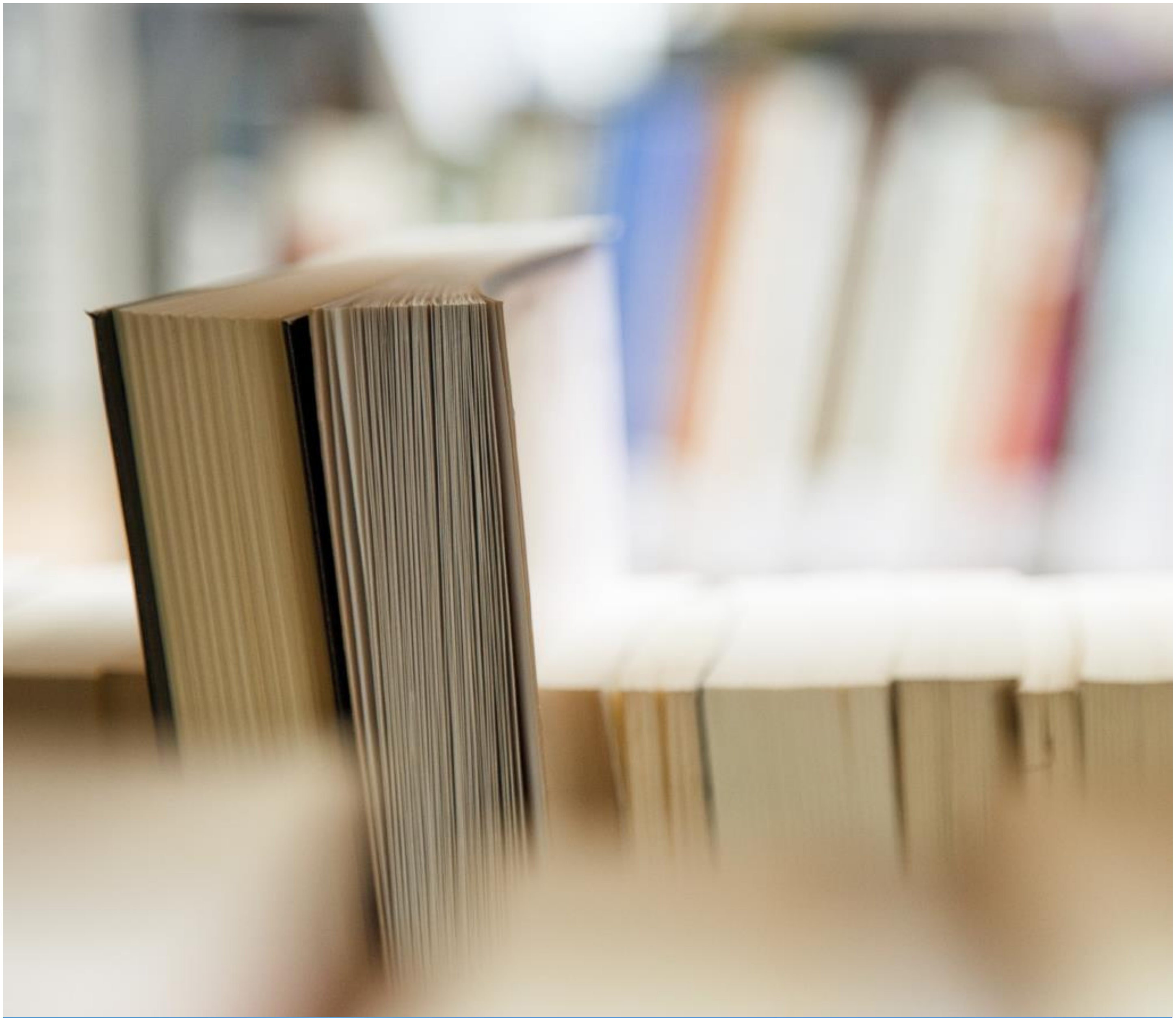

SIMPLE IS BETTER

JIMIT ZAVERI 11/28/17 LUCKY IDIOT

SIMPLE IS BETTER – ISSUE -11 – CASH FLOW STATEMENT

We have seen profit and loss account in Issue-8, Balance sheet in Issue-9 and Relationship between balance sheet and profit & loss account in Issue-10. After understanding of Profit & loss account and Balance sheet, we move forward to the third financial statement in the current issue that is ***"Cash flow statement"***.

"The cash flow statement shows how much cash comes in and goes out of the company over the quarter or the year." - Investopedia

Cash flow statement shows cash inflow and a cash outflow from the business. Income statement gets prepared on the basis of accrual accounting and due to accrual accounting, we check cash flow statement which shows actual cash inflow and outflow and help us to know the liquidity position of the company.

Cash flow statement provide answer to the questions such as - How cash of the firm is get affected?, can the firm able to meet its capital expenditure by operating activities or need to select an external funding option?, payment of dividend from the operating business or from selling any assets or by bringing an borrowing?

Now, before moving towards the understanding of cash flow statement, we understand accrual accounting to the income statement so that we can easily able to understand the importance of the cash flow statement.

Example-

Mr.A has open a shop which is selling a ball-pen. Price of all ball-pen are Rs.10/per ball pen and costing for those ball-pen are Rs.2/ per ball-pen.

Mr.A can able to sell 300 ball-pen at the 1st month. Mr.A has sold all ball-pen on the cash basis. Let's see the income statement of the Mr.A on the 1st month end. Mr.A has sold off all ball-pen on the cash basis than cash profit will be equal to profit at the income statement.

Income Statement			Cash flow statement	
Revenue (300*Rs.10)	3000		Revenue (300*Rs.10)	3000
Cost (300*Rs.2)	600		Cost (300*Rs.2)	600
Profit (R-C)	2400		Cash Profit (R-C)	2400

Now, on the 2nd month, Mr.A has decided to boost up revenue by providing credit to the customers. And due to his credit policy, he can able to sold 600 ball-pen at the 2nd month. From that 600 ball-pen, Mr.A has sold off 200 ball-pen on the credit basis. Let's see income statement for the 2nd month.

Income Statement			Cash flow statement	
Revenue (600*Rs.10)	6000		Revenue (400*Rs.10)	4000
Cost (600*Rs.2)	1200		Cost (600*Rs.2)	1200
Profit (R-C)	4800		Cash Profit (R-C)	2800

Here, in above example, we can able to see that while Mr.A has sold off ball-pen on the cash basis then cash profit and profit at income statement will be equal. But while on 2nd month, Mr.A has sold off 200 ball-pen on the credit basis, then actual cash comes to the Mr.A is Rs.4000 and still, Rs.2000 is pending to get from the customers. Thus, actual cash profit will be different from the profit we show on the income statement. Income statement recognized full revenue on the books but Mr.A does not get Rs.6000 on the 2nd month, actually, he gets Rs.4000 on the 2nd month. And Mr.A has to fulfill all his dues, expenses from those received cash. If Mr.A having a borrowing and he needs to pay an interest of Rs.3000 then Mr.A is not able to meet his interest expenses from his cash earning. He need to bring addition Rs.200 to meet his interest cost (Rs.2800 cash profit - Rs.3000 interest cost = -Rs.200 loss) but income statement shows profit (Rs.4800 profit - Rs.3000 interest cost = Rs.1800 profit). This is the main reason to analyze the cash flow statement.

Now, let's move forward to the understanding a cash flow statement in a simple manner.

Cash flow statement having a three-section which are 1) Cash flow from Operating Activities, 2) Cash flow from Investing Activities, and 3) Cash flow from Financing Activities.

1) Cash flow from Operating Activities (CFO)

The first section of the cash flow statement is CFO which shows that how much cash company can able to generate from sales of the company's goods & services, less cash needed to manufacture goods & services. CFO indicates activities that are directly related to the daily core business operations. Typical operating activities include sales, marketing, manufacturing, technology upgrade, resource hiring etc.

	Year ended March 31, 2017 `	Year ended March 31, 2016 `
A. CASH FLOW FROM OPERATING ACTIVITIES		
Net Profit before tax and extraordinary items	33,13,49,509	34,56,18,985
Adjustments for:		
Depreciation & Amortisation	2,64,84,761	2,52,46,566
Interest received	(3,36,78,177)	(3,38,14,074)
Income from Investments	(83,52,428)	(89,26,731)
Amortisation of Premium on Investments	1,05,485	1,05,744
Dividend received	(48,071)	(5,213)
Rent receipts	(1,94,200)	(1,93,200)
Profit on sale of Fixed Assets	(4,32,249)	(75,15,480)
Interest paid	43,22,886	8,16,418
Operating Profit before Working Capital Changes	**31,95,57,516**	**32,13,33,015**
Adjustments for:		
Trade & other receivables	(9,81,66,959)	(5,00,34,922)
Inventories	(63,98,167)	(69,34,030)
Trade payables	5,32,20,665	6,41,17,213
Cash generated from operations	26,82,13,055	32,84,81,276
Direct Taxes Paid	(14,02,59,519)	(11,48,98,387)
Net Cash from operating activities	**12,79,53,536**	**21,35,82,889**

CFO is calculated by making a certain adjustment into the Net profit before tax. Non-cash expenses, non-core operational expenses are getting added back to Profit before tax and non-cash revenue, non-core operational revenue is get subtracted from profit before tax. As we can able to see in above example that depreciation is non-cash expenses, interest received, income from investment, dividend received, interest paid etc. are non-core operational income/expenses.

After making an above all adjustment, we need to make an adjustment for the changes in working capital. Company's working capital is a core part of daily business activities and if the company cannot able to manage working capital in a proper way then the company will face financial problems. An increase in working capital requires additional cash to be tied up in operations because an increase in current assets is a net outflow. In contrast, a decrease in working capital position means the firm has more cash available that can be used for other projects since an increase in current liabilities is a net inflow.

If receivable decreases mean customers have paid their credit amount and due to it, cash comes to the business. And if receivable increases from one accounting period to the next, the amount of the increase must be deducted from net sales because, although the amounts represented in AR are revenue, they are not cash.

If inventories increase Means Company has purchase more inventories, raw material and due to which cash goes out from the business. If inventories decreases mean company can able to convert its inventories into sales and due to which cash comes into the business.

If payable increases mean company will get the short-term fund to meet its daily core operational needs and if payable decreases mean company has paid off their short-term dues and cash goes out from the business.

After all, above adjustment, we can able to get cash flow from operating activities which means how much cash company can able to generate from the core operations. If CFO continuously comes negative means that company cannot able to generate cash from its core operations. So that for the survival, the company will need to bring additional equity capital or borrowings to the business (Except new businesses, banking, and finance business).

(₹ in Lakhs)

	As at 31 March 2017	As at 31 March 2016	Year ended 31-Mar-2015
Movements in working capital:			
(Increase)/Decrease in Trade receivables	(5,195.99)	(96,522.06)	(72,844.53)
(Increase)/Decrease in Inventories	(12,330.61)	(11,484.22)	(15,314.05)
Increase/(Decrease) in Trade payables	(14,258.46)	44,382.13	32,677.89

(₹ in Lakhs)

	Notes	As at 31 March 2017	As at 31 March 2016	As at 1 April 2015
2 Current liabilities				
(a) Financial liabilities				
(i) Borrowings	24	134,162.99	138,247.09	76,180.25

Continuously increases in receivables and inventories in higher proportion compared to payable which increases need of higher working capital and company cannot able to meet such obligation for the longer period of times than company will fall under the working capital crisis kind of situation; whereas company cannot able to meet its daily core operations and has to bring more external funding to run daily operations.

We need to compare a CFO with the net profit if the company is generating huge net profit but very less CFO then we can say that company is more focusing on boosting up net profit but not focusing on generating more cash.

2) Cash flow from Investing Activities (CFI)

The second section of the cash flow statement is Cash flow from investing activities which shows activities pertaining to investments that the company makes with an intention of reaping benefits at a later stage. CFI reflect that how much cash is spent by a company for capital expenditure such as making an investment into own business for expansion purpose, maintain current position, bringing new technologies etc. also this section reflect the cash utilize for purchasing an investment avenues such as equity shares, bonds, mutual funds, properties etc and getting cash from selling an investment avenues.

	Year ended March 31, 2017	Year ended March 31, 2016
B. CASH FLOW FROM INVESTING ACTIVITIES		
Purchase of fixed assets	(3,82,15,824)	(2,19,53,670)
Sale / Transfer of fixed assets	4,90,476	93,80,000
Sundry Deposits	(9,25,00,000)	-
Loan / advances from / (to) subsidiary company	(24,44,176)	(2,68,05,921)
Fixed deposit with banks withdrawn/(placed) (under lien)	(51,62,087)	1,48,85,411
Interest received	4,40,16,269	3,80,98,197
Dividend received	48,071	5,213
Rent received	1,94,200	1,93,200
Net Cash (used in) / generated from Investing Activities	**(9,35,73,071)**	**1,38,02,430**

In above example, we can able to see that company has utilized cash for purchasing fixed assets, deposits, investment to a subsidiary company, etc and get cash from interest, dividend, a sale of fixed assets, sell off investments. Negative net CFI numbers show that company has utilized more cash to investing activities compared to cash generation from investing activities. In FY16, the company had generated more cash on the net basis means that company had utilized less cash into investing activities compared to cash generation from investing activities.

Cash Flow Consolidated Figures in Rs. Crores / Standalone

Description	Mar 12	Mar 13	Mar 14	Mar 15	Mar 16	Mar 17
Cash From Operating Activity	-6,226.77	-4,354.76	-7,142.77	-1,365.38	-3,239.59	6,234.85
Cash From Investing Activity	**-5,864.18**	**-6,922.35**	**-5,509.87**	**-4,778.15**	**-4,626.56**	**-9,740.24**
Net Fixed Assets	-1,588.26	-1,266.30	356.95	-558.78	4,003.32	-606.33
Net Investments	-1,187.08	-231.49	-3,111.25	-3,838.26	-1,385.18	-2,717.51
Others	-3,088.84	-5,424.56	-2,755.57	-381.11	-7,244.70	-6,416.40
FCF	**-7815.03**	**-5621.06**	**-6785.82**	**-1924.16**	**763.73**	**5628.52**

Results Balance Sheet Consolidated Figures in Rs. Crores / Standalone

Description	Mar 12	Mar 13	Mar 14	Mar 15	Mar 16	Mar 17
Shareholder's Funds	29,386.78	33,859.69	37,711.61	40,909.07	44,180.36	50,216.52
Non-Current Liabilities	42,075.07	52,724.28	60,275.71	70,561.03	61,234.61	67,105.44
Current Liabilities	48,281.71	55,962.21	70,190.00	79,096.62	85,046.43	89,437.96

While we deduct capital expenditure from the cash flow from operating activities then we will get free cash flow; which means that surplus cash with the company after meeting capital expenditure requires for the business. If company having a continuously higher capital expenditure than the company cannot able to generate huge cash as a free cash flow. If company having a continuously negative free cash flow than that means the company cannot able to meets capital expenditure requires for the business from the cash from operating activities. Such business needs to bring further additional funding for continuing with the capital expenditure; which is resulted in increases of long-term borrowing or dilution of the equity capital.

₹ crores

Particulars	Year ended March 31, 2017	Year ended March 31, 2016
Net cash from operating activities	**4,007.19**	**3,722.37**
B. CASH FLOW FROM INVESTING ACTIVITIES		
Capital expenditure on property, plant & equipment and intangible assets including capital advances	(1,238.11)	(1,638.45)
Proceeds from sale of property, plant & equipment	1.58	9.98
Sale of investments	28,334.82	27,032.19
Purchase of investment	(29,048.77)	(27,677.43)
Investment in associates (net of dividend received)	(216.92)	(197.19)
Interest income on financial assets carried at amortised cost	157.47	163.54
Dividend income	37.98	7.18
Net cash (used) in investing activities	**(1,971.95)**	**(2,300.18)**

₹ in crores

Particulars	Note	As at March 31, 2017	As at March 31, 2016	As at April 1, 2015
ASSETS				
Non-current assets				
(e) Financial assets				
(i) Investments	9	1,522.31	1,029.51	913.40
Current assets				
(b) Financial assets				
(i) Investments	9	4,544.06	3,471.57	2,477.63

If a company does not need to utilize cash for the capital expenditure then company utilize excess cash for purchasing investment avenue or paying out a dividend to the shareholders or repurchase outstanding shares. We can see the above example that company is utilizing cash for the purchasing an investment avenue and due to which investment is increasing year-on-year on the balance sheet of the company. Dividend payment & repurchase of shares will be discussed under Cash flow from Financing Activities.

3) Cash flow from Financing Activities (CFF)

The third section of the cash flow statement is known as a Cash flow from Financing Activities which are pertaining to all financial transactions of the company such as distributing dividends, paying interest to service debt, raising fresh debt, issuing corporate bonds, issuing equity/preference shares, repurchase of equity/preference shares etc.

	Year ended March 31,2017	Year ended March 31,2016
C. CASH FLOW FROM FINANCING ACTIVITIES		
Increase / (Decrease) in Long Term Loan	-	-
Increase / (Decrease) in Short Term Loans	6,93,663	-
Dividend paid (including interim Dividend & Dividend Tax)	(3,86,99,430)	(10,99,41,548)
Interest paid	(73,33,165)	(8,16,418)
Net Cash (used in) / generated from financing Activities	(4,53,38,932)	(11,07,57,966)

As the name suggests, this section shows the funding options to meets the operational needs of the business.

Changes in cash from financing are "cash in" when capital is raised, and they're "cash out" when dividends are paid. Thus, if a company issues a bond to the public, the company receives cash financing; however, when interest is paid to bondholders, the company is reducing its cash. In above example, we can able to see that company has repaid its short-term loans, interest on borrowings, distributing dividends to shareholders. Negative Net cash flow from financing activities indicate that company is paying out more cash compare to raising cash from financing options.

(1)

₹ crores

Particulars	Year ended March 31, 2017	Year ended March 31, 2016
C. CASH FLOW FROM FINANCING ACTIVITIES		
Interest paid	(27.40)	(13.97)
Dividends paid	(1,737.34)	(1,397.81)
Tax on dividend	(353.69)	(284.54)
Additions to minority interest	52.72	39.58
Proceeds from issue of equity share capital	1.45	0.56
Proceeds from non current-borrowings	61.92	133.98
Proceeds from current-borrowings	(33.52)	47.47
	(2,035.86)	**(1,474.73)**
Net cash (used) in financing activities	(2,035.86)	(1,474.73)

(2)

(₹ in millions, except share and per share data, unless otherwise stated)

	For the year ended	
	March 31, 2017	March 31, 2016
Cash flows from financing activities:		
Proceeds from issuance of equity shares	^	4
Repayment of loans and borrowings	(112,803)	(137,298)
Proceeds from loans and borrowings	125,922	172,549
Payment for contingent consideration in respect of business combination	(138)	-
Payment for buy back of shares	(25,000)	-
Interest paid on loans and borrowings	(1,999)	(1,348)
Payment of cash dividend (including dividend tax thereon)	(8,734)	(35,494)
Net cash used in financing activities	₹ (22,752)	₹ (1,587)

(₹ in millions, except share and per share data, unless otherwise stated)

	Notes	As at		
		March 31, 2017	March 31, 2016	April 1, 2015
EQUITY AND LIABILITIES				
Equity				
Share capital	15	₹ 4,861	₹ 4,941	₹ 4,937

If there is no need for investing cash into the business then company purchase investment avenues (I.e. seen at CFI section) or paying out a dividend to the shareholders or repurchase outstanding shares. In above 1st example, we can able to see that company is paying out more cash as a dividend to the shareholders and in the 2nd example, we can able to see buyback of share (repurchase of shares) from the shareholders.

Reverse to it, while the company cannot able to meet its capital expenditure from the cash generated from the operating activities then company requires raising additional fund either through debt or through issuing equity capital. As we have seen example in cash flow from investing activities section where free cash flow of the company is negative then company requires raising the fund to meets the investment requirements.

Also, we can able to see that company is paying a dividend to the shareholders from borrowings; the company is not able to generate free cash flow which means that company is paying out a dividend to shareholders either from selling an investment or from additional debt.

Cash Flow Consolidated Figures in Rs. Crores / Standalone

Description	Mar 12	Mar 13	Mar 14	Mar 15	Mar 16	Mar 17
Cash From Operating Activity	-6,226.77	-4,354.76	-7,142.77	-1,365.38	-3,239.59	6,234.85
Cash From Investing Activity	**-5,864.18**	**-6,922.35**	**-5,509.87**	**-4,778.15**	**-4,626.56**	**-9,740.24**
Net Fixed Assets	-1,588.26	-1,266.30	356.95	-558.78	4,003.32	-606.33
Net Investments	-1,187.08	-231.49	-3,111.25	-3,838.26	-1,385.18	-2,717.51
Others	-3,088.84	-5,424.56	-2,755.57	-381.11	-7,244.70	-6,416.40
FCF	**-7815.03**	**-5621.06**	**-6785.82**	**-1924.16**	**763.73**	**5628.52**

	2016-17	2015-16	2014-15	2013-14
	₹ crore	₹ crore	₹ crore	₹ crore
C. Cash flow from financing activities:				
Proceeds from issue of share capital	53.32	70.19	98.89	144.05
Proceeds from non-current borrowings	30900.44	30224.75	29221.10	22261.41
Repayment of non-current borrowings	(27531.88)	(19753.06)	(20836.14)	(10963.87)
Proceeds from other borrowings (net)	1704.64	44.07	3064.37	6123.99
Payment (to)/from non controling interest (net)- including sale proceeds on divestment of part stake in subsidiary companies	2058.82	970.58	1871.10	893.15
Dividends paid	(1701.51)	(1512.33)	(1322.73)	(1140.85)
Additional tax on dividend	(391.54)	(329.91)	(280.10)	(277.50)
Interest paid (including cash flows from interest rate swaps)	(1565.20)	(2461.59)	(3925.74)	(3904.75)
Net cash (used in)/from financing activities	3527.09	7252.70	7890.75	13135.63

After completion of the three section of cash flow statement, we can come to know about the net cash generation or utilization of company. This cash balance we can able to see at the asset side of the balance sheet as a cash balance. Here in below example, we can see that net cash outflow from the company which resulted in a reduction of the cash balance of the company.

₹ crores

Particulars	Year ended March 31, 2017	Year ended March 31, 2016
Net cash from operating activities	4,007.19	3,722.37
Net cash (used) in investing activities	(1,971.95)	(2,300.18)
Net cash (used) in financing activities	(2,035.86)	(1,474.73)
D. INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS (A+B+C)	(0.62)	(52.54)
Cash and cash equivalents at the beginning of the year	74.68	127.22
Cash and cash equivalents at the end of the year	74.06	74.68

Cash flow statement indicates the liquidity position of the company. It shows cash in and out of the business and cash is one of the key element for the continuation of any business. As an investor, we have to focus on the free cash flow generated by the company which indicates that whether the business is strong enough for adopting future growth or not. But it is not always essential that negative CFO or free cash flow indicates weakness of the company. While any company is new to the business or need to expand its footprints then company need to make an additional capex to make stronger its position. We always need to make a detailed study before making any conclusion.

It is similar to our life, if we spend more then what cash we are able to generate then we need to either sell any of our assets, investment or need to bring a debt to survive into our life. If we generate enough revenue and make an investment of that excess surplus then we can able to create a fortune and get a good result in form of dividends.

For further detail, kindly visit - [How to Read the Cash Flow Statement by Safal Niveshak]

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- A Smart, Thoughtful Investor in the Making
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Simple is Better Series

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Disclaimer

Above article is just my perception, and perception can be wrong. For me, my perception can be right but for others, it might be wrong.

I am Grateful to

I am really grateful to - Mr. Neeraj Marathe Sir, Prof. Sanjay Bakshi Sir, Mr. Vishal Khandelwal Sir, Dr. Vijay Malik Sir, Mr. Rajeev Thakkar Sir, Mr. Raunak Onkar Sir, Mr. Vijay Kedia Sir, Mr. Howard Marks, Mr. Warren Buffett, Mr. Charlie Munger, Mr. Benjamin Graham, Mr.Walter Schloss, Mr.Porinju Veliyath

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As a founder of Lucky Idiot; My mission through "Lucky Idiot" is to educate novice investors and to distribute learning to more and more people in a simple manner.

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