

67.2 An exercise on reading the Cash Flow Statement

Figures based on the published Cash Flow Statements of two comparable companies are presented side by side below.

Compare the two statements, comment on the differences, and state, on the basis of the available evidence, with reasons, which company appears to you to be in a better financial position.

Cash Flow Statements	A	B
Cash Flows from Operations	2 116	3 412
interest paid	(159)	(364)
tax (paid) received	3	(429)
Net Cash Flow from Operating Activities	<u>1 960</u>	<u>2 619</u>
Cash Flows from Investing Activities		
purchase of fixed assets	(2 018)	(2 700)
proceeds on disposal of fixed assets	151	664
interest received	112	96
	<u>(1 755)</u>	<u>(1 940)</u>
Cash Flows from Financing Activities		
proceeds from issue of shares	22	123
repayment of loans	(2 049)	(109)
new borrowings	2 056	
dividends paid	(131)	(510)
Net Cash used in Financing Activities	<u>(102)</u>	<u>(496)</u>
Net Increase in Cash	103	183
Cash at 1 January 2050	700	1 146
Cash at 31 December 2050	<u>£ 803</u>	<u>£1 329</u>

Response

It is difficult to judge performance from the Cash Flow Statement alone. We can see for example that B's cash flow from operations is 61% greater than A's. Positive cash flow is good, and more cash is better than less, but we cannot definitely say that B has performed better than A without also comparing the total value invested in each company.

However, bearing such limitations in mind, it is worth pointing out that:

- B is paying proportionately more interest – the company seems to have borrowed more heavily than A or at higher rates of interest
- A has received a tax refund – possibly tax relief in respect of losses

- B is more aggressively renewing its fixed assets, with a higher value of both fixed asset purchases and disposals
- it is curious and worth further investigation that A has received more interest, despite having less cash at the beginning and end of the period
- B has repaid £109 of loans. A seems to have paid off and renewed substantial borrowings, without any great overall increase

Overall, it would seem that both companies are in reasonable health financially – both have been able to increase their fixed asset base and pay dividends without substantial new share issues, and without significant new borrowings.

Comparing the two, B is perhaps in a better state than A. Despite greater investment in fixed assets, and some repayment of debt, B is still able to pay a dividend nearly four times greater than A (but note, we cannot be certain of this interpretation without sight of the balance sheets – B may be required to pay a bigger dividend because it has a greater value of shares in issue).