**Name:**

MGMT 240: Principles of Finance

Week 4 Assignment – Cash Flow

**Instructions**

**Cash Flow Coverage Ratio**

Company XYZ has the following financial information for the year:

* Operating Cash Flow: $800,000
* Total Fixed Expenses: $500,000
* Debt Service Costs: $200,000

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| Cash Flow Coverage Calculation for Company XYZ | * The cash flow coverage ratio is calculated using the formula Operating cash flow / Total Fixed expenses + interest expense. * Cash Flow Coverage Ratio = $800,000 / ($500,000 + $200,000) * = $800,000/ $700,000 = 1.14 or 8:7 |
| What is the significance of the cash flow coverage ratio in assessing a company’s financial health? | The cash flow coverage ratio determines the company's capacity to meet its predetermined debt payments and fixed operational costs about its operating cash flows (Sunmola, 2021). In addition, a ratio greater than 1 shows that the company can generate adequate cash to meet its obligations. A high ratio usually signals potentially strong financial health and a lesser likelihood of experiencing financial crises. It shows the company's safety margin regarding its fixed expenses (Berman & Knight, 2013). |

**Cash Flow Margin**

Company XYZ has the following financial information for the year:

* Net Sales Revenue: $1,500,000
* Cost of Goods Sold: $800,000
* Operating Expenses: $400,000
* Non-operating Income: $50,000
* Taxes Paid: $100,000

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| Cash Flow Margin Calculation | Cash Flow Margin = (Net Sales – Cost of Goods Sold – Operating Expenses + Non-operating Income – Taxes) / Net Sales   * Cash Flow Margin = ($1,500,000 - $800,000 - $400,000 + $50,000 - $100,000) / $1,500,000 = $250,000 / $1,500,000 * $250,000 / $1,500,000 = 0.167 or 16.7% |
| Discuss the importance of the cash flow margin in evaluating a company's profitability | The cash flow margin shows how much cash a company generates from sales. It reveals the ability of the company to convert its sales into cash within the shortest period possible. A high cash flow margin shows that the company is more profitable and has a more significant potential to generate more cash from its sales, which is a good indicator of the quality of earnings (Berman & Knight, 2013). |

**Operating Cash Flow Ratio**

Company XYZ has the following financial information for the year:

* Net Income: $500,000
* Depreciation Expense: $100,000
* Interest Expense: $50,000
* Income Tax Expense: $75,000

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| Calculations:   1. Operating cash flow 2. Operating cash flow ratio | * Operating Cash Flow = Net Income + Depreciation + Interest Expense + Income Tax Expense * $500,000 + $100,000 + $50,000 + $75,000 = $725,000 * Operating Cash Flow Ratio = Operating Cash Flow / Current Liabilities * No current liabilities * Consider operating cash flow to net income ratio = Operating cash flow / Net Income. * Operating cash flow to net income ratio = $725,000 / $500,000 = 1.45 or 29:20. |

**Cash Flow Return on Investment (CFROI)**

Company XYZ has the following financial information for the year:

* Initial Investment: $1,000,000
* Operating Cash Flow (annual): $200,000
* Terminal Value (end of investment period): $1,500,000
* Investment period: 5 years

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| CFROI Calculation | CFROI = (Annual Operating Cash Flow + Terminal Value - Initial Investment) / (Initial Investment × Investment Period)  = ($200,000 × 5 + $1,500,000 - $1,000,000) / ($1,000,000 × 5)  = ($1,000,000 + $1,500,000 - $1,000,000) / $5,000,000  = $1,500,000 / $5,000,000 = 0.30 or 30% |
| Define CFROI and discuss factors that influence it | The CFROI expresses the return on total cash generated relative to the company's capital, indicating its performance in creating value. Factors affecting CFROI include operating cash flows since higher efficient cash flows improve returns and investment costs because low initial investment gives high CFROI. Also, a terminal value is important; a high residual value in the terminal period enhances the return value. Finally, investment duration influences CFROI because long investments produce lower annualized returns; hence, high-return short investments are the most appropriate (Berman & Knight, 2013). |

**Cash Conversion Cycle**

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| Explain how the cash conversion cycle affects a company's liquidity and working capital management. | The cash conversion cycle (CCC) refers to the time resources trapped in the working capital cycle before generating cash inflows. It is used in liquidity management, working capital analysis, and evaluating business performance (Berman & Knight, 2013). A shorter CCC increases the cash flow, reduces reliance on external financing, and increases the overall liquidity. CCC management contributes to low inventory and receivables, aligns stock with sales, and enables companies to negotiate favorable repayment terms. From a financial perspective, a low CCC means better operating profitability, lower cost of financing, and higher reinvestment and growth possibilities. |

**References**

Berman, K., & Knight, J. (2013). Financial intelligence: A manager's guide to knowing what the numbers really mean (Rev. ed.). Harvard Business Review Press.

Sunmola, P. T. (2021). *The Use of Cash Flow Ratios for Risk Evaluation in An Organisation* (Doctoral dissertation, Bachelor’s thesis, Tallinn: Tallinn University of Technology School of Business and Governance).