

CONCEPT: RATIOS – FREE CASH FLOW (FCF)

● **Free Cash Flow (FCF)** measures the cash that was earned from _____

- ☐ Cash from Operating Activities on the Statement of Cash Flows indicates the company's cash-generating power
- ☐ We reduce this amount for necessary investments in fixed assets and necessary dividends to stockholders
- ☐ The remainder is the free cash flow. In finance, FCF is important: the focus is on cash, rather than income

$$FCF = \text{Cash Provided from Operating Activities} - \text{Capital Expenditures} - \text{Cash Dividends}$$

Note: Some FCF calculations ignore dividends: Double check with your professor for the calculation you will use!

Analysis: FCF helps investors understand the amount of cash generated to expand operations or pay dividends.

A negative FCF could indicate that Operating Cash Flows are _____. However, negative FCF can also indicate _____ into fixed assets that can provide more cash flows in the future.

PRACTICE: ABC Company's Statement of Cash Flows indicated the following: Cash Flows from Operating Activities \$120,000; Cash Flows from Investing Activities (\$80,000); and Cash Flows from Financing Activities \$200,000. Other information includes the purchase of Land for \$25,000 and Machinery for \$15,000. During the year, ABC Company paid \$10,000 in dividends. What is ABC's free cash flow?

- a) \$30,000
- b) \$40,000
- c) \$70,000
- d) \$240,000

PRACTICE: XYZ Company uses the indirect method to calculate cash flows from operating activities. This year the cash flows from operating activities totaled \$60,000. The company paid \$10,000 in dividends and obtained a loan from the bank of \$50,000. The company also purchased Equipment for \$20,000 and Land for \$10,000. What is XYZ's free cash flow?

- a) \$20,000
- b) \$50,000
- c) \$60,000
- d) \$70,000