Twitter Thread by Value Educator

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Net Profit vs Cash Flow from operations (CFO) - What is more important?

A short thread with examples

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1. Net income is the profit a company has earned for a period, while cash flow from operations measures the cash going in and out during a company's day-to-day operations i.e., the cash which is generated through its core business.

Net Profit

Net Profit Calculation	
	Sales
-	Cost of goods sold (COGS)
	Gross Profit
-	Selling, general & admin expenses
	EBITDA
-	Depreciation & Ammortization
	EBIT
-	Finance cost
	EBT
-	Taxes
	Net Profit

Cash Flow from Operations (CFO)

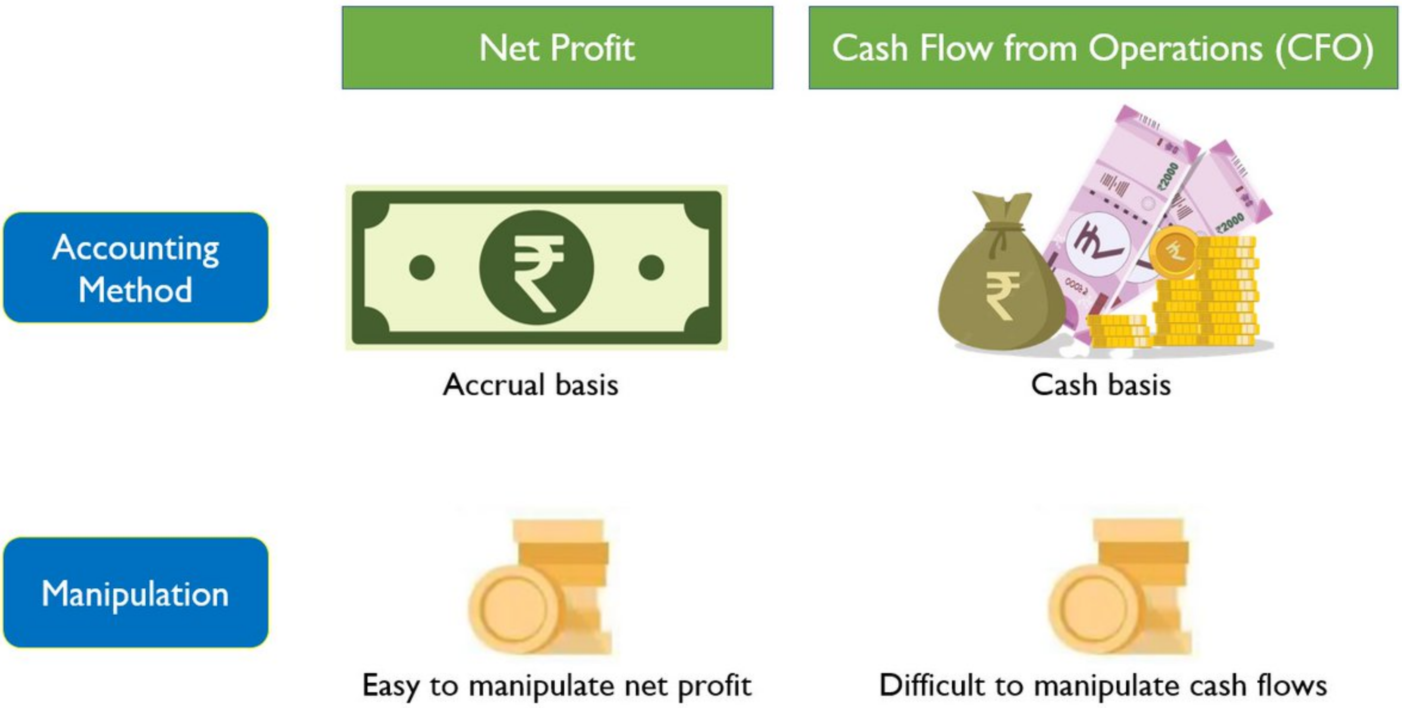
Cash Flow from Operations (CFO) Calculation	
	Net Profit
+	Depreciation & Ammortization
-	Changes in working capital
	Cash Flow from Operations (CFO)

2. Net income is calculated by subtracting the cost of goods sold, operating expenses, depreciation & amortization, interest expense and taxes from total revenue.

3. Cash flow from operations is calculated by adding the non-cash expenses such as depreciation and amortization to the net profit and then subtracting the changes in working capital.

Now lets understand few differences between Net Profit and Cash Flow from operations (CFO)

1. Net profit is recorded on an accrual basis whereas CFO deals with only cash items. Income earned is recorded in the net profit even if cash is not received



whereas CFO deals with only cash items.

2. Since the net profit is recorded on an accrual basis it's a bit easy to manipulate net profit as compared to CFO.

Let’s understand this with some examples.

Case 1: AMI Organics
If we check in the case of AMI organics, in FY22 its CFO was negative even though net profit was positive. It was because its changes in working capital were greater than net profit in FY22.

AMI ORGANICS LIMITED

(₹ Crores)

	FY16	FY17	FY18	FY19	FY20	FY21	FY22
Net Profit	12.66	12.05	18.50	23.30	27.47	54.00	71.95
Cash Flow from Operations (CFO)	9.86	28.54	8.46	14.84	27.08	27.96	-8.66

Also in multiple years like FY21, FY19, FY18, FY16 etc the CFO was less than the net profit.

Case 2: HCG

Similarly if we check in the case of Healthcare Global (HCG), its CFO has always been greater than its net profit. This is because HCG is a speciality hospital chain and in hospitals the depreciation costs are so high that the company looks loss making

adding life to years

(₹ Crores)

	FY16	FY17	FY18	FY19	FY20	FY21	FY22
Net Profit	-1.46	22.17	20.52	-24.80	-107.00	-193.00	53.73
Cash Flow from Operations (CFO)	73.20	91.28	97.81	98.50	130.00	121.00	220.00

but if we look at CFO we get to know that it is actually generating cash. So CFO can be one of the good measures while analysing hospitals.

Conclusion:

1. Suppose if a company is outsourcing its manufacturing vs a company is manufacturing the products in-house. The company which is outsourcing has no plant and equipment so it will record high net profit since its depreciation costs will be low as compared to a company which is manufacturing the product in-house. So in such a case looking at the CFO makes more sense.

2. Also in some industries such as hospitals, the depreciation costs are so high that the company looks loss making but if we look at CFO we get to know that it is actually generating cash as we saw in the case of HCG.

3. So rather than only looking at the net profit it is very important to check how much cash the company is generating through its core operations.

So CFO is one of the important metrics to look for.

Micro Cap Club : https://t.co/mc3mTAviKQ