Twitter Thread by Ali Ladha

Ali Ladha
@AliTheCFO

STOP focusing on Profit

START focusing on Cash Flow

Cash Flow Statement 101:

Every company has 3 reports in its financial statements

1. Balance sheet
2. Income statement
3. Cash flow statement

Most people focus on the Income Statement to look at PROFIT

There is nothing wrong with this…

But profit, isn't CASH FLOW

Profit is an accounting measure

It doesn't tell you how much MONEY actually came into the business

Sounds confusing?

Let's look at an example:

In 2021 Google's profit was: $76 billion

Alphabet Inc.
CONSOLIDATED STATEMENTS OF INCOME
(In millions, except share amounts which are reflected in thousands and per share amounts)

	Quarter Ended December 31,		Year Ended December 31,	
	2020	2021	2020	2021
	(unaudited)			(unaudited)
Revenues	$ 56,898	$ 75,325	$ 182,527	$ 257,637
Costs and expenses:				
Cost of revenues	26,080	32,988	84,732	110,939
Research and development	7,022	8,708	27,573	31,562
Sales and marketing	5,314	7,604	17,946	22,912
General and administrative	2,831	4,140	11,052	13,510
Total costs and expenses	41,247	53,440	141,303	178,923
Income from operations	15,651	21,885	41,224	78,714
Other income (expense), net	3,038	2,517	6,858	12,020
Income before income taxes	18,689	24,402	48,082	90,734
Provision for income taxes	3,462	3,760	7,813	14,701
Net income	$ 15,227	$ 20,642	$ 40,269	$ 76,033
Basic earnings per share of Class A and B common stock and Class C capital stock	$ 22.54	$ 31.15	$ 59.15	$ 113.88
Diluted earnings per share of Class A and B common stock and Class C capital stock	$ 22.30	$ 30.69	$ 58.61	$ 112.20
Number of shares used in basic earnings per share calculation	675,582	662,663	680,816	667,650
Number of shares used in diluted earnings per share calculation	682,969	672,493	687,028	677,674

You would think that if Google's profit was $76 billion...

The cash in Google's bank account would also increase by $76 billion?

Not quite..

If you look at Google's bank account,

From 2020 to 2021, CASH actually went DOWN ■■

From $26.4 billion to $20.9 billion

This is a reduction of $5.5 billion

	As of December 31, 2020	As of December 31, 2021 (unaudited)
Assets		
Current assets:		
Cash and cash equivalents	$ 26,465	$ 20,945
Marketable securities	110,229	118,704
Total cash, cash equivalents, and marketable securities	136,694	139,649
Accounts receivable, net	30,930	39,304
Income taxes receivable, net	454	966
Inventory	728	1,170
Other current assets	5,490	7,054
Total current assets	174,296	188,143



So let’s get this straight…

Google MADE $76 billion in profit

But its cash balance went DOWN by almost $5.5 billion?

If a company makes a profit, shouldn’t its cash balance go up?!?

What's going on here?!

How can we uncover this mismatch between profit and cash?

By looking at the CASH FLOW statement

The cash flow statement tells you 3 things:

1. How PROFIT was converted into CASH

2. How that cash was used

3. How you got the cash balance in your bank account

In the case of Google,

The Cash Flow Statement starts with $76 billion in profit

And ends with a decrease of $5.5 billion in cash

Alphabet Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)

	Quarter Ended December 31,		Year Ended December 31,	
	2020	2021 (unaudited)	2020	2021 (unaudited)
Operating activities				
Net income	$ 15,227	$ 20,642	$ 40,269	$ 76,033
Adjustments:				
Depreciation and impairment of property and equipment	3,539	3,215	12,905	11,555
Amortization and impairment of intangible assets	186	224	792	886
Stock-based compensation expense	3,223	3,954	12,991	15,376
Deferred income taxes	1,670	1,616	1,390	1,808
Gain on debt and equity securities, net	(3,262)	(2,478)	(6,317)	(12,270)
Other	392	(14)	1,267	(213)
Changes in assets and liabilities, net of effects of acquisitions:				
Accounts receivable	(5,445)	(5,819)	(6,524)	(9,095)
Income taxes, net	740	(3,369)	1,209	(625)
Other assets	(738)	(399)	(1,330)	(1,846)
Accounts payable	963	1,157	694	283
Accrued expenses and other liabilities	4,613	4,541	5,504	7,304
Accrued revenue share	1,362	1,296	1,639	1,682
Deferred revenue	207	368	635	774
Net cash provided by operating activities	22,677	24,934	65,124	91,652
Investing activities				
Purchases of property and equipment	(5,479)	(6,383)	(22,281)	(24,640)
Purchases of marketable securities	(31,644)	(40,090)	(136,576)	(135,196)
Maturities and sales of marketable securities	35,155	36,168	132,906	128,294
Purchases of non-marketable securities	(5,311)	(770)	(7,175)	(2,838)
Maturities and sales of non-marketable securities	425	344	1,023	934
Acquisitions, net of cash acquired, and purchases of intangible assets	(370)	(385)	(738)	(2,618)
Other investing activities	(57)	100	68	541
Net cash used in investing activities	(7,281)	(11,016)	(32,773)	(35,523)
Financing activities				
Net payments related to stock-based award activities	(1,647)	(2,923)	(5,720)	(10,162)
Repurchases of common and capital stock	(7,904)	(13,473)	(31,149)	(50,274)
Proceeds from issuance of debt, net of costs	0	6,250	11,761	20,199
Repayments of debt	(57)	(6,365)	(2,100)	(21,435)
Proceeds from sale of interest in consolidated entities, net	338	0	2,800	310
Net cash used in financing activities	(9,270)	(16,511)	(24,408)	(61,362)
Effect of exchange rate changes on cash and cash equivalents	210	(181)	24	(287)
Net increase (decrease) in cash and cash equivalents	6,336	(2,774)	7,967	(5,520)
Cash and cash equivalents at beginning of period	20,129	23,719	18,498	26,465
Cash and cash equivalents at end of period	$ 26,465	$ 20,945	$ 26,465	$ 20,945

In essence, the Cash Flow Statement is saying:

In 2021:

Google Made a PROFIT of $76 billion

But lost $5.5 billion of Cash

Let’s dig into why this happened:

As you can tell from the graphic, the cash flow statement has three sections:

1. Cash flow from Operating Activities
2. Cash flow from Investing Activities
3. Cash flow from Financing Activities

We’ll cover each of them:

Cash flow from Operating Activities

Tells you:

• How profit was converted into cash
• How much cash the business made

In the case of Google,

The company made $76 billion of profit in 2021

But it actually collected COLD HARD cash of $91.6 billion during the year

Cash collected at Google was HIGHER than Profit!

Alphabet Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)

	Quarter Ended December 31,		Year Ended December 31,	
	2020	2021	2020	2021
	(unaudited)			(unaudited)
Operating activities				
Net income	$ 15,227	$ 20,642	$ 40,269	$ 76,033
Adjustments:				
Depreciation and impairment of property and equipment	3,539	3,215	12,905	11,555
Amortization and impairment of intangible assets	186	224	792	886
Stock-based compensation expense	3,223	3,954	12,991	15,376
Deferred income taxes	1,670	1,616	1,390	1,808
Gain on debt and equity securities, net	(3,262)	(2,478)	(6,317)	(12,270)
Other	392	(14)	1,267	(213)
Changes in assets and liabilities, net of effects of acquisitions:				
Accounts receivable	(5,445)	(5,819)	(6,524)	(9,095)
Income taxes, net	740	(3,369)	1,209	(625)
Other assets	(738)	(399)	(1,330)	(1,846)
Accounts payable	963	1,157	694	283
Accrued expenses and other liabilities	4,613	4,541	5,504	7,304
Accrued revenue share	1,362	1,296	1,639	1,682
Deferred revenue	207	368	635	774
Net cash provided by operating activities	22,677	24,934	65,124	91,652

Cash flow from Investing Activities

Tells you:

- What assets did the company buy?
- Did the company do any M&A?

In the case of Google,

The company spent $35.5 billion buying:

- Property and equipment
- Marketable securities (bonds and stocks)
- Making acquisitions (M&A)

Investing activities				
Purchases of property and equipment	(5,479)	(6,383)	(22,281)	(24,640)
Purchases of marketable securities	(31,644)	(40,090)	(136,576)	(135,196)
Maturities and sales of marketable securities	35,155	36,168	132,906	128,294
Purchases of non-marketable securities	(5,311)	(770)	(7,175)	(2,838)
Maturities and sales of non-marketable securities	425	344	1,023	934
Acquisitions, net of cash acquired, and purchases of intangible assets	(370)	(385)	(738)	(2,618)
Other investing activities	(57)	100	68	541
Net cash used in investing activities	(7,281)	(11,016)	(32,773)	(35,523)

Cash flow from Financing Activities

Tells you:

• Did the company raise money from investors?
• Did the company get a loan?

In the case of Google

The company spent $61.3 billion on:

• Buying back stock
• Paying back debt
• Issuing stock rewards

Financing activities				
Net payments related to stock-based award activities	(1,647)	(2,923)	(5,720)	(10,162)
Repurchases of common and capital stock	(7,904)	(13,473)	(31,149)	(50,274)
Proceeds from issuance of debt, net of costs	0	6,250	11,761	20,199
Repayments of debt	(57)	(6,365)	(2,100)	(21,435)
Proceeds from sale of interest in consolidated entities, net	338	0	2,800	310
Net cash used in financing activities	(9,270)	(16,511)	(24,408)	(61,362)

So the final tally is:

• Cash Flow from Operating Activities: $91.6 billion

• Cash Flow from Investing Activities: ($35.5) billion

• Cash Flow from Financing Activities: ($61.3) billion

The sum makes up the decrease in cash of ($5.5) billion

(minor diff. due to f/x)

So what does this mean?

It means Google generates INSANE amounts of cash to the tune of $91 billion per year

However, the company also SPENDS all of this cash

It is spent on FINANCING and INVESTING activities until it's in a negative position of $5.5 billion

Is this a bad thing?

No.

If Google is investing in new equipment, that's probably a good long-term decision for the company

If Google is buying back stock, that rewards its shareholders

You're probably asking yourself….

But if Google made $91 billion in cash, shouldn't it keep some of itself?

Google can actually afford to go into a negative cash position because its balance sheet is actually FLUSH with CASH

At the end of 2021, Google had $20.9 billion of cash

Google also had $118.8 billion of marketable securities (stocks and bonds) that can be sold and converted to cash.

So Google's total cash + marketable securities otherwise called "cash equivalents" balance was $139.6 billion

Alphabet Inc.
CONSOLIDATED BALANCE SHEETS
(In millions, except share amounts which are reflected in thousands and par value per share amounts)

	As of December 31, 2020	As of December 31, 2021 (unaudited)
Assets		
Current assets:		
Cash and cash equivalents	$ 26,465	$ 20,945
Marketable securities	110,229	118,704
Total cash, cash equivalents, and marketable securities	136,694	139,649

Hopefully, now it's starting to make sense why the company doesn't need to keep its cash and it can spend it all...

The company already has so much CASH on hand!

Adding another $91 billion is not necessary

The executives at Google chose to spend the cash on investments and give it back to shareholders instead of adding more cash to the company's bank account

TL;DR

• Profit is an accounting measure

• Profit doesn’t tell you how much CASH was made

• Uncover the mismatch between profit and Cash Flow

• The Cash Flow Statement explains How PROFIT was converted into CASH

If you learned something new in this thread, retweet it!

Let's learn together and follow @AliTheCFO

I tweet about:

• Finance
• Business
• Personal Growth