Chapter 5
WALKING THROUGH FROM EARNINGS TO CASH FLOW

Or how to move mountains together!

Chapter 2 showed the structure of the cash flow statement, which brings together all the receipts and payments recorded during a given period and determines the change in net debt position.

Chapter 3 covered the structure of the income statement, which summarises all the revenues and charges during a period.

It may appear that these two radically different approaches have nothing in common. But common sense tells us that a rich woman will sooner or later have cash in her pocket, while a poor woman is likely to be strapped for cash – unless she should make her fortune along the way.

Although the complex workings of a business lead to differences between profits and cash, they converge at some point or another.

The aim of this chapter is to reconcile the cash flow and earnings approaches.

First of all, we will examine revenues and charges from a cash flow standpoint. Based on this analysis, we will establish a link between changes in wealth (earnings) and the change in net debt that bridges the two approaches.

We recommend that readers get to grips with this chapter, because understanding the transition from earnings to the change in net debt represents a key step in comprehending the financial workings of a business.

Section 5.1
ANALYSIS OF EARNINGS FROM A CASH FLOW PERSPECTIVE

This section is included merely for explanatory and conceptual purposes. Even so, it is vital to understand the basic financial workings of a company.

1/ OPERATING REVENUES

Operating receipts should correspond to sales for the same period, but they differ because:

- customers may be granted a payment period; and/or
- payments of invoices from the previous period may be received during the current period.

As a result, operating receipts are equal to sales only if sales are immediately paid in cash. Otherwise, they generate a change in trade receivables.

Sales for the period	−	Increase in trade receivables	=	Operating receipts
		or		
	+	Reduction in trade receivables		

2/ CHANGES IN INVENTORIES OF FINISHED GOODS AND WORK IN PROGRESS

As we have already seen in by-nature income statements, the difference between production and sales is adjusted for through changes in inventories of finished goods and work in progress.[1] But this is merely an accounting entry to deduct from operating costs, costs that do not correspond to products sold. It has no impact from a cash standpoint.[2] As a result, changes in inventories need to be reversed in a cash flow analysis.

1 *This adjustment is not necessary in by-function income statements as explained in Chapter 3.*

2 *In accounting parlance, this is known as a "closing entry".*

3/ OPERATING COSTS

Operating costs differ from operating payments in the same way as operating revenues differ from operating receipts. Operating payments are the same as operating costs for a given period only when adjusted for:

- timing differences arising from the company's payment terms (credit granted by its suppliers, etc.);
- the fact that some purchases are not used during the same period. The difference between purchases made and purchases used is adjusted for through change in inventories of raw materials.

These timing differences give rise to:

- changes in trade payables in the first case;
- discrepancy between raw materials used and purchases made, which is equal to change in inventories of raw materials and goods for resale.

Operating payments = operating costs except depreciation, amortisation and impairment losses	+	reduction in supplier credit
		or
	−	increase in supplier credit
	+	increase in inventories of raw materials and good for resale
		or
	−	reduction in inventories of raw materials and good for resale

The only differences between operating revenues and receipts and between operating charges and payments are timing differences deriving from deferred payments (payment terms) and deferred charges (changes in inventories).

The total amount of the timing differences between operating revenues and charges and between operating receipts and payments can thus be summarised as follows for by-nature and by-function income statements:

	BY-NATURE INCOME STATEMENT		DIFFERENCE	CASH FLOW STATEMENT
	Net sales	–	Change in trade receivables (deferred payment)	= **Operating receipts**
+	**Changes in inventories of finished goods and work in progress**	–	Changes in inventories of finished goods and work in progress (deferred charges)	
–	**Operating costs except depreciation, amortisation and impairment losses**	+	Change in trade payables (deferred payments)	
		–	Change in inventories of raw materials and goods for resale (deferred charges)	= – **Operating payments**
=	**EBITDA**	–	Change in operating working capital	= **Operating cash flows**

	BY-FUNCTION INCOME STATEMENT		DIFFERENCE	CASH FLOW STATEMENT
	Net sales	–	Change in trade receivables (deferred payment)	= **Operating receipts**
–	**Operating costs except depreciation, amortisation and impairment losses**	+	Change in trade payables (deferred payments)	
		–	Change in inventories of finished goods, work in progress, raw materials and goods for resale (deferred changes)	= – **Operating payments**
=	**EBITDA**	–	Change in operating working capital	= **Operating cash flows**

Astute readers will have noticed that the items in the central column of the above table are the components of the change in operating working capital between two periods, as defined in Chapter 4.

Over a given period, the change in operating working capital represents a need for, or a source of, financing that must be added to or subtracted from the other financing requirements or resources.

The change in operating working capital accounts for the difference between EBITDA and operating cash flow.

If positive, it represents a financing requirement, and we refer to an increase in operating working capital. If negative, it represents a source of funds, and we refer to a reduction in operating working capital.

The change in working capital merely represents a straightforward timing difference between the balance of operating cash flows (operating cash flow) and the wealth created by the operating cycle (EBITDA). As we shall see, it is important to remember that timing differences may not necessarily be small, of limited importance, short or negligible in any way.

The analysis of changes in working capital is one of the pillars of financial analysis.

4/ CAPITAL EXPENDITURE

Capital expenditures[3] lead to a change in what the company owns without any immediate increase or decrease in its wealth. Consequently, they are not shown directly on the income statement. Conversely, capital expenditures have a direct impact on the cash flow statement.

3 *Or investments in xed assets.*

From a capital expenditure perspective, there is a fundamental difference separating the income statement and the cash flow statement. The income statement spreads the capital expenditure charge over the entire life of the asset (through depreciation), while the cash flow statement records it only in the period in which it is purchased.

A company's capital expenditure process leads to both cash outflows that do not diminish its wealth at all and the accounting recognition of impairment in the purchased assets through depreciation and amortisation that does not reflect any cash outflows.

Accordingly, there is no direct link between cash flow and net income for the capital expenditure process, as we knew already.

5/ FINANCING

Financing is by its very nature a cycle that is specific to inflows and outflows. Sources of financing (new borrowings, capital increases, etc.) do not appear on the income statement, which shows only the remuneration paid on some of these resources, i.e. interest on borrowings but not dividend on equity.[4]

Outflows representing a return on sources of financing may be analysed as either charges (i.e. interest) or a distribution of wealth created by the company among its equity capital providers (i.e. dividends).

4 *Except in the UK where companies deduct dividends from net income and end the income statement with "retained pro t".*

The distinction between capital and interest payments is not of paramount importance in the cash flow statement, but is essential in the income statement.

To keep things simple, assuming that there are no timing differences between the recognition of a cost and the corresponding cash outflow, a distinction needs to be drawn between:

- interest payments on debt financing (financial expense) and income tax which affect the company's cash position and its earnings;
- the remuneration paid to equity capital providers (dividends) which affects the company's cash position and earnings transferred to reserves;
- new borrowings and repayment of borrowings, capital increases and share buy-backs[5] which affect its cash position, but have no impact on earnings.

5 *When a company buys back some of its shares from some of its shareholders. For more see Chapter 38.*

Lastly, corporate income tax represents a charge that appears on the income statement and a cash payment to the State which, though it may not provide any financing to the company, provides it with a range of free services and entitlements, e.g. police, education, roads, etc.

We can now finish off our table and walk through from earnings to decrease in net debt:

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FROM THE INCOME STATEMENT . . . TO THE CASH FLOW STATEMENT

	INCOME STATEMENT		DIFFERENCE		CASH FLOW STATEMENT
	EBITDA	−	Change in operating working capital	=	**Operating cash flow**
		−	Capital expenditure	=	− Capital expenditure
		+	Disposals	=	+ Disposals
−	Depreciation, amortisation and impairment losses on fixed assets	+	Depreciation, amortisation and impairment losses on fixed assets (non-cash charges)	=	
=	**EBIT (Operating profit)**			=	**Free cash flow before tax**
−	Financial expense net of financial income			=	− Financial expense net of financial income
−	Corporate income tax			=	− Corporate income tax
		+	Proceeds from share issues	=	+ Proceeds from share issues
		−	Share buy-backs		− Share buy-backs
		−	Dividends paid	=	− Dividends paid
=	**Net income (net earnings)**	+	Column total		= **Decrease in net debt**

Section 5.2
CASH FLOW STATEMENT

The same table enables us to move in the opposite direction and thus account for the decrease in net debt based on the income statement. To do so, we simply need to add back all the movements shown in the central column to net profit.

	Net income
+	Depreciation, amortisation and impairment losses on fixed assets
–	Change in operating working capital
–	Capital expenditure net of asset disposals
+	Disposals
+	Proceeds from share issue
–	Share buy-backs
–	Dividends paid
=	**Decrease in net debt**

The following reasoning may help our attempt to classify the various line items that enable us to make the transition from net income to decrease in net debt.

Net income should normally turn up in "cash at hand". This said, we also need to add back certain noncash charges (depreciation, amortisation and impairment losses on fixed assets) that were deducted on the way down the income statement but have no cash impact, to arrive at what is known as **cash flow**.

Cash flow will appear in "cash at hand" only once the timing differences related to the operating cycle as measured by change in operating working capital have been taken into account.

Lastly, the investing and financing cycles give rise to uses and sources of funds that have no immediate impact on net income.

1/ FROM NET INCOME TO CASH FLOW

As we have just seen, depreciation, amortisation, impairment losses on fixed assets and provisions are non-cash charges that have no impact on a company's cash position. From a cash flow standpoint, they are no different from net income.

Consequently, they are added back to net income to show the total financing generated internally by the company.

These two items form the company's cash flow, which accountants allocate between net income on the one hand, and depreciation, amortisation and impairment losses on the other hand, according to the relevant accounting and tax legislation.

Cash flow can therefore be calculated by adding certain noncash charges net of write-backs to net income.

The simplicity of the cash flow statement shown in Chapter 2 was probably evident to our readers, but it would not fail to shock traditional accountants, who would find it hard to accept that financial expense should be placed on a par with repayments of borrowings. Raising debt to pay financial expense is not the same as replacing one debt with another. The former makes the company poorer, whereas the latter constitutes liability management.

As a result, traditionalists have managed to establish the concept of cash flow. We need to point out that we would advise computing cash flow before any capital gains (or losses) on asset disposals and before nonrecurring items, which do not affect it.

Cash flow is not as pure a concept as EBITDA. This said, a direct link may be established between these two concepts by deriving cash flow from the income statement using the top-down method:

	EBITDA
–	Financial expense net of financial income
–	Corporate income tax
=	Cash flow

or the bottom-up method:

	Net income
+	Depreciation, amortisation and impairment losses
+/–	Capital losses/gains on asset disposal
+/–	Other non cash items
=	Cash flow

Cash flow is influenced by the same accounting policies as EBITDA. Likewise, it is not affected by the accounting policies applied to tangible and intangible fixed assets.

Note that the calculation method differs slightly for consolidated accounts[6] since the contribution to consolidated net profit made by equity-accounted income is replaced by the dividend payment received. This is attributable to the fact that the parent company does not actually receive the earnings of an associate company,[6] since it does not control it, but merely receives a dividend.

Furthermore, cash flow is calculated at group level without taking into account minority interests. This seems logical since the parent company has control of and allocates the cash flows of its fully-consolidated subsidiaries.[6] In the cash flow statement, minority interests[6] in the controlled subsidiaries are reflected only through the dividend payments that they receive.

Lastly, readers should beware of cash flow as there are nearly as many definitions of cash flow as there are companies in the world!

The upper definition is widely used, but frequently free cash flows, cash flow from operating activities, and operating cash flow are simply called "cash flow" by some professionals. So it is safest to check which cash flow they are talking about.

6 *For details on consolidated accounts, see Chapter 6.*

2/ FROM CASH FLOW TO CASH FLOW FROM OPERATING ACTIVITIES

We introduced in Chapter 2 the concept of cash flow from operating activities, which is not the same as cash flow.

To go from cash flow to cash flow from operating activities, we need to adjust for the timing differences in cash flows linked to the operating cycle.

This gives us the following equation:

Cash flow from operating activities = Cash flow – Change in operating working capital.

Note that the term "operating activities" is used here in a fairly broad sense of the term, since it includes financial expense and corporate income tax.

3/ OTHER MOVEMENTS IN CASH

We have now isolated the movements in cash deriving from the operating cycle, so we can proceed to allocate the other movements to the investment and financing cycles.

The investment cycle includes:

- capital expenditures (acquisitions of tangible and intangible assets);
- disposals of fixed assets, i.e. the price at which fixed assets are sold and not any capital gains or losses (which do not represent cash flows);
- changes in long-term investments (i.e. financial assets).

Where appropriate, we may also factor in the impact of timing differences in cash flows generated by this cycle, notably non-operating working capital (e.g. amount owed to a supplier of fixed asset).

The financing cycle includes:

- capital increases in cash, the payment of dividends (i.e. payment out of the previous year's net profit) and share buy-backs;
- change in net debt resulting from the repayment of (short-, medium- and long-term) borrowings, new borrowings, changes in marketable securities (short-term investments) and changes in cash and equivalents.

This brings us back to the cash flow statement in Chapter 2, but using the indirect method, which starts with net income and classifies cash flows by cycle (i.e. operating, investing or financing activities; see next page):

This format calls for the following comments:

(a) Even though the order used in cash flow statements indicates the pre-eminence of operating activities, it is important to recognise that operating activities are to some extent a catch-all category containing all the items not allocated to investing or financing activities. Indeed, the scope of operating activities is in most cases different from the operating cycle in the strict sense of the term, as described in Chapter 2. Aside from the items falling within a narrower definition of the operating cycle, operating activities include financial expense and income tax, which logic dictates should appear under financing activities or be split among the three cycles.

Readers may legitimately ask whether the best indicator of the company's operating performance is:

- operating cash flow minus theoretical tax on operating profit; or
- cash flow minus the change in working capital, which is cash flow from operating activities.

CASH FLOW STATEMENT FOR INDESIT (€m)

		2005	*2006*	*2007*
	OPERATING ACTIVITIES			
	Net income	50	77	105
+	Depreciation, amortisation and impairment losses on fixed assets	141	143	141
+	Other non-cash items	46	(16)	(44)
=	**CASH FLOW**	**238**	**204**	**202**
−	Change in working capital	28	(40)	(20)
=	**CASH FLOW FROM OPERATING ACTIVITIES (A)**	**210**	**244**	**222**
	INVESTING ACTIVITIES			
	Capital expenditure	190	136	126
−	Disposal of fixed assets	4	5	20
+/−	Acquisition (disposal) of financial assets	(5)	(9)	(12)
+/−	Acquisition (disposal) of other LT assets	4	(6)	(2)
=	**CASH FLOW FROM INVESTING ACTIVITIES (B)**	**186**	**116**	**93**
=	**FREE CASH FLOW AFTER FINANCIAL EXPENSE (A − B)**	**24**	**128**	**129**
	FINANCING ACTIVITIES			
	Proceeds from share issues (C)	6	3	2
	Dividends paid (D)	37	37	40
	A − B + C − D = DECREASE/(INCREASE) IN NET DEBT	**(6)**	**94**	**92**
	Decrease in net debt can be broken down as follows:			
	Repayment of short-, medium- and long-term borrowings	(9)	110	113
−	New short-, medium- and long-term borrowings	4	5	
+	Change in marketable securities (short-term investments)	12	(6)	(23)
+	Change in cash and equivalents	(13)	(15)	2
=	**DECREASE/(INCREASE) IN NET DEBT**	**(6)**	**94**	**92**

First of all, we note that the difference between these two indicators is attributable primarily to financial expense after tax, which is generally modest in a low-interest-rate environment.

In our view, operating cash flow minus theoretical tax on operating profit is the most useful because it is a key factor influencing both investment decisions (Chapter 18) and valuations (Chapter 40). However, most if not all cash flow statements define cash flow from operating activities as cash flow minus the change in working capital.

Cash flow is a fairly mongrel concept because it is calculated before the return (dividends) paid on certain funds (i.e. shareholders' equity) but after that (financial expense) paid on other funds (i.e. debt).

(b) Investing activities are shown as a financing requirement (or a surplus in rare cases), which is calculated as the difference between capital expenditure and disposals.

(c) In practice, most companies publish a cash flow statement that starts with net income and moves down to changes in "cash and equivalents" or change in "cash", a poorly defined concept since certain companies include marketable securities while others deduct bank overdrafts and short-term borrowings.

Furthermore, net debt reflects the level of indebtedness of a company much better than cash and cash equivalents or than cash and cash equivalents minus short-term borrowings, since the latter are only a portion of the debt position of a company. On the one hand, one can infer relevant comments from changes in the net debt position of a company. On the other hand, changes in cash and cash equivalents are rarely relevant as it is so easy to increase cash in the balance sheet at the closing date: simply get into long-term debt and put the proceeds in a bank account! Cash on the balance sheet has increased but net debt is still the same.

As we will see in Chapter 36, net debt is managed globally and looking at only one side (cash and cash equivalents and marketable securities) is therefore of little interest.

SUMMARY

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The first step in the process of moving from the income statement to a cash flow perspective is to recreate operating cash flows. The only differences between operating receipts and operating revenues and between operating costs and operating payments are timing differences related to payment terms (deferred payments) and changes in inventories (deferred charges).

The change in operating working capital accounts for the difference between operating cash flow and the generation of wealth within the operating cycle (EBITDA).

For capital expenditures, there is no direct link between cash flow and net income, since the former records capital expenditures as they are paid and the latter spreads the cost of capital expenditures over their whole useful life.

From a financing standpoint, the cash flow statement does not distinguish between capital and remuneration related to sources of financing, while the income statement shows only returns on debt financing (interest expenses) and corporate income tax.

Net income should normally appear in "cash at hand", along with certain noncash charges that together form cash flow. Cash flow may be translated into an inflow or outflow of cash only once adjusted for the change in operating working capital to arrive at cash flow from operating activities in a broad sense of the term.

Lastly, factoring in the investment cycle, which gives rise to outflows sometimes offset by fixed asset disposals, and the equity financing cycle, we arrive at the decrease in net debt.

QUESTIONS

@ *quiz*

1/ Do inventories valuation methods influence:

- the company's net income?
- the company's cash position?

2/ Same question for the following:

(a) depreciation and amortisation
(b) corporate income tax
(c) capital increase through cash contribution
(d) cash purchase of fixed assets
(e) recognition and payment of salaries
(f) disposal for cash of an asset at its book value
(g) sale of goods on credit
(h) payment for these goods
(i) repayment of medium-term loan
(j) financial expenses

3/ What differences are there between cash flow from operating activities and operating cash flow?

4/ What noncash charges must be factored back into calculations of cash flow?

5/ Is cash flow a measure of an increase in wealth? Or an increase in cash?

6/ Why is the difference between EBITDA and operating cash flows equal to a change in working capital?

7/ What difference is there between sales in a financial year and operating receipts over the same period?

8/ What is the difference between cash flow and cash flow from operating activities?

9/ Why is decrease in net debt more relevant than change in cash position or marketable securities?

10/ Make use of the cash flow statement to show how impairment losses on current assets have no impact on cash.

11/ Will a capital increase by way of incorporation of reserves appear on the cash flow statement?

12/ Pearson plc is in the process of revaluing all of its tangible assets. How will this impact on the cash flow statement?

EXERCISE

1/ *Ellingham plc*

Draw up a cash flow statement for Ellingham for 2005 and 2006. If you so wish, create a cash-earnings link at each level. What is your interpretation of these figures?

ANSWERS

Questions

1/ *Yes, the lower inventories are valued, the lower net income for the current year. No, except for corporate income tax.*
2/ *(a)Yes, as depreciation and amortisation are expenses; no, as depreciation and amortisation are noncash expenses. (b) Yes and yes as corporate, income tax is a cash expense. (c) No, yes as a source of financing is neither a revenue nor an expense. (d) No, yes as the cash purchase of a fixed asset is not an expense but a cash payment. (e) Yes, yes as salaries paid are cash expense. (f) No, yes as no capital gain is registered. (g) Yes, no as a revenue is registered but the cash receipt still has to be received (goods sold on credit). (h) No, yes as the cash receipt is now received but the revenue has already been registered. (i) No, yes as repayment of a loan does not modify the wealth of the company but its cash position. (j) Yes, yes as financial expenses reduce the wealth of the company and its cash position.*
3/ *Unlike operating cash flow, cash flow from operating activities encompasses not only operations but also financial expense, tax and some exceptional items.*
4/ *Depreciation, amortisation and impairment losses on fixed assets and provisions for liabilities and charges.*
5/ *No, cash flow is not a measure of increase in wealth because it does not take into account depreciation, which reflects the wear and tear of fixed assets and thus a source of wealth destruction. No, because customers do not pay cash, because suppliers are not paid in cash.*
6/ *The difference between EBITDA and operating cash flow is nothing but new invoices received or sent but not yet paid either by the company or its customers, or variation in inventories, i.e. increase in working capital.*
7/ *Change in trade receivables.*
8/ *Changes in working capital.*
9/ *Because it is easier to modify the cash position of a company at year end than the net debt position which reflects its true level of indebtedness.*
10/ *Impairment losses reduce earnings, but also bring down working capital: they cancel each other out at the level of the cash flow from operating activities.*
11/ *No, it will not impact on the company' s cash flow as it is a pure accounting entry.*
12/ *It will have no impact as it is a noncash operation.*

Exercise

Ellingham plc[7]

Cash forecast	*Jan 2008*	*Feb 2008*	*Mar 2008*	*Apr 2008*	*May 2008*	*Jun 2008*	*Jul 2008*	*Aug 2008*	*Sep 2008*	*Oct 2008*	*Nov 2008*	*Dec 2008*	*2008*	*2009*	*2010*
Operating inflows															
Sales					12	12	12	12	12	12	12	12	96	144	144
Operating outflows															
– Purchases				8	4	4	4	4	4	4	4	4	40	48	48
– Personnel costs	4	4	4	4	4	4	4	4	4	4	4	4	48	48	48
– Shipping		2	2	2	2	2	2	2	2	2	2	2	22	24	24
– Interest expense						1						0.9	1.9	1.5	1.1
– Capital expenditure	30												30		
+ New borrowings	20												20		
– Repayment of borrowings	2						2						4	4	4
Change in cash	**–16**	**–6**	**–6**	**–14**	**2**	**1**	**0**	**2**	**2**	**2**	**2**	**1.1**	**–29.9**	**18.5**	**18.9**
Cumulated balance	**–16**	**–22**	**–28**	**–42**	**–40**	**–39**	**–39**	**–37**	**–35**	**–33**	**–31**	**–29.9**			

(N.B.: No sales in January 2008 in order to build up initial stock of finished goods.)

7 *An Excel version of the solutions is available on the website.*

	Income statement (by nature)	*2008*	*2009*	*2010*
	Sales	132	144	144
+	Change in finished goods and in-progress inventory[1]	10	0	0
=	**Production for period**	**142**	**144**	**144**
–	Raw materials used in the business[2]	48	48	48
–	Payroll costs	48	48	48
–	Shipping	24	24	24
=	**EBITDA**	**22**	**24**	**24**
–	Depreciation and amortisation	6	6	6
=	**Operating income**	**16**	**18**	**18**
–	Interest expense	1.9	1.5	1.1
=	**Net earnings**	**14.1**	**16.5**	**16.9**

[1] Change in finished goods and in-progress inventory: €4m in raw materials + €4m in payroll costs + €2m in shipping costs = €10m.
[2] Breakdown of raw materials used in the business in year 1: €52m (purchases) – €4m (increase in raw materials inventories) = €48m.

	Income statement (by function)	*2008*	*2009*	*2010*
	Sales	**132**	**144**	**144**
–	Cost of sales	116	126	126
=	**Operating income**	**16**	**18**	**18**
–	Interest expense	1.9	1.5	1.1
=	**Net income**	**14.1**	**16.5**	**16.9**

Cash flow statement – Format 1	*2008*	*2009*	*2010*
EBITDA	22	24	24
– Change in working capital	36	0	0
= **Operating cash flows**	**–14**	**24**	**24**
– Capital expenditure	30	0	0
– Interest expense	1.9	1.5	1.1
= **Net decrease in debt**	**–45.9**	**22.5**	**22.9**
New borrowings	20	0	0
– Debt repayments	4	4	4
– Change in cash and equivalents	–29.9	18.5	18.9

Cash flow statement – Format 2	*2008*	*2009*	*2010*
Net income	14.1	16.5	16.9
+ Depreciation and amortisation	6	6	6
= **Cash flow**	**20.1**	**22.5**	**22.9**
– Change in working capital	36	0	0
= **Cash flow from operating activities**	**–15.9**	**22.5**	**22.9**
– Capital expenditure	30	0	0
= **Net decrease in debt**	**–45.9**	**22.5**	**22.9**
New borrowings	20	0	0
– Debt repayments	4	4	4
– Change in cash and equivalents	–29.9	18.5	18.9

Balance sheet	*Date 0*	*End 2008*	*End 2009*
Fixed assets, net (A)	**0**	**24**	**18**
Inventories	0	14	14
+ Trade receivables	0	36	36
− Trade payables and other debts	0	14	14
= **Working capital (B)**	**0**	**36**	**36**
= ***Capital employed (A+B)***	***0***	***60***	***54***
Shareholders' equity (C)	**40**	**54.1**	**70.6**
Bank and financial debts	0	16	12
− Marketable securities	0	0	0
− Cash and equivalents	40	10.1	28.6
= **Net debt (D)**	**−40**	**5.9**	**−16.6**
= ***Invested capital (C+D)***	***0***	***60***	***54***

The creation of their Spanish subsidiary is a clever move. This outfit is profitable the first year, capital expenditure and increase in working capital (30 + 36) are nearly entirely paid back at end-2010 after only three years of activity. It is almost too good to be true!

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