ABSTRACT

This paper examines the relationship between future cash flow and historical earnings. It employs the framework developed by the Barth, Cram, and Nelson (2001) study which includes two major models: (1) Aggregated Earnings model; and (2) Disaggregated Earnings model (Cash flow plus six accruals components, namely change in accounts receivable, change in inventories, change in accounts payable, depreciation, amortization and other accruals), with the aim to examine the relationship between future cash flow and historical earnings. These models are applied to the Hong Kong market in order to investigate their predictability for future cash flow. Major findings of this study are consistent with that of BCN's study: Aggregated Earnings and Disaggregated Earnings models can both apply to the Hong Kong market. However, the latter is found to be a comparatively better model in predicting future cash flow in the Hong Kong market. Results also show that all disaggregated earnings components except Amortization are significant predictors for future cash flow. Moreover, under Disaggregated Earnings model, proof shows that Aggregated Accruals might mask some information. Therefore, it is better to break Aggregated Accruals into various disaggregated accrual components to gain a higher explanatory power in predicting future cash flow.