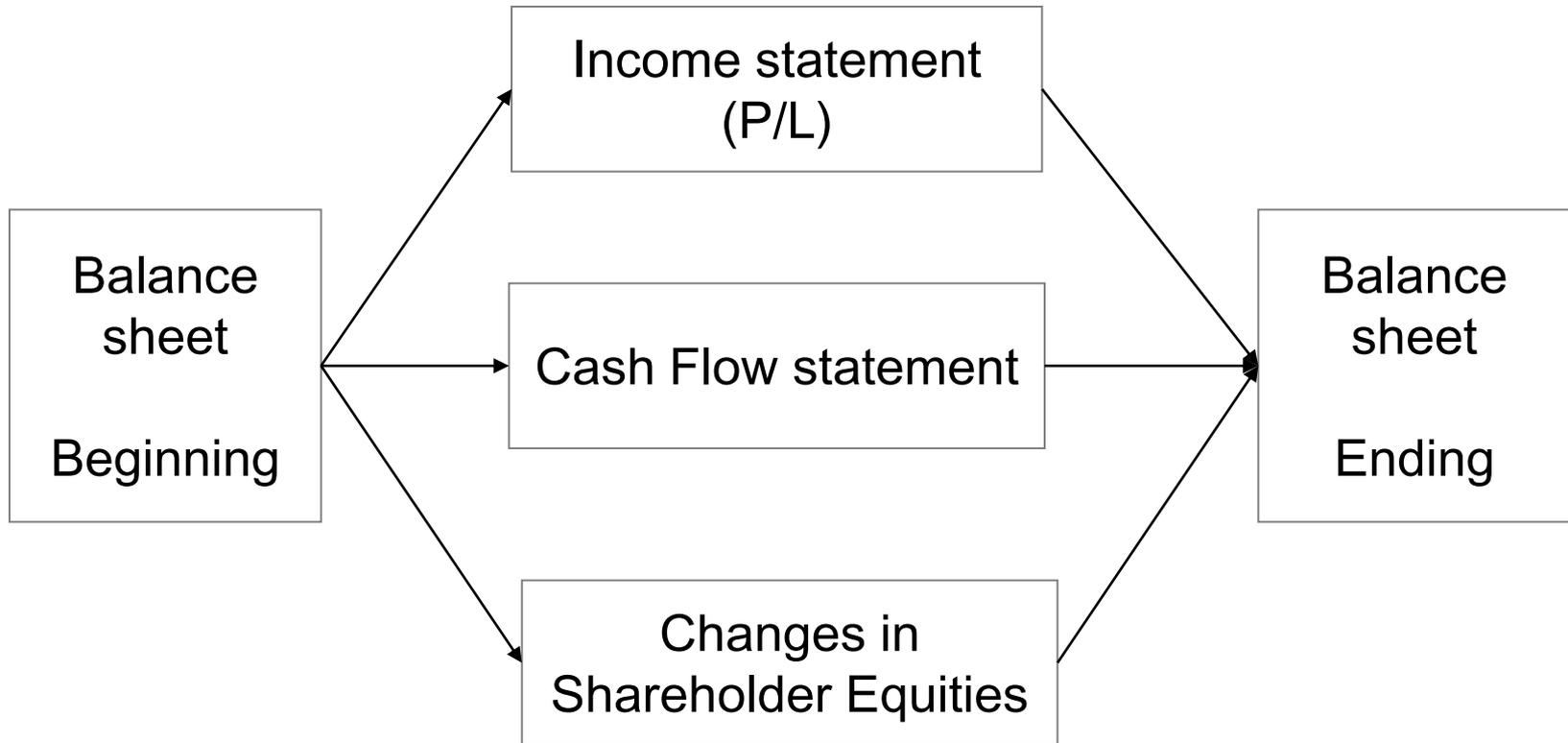


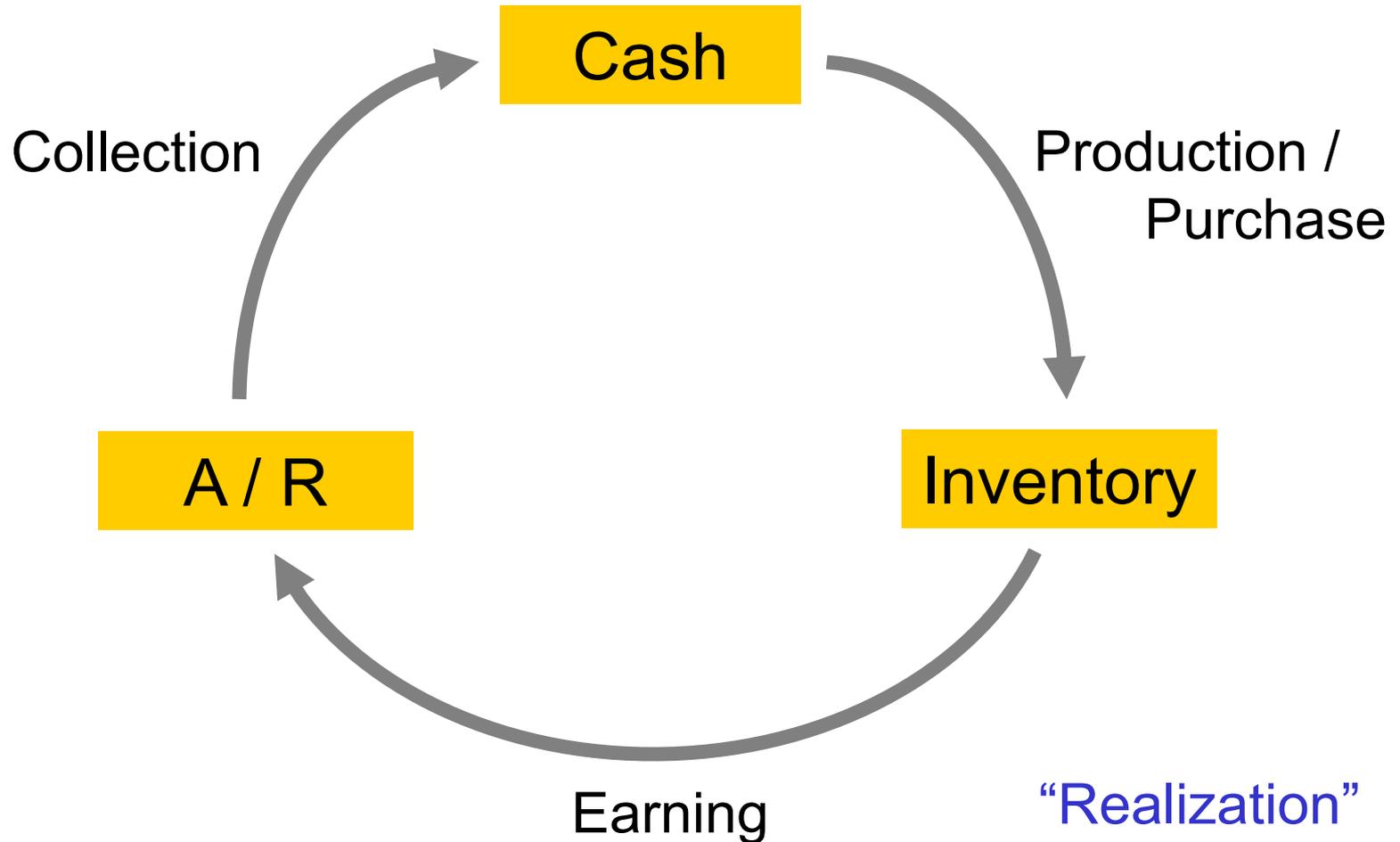
Financials

Lecture 7

Financial statements

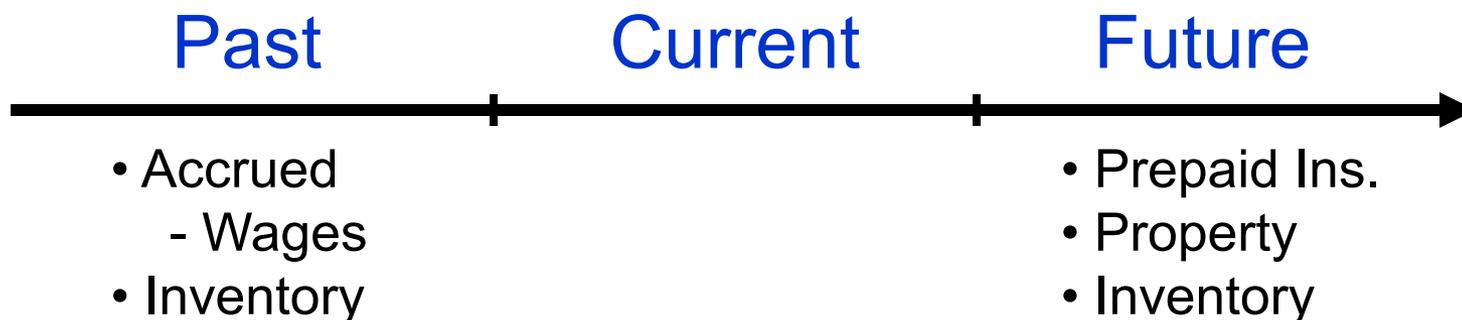


Business Financial Flow

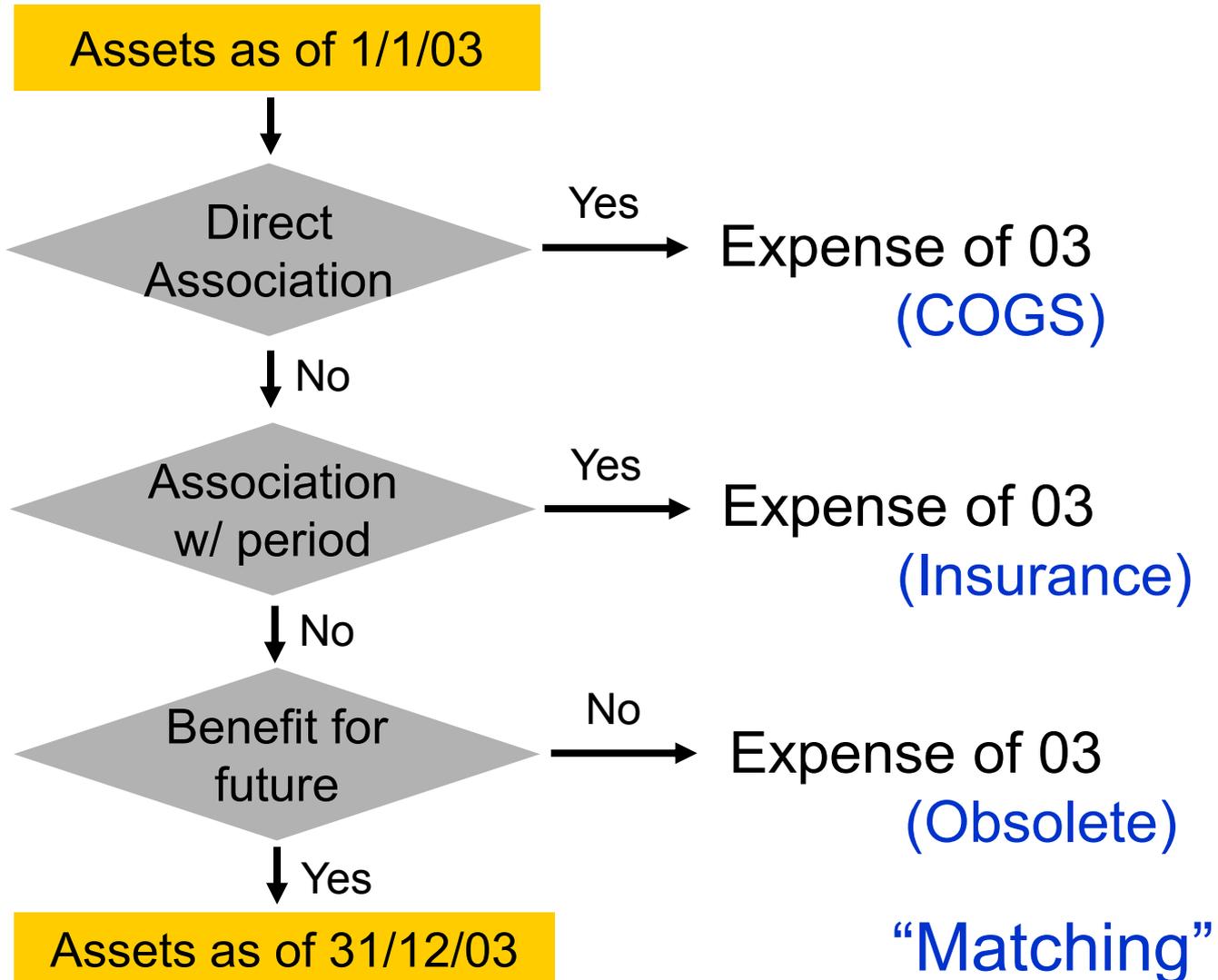


Income Statement: Accrual Method

- Store up expenses until sold
- “Match” revenues w/expenses
- Expenses (Timing of)



Expenditures in 1/1/03 – 31/12/03



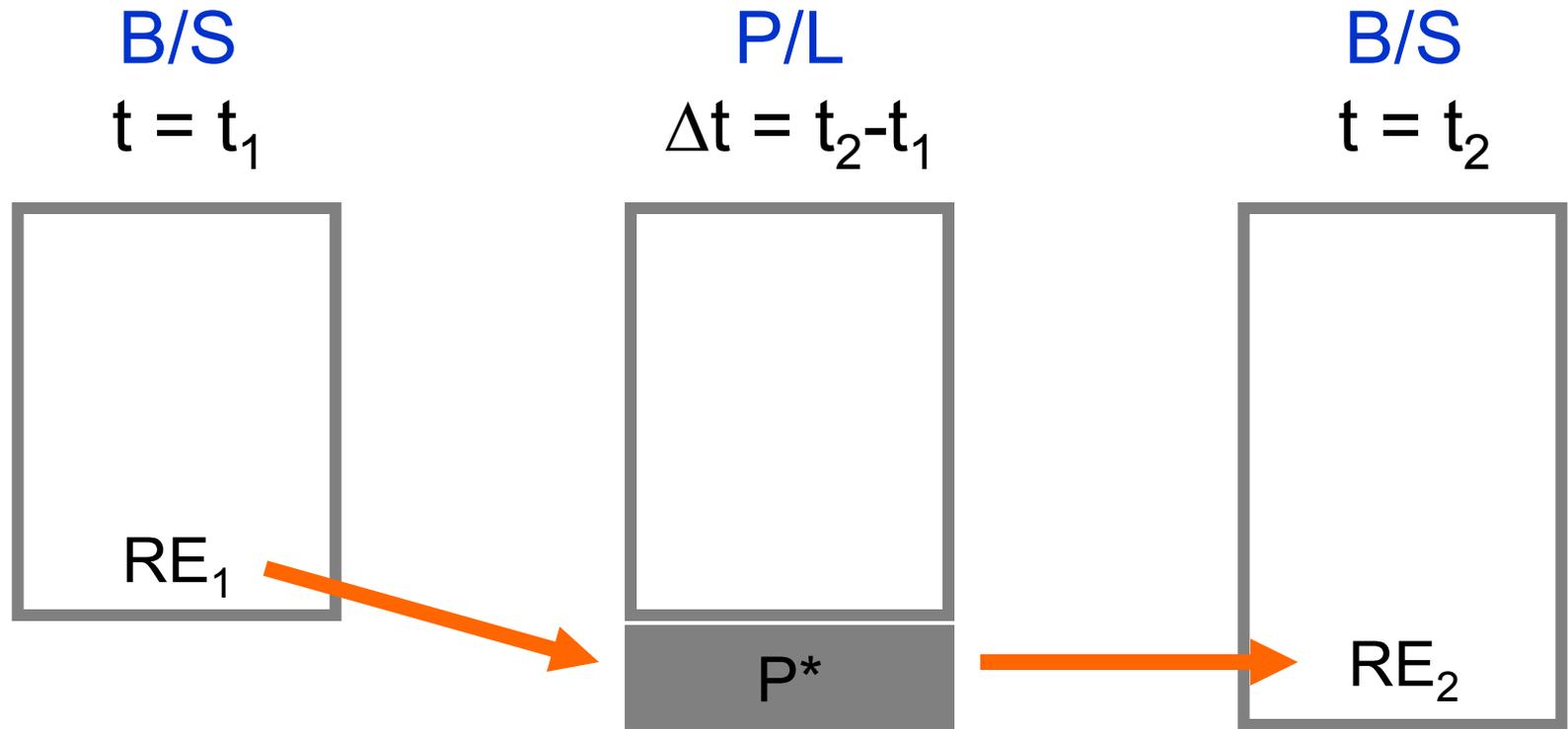
Income Statement

King's Shoe Store, Inc.

Income Statement for the Year Ending December 31, 2000

| | | |
|-------------------------|---------|------------------|
| Revenue: | | |
| Sales Revenue | 625,000 | |
| Other Revenue | - | |
| Total Revenue | | <u>625,000</u> |
| Expenses: | | |
| Cost of Goods Sold | 90,000 | |
| Salary Expense | 110,000 | |
| Insurance Expense | 500 | |
| Depreciation Expense | 30,000 | |
| Total Expense | | <u>230,500</u> |
| Operating Income | | <u>394,500</u> |
| Less Income taxes (35%) | | <u>(138,075)</u> |
| Net Income | | <u>256,425</u> |

Relationship of Financial Statements



$$RE_1 (\$143K) + P^* (\$256K) = RE_2 (\$399K)$$

Balance Sheet

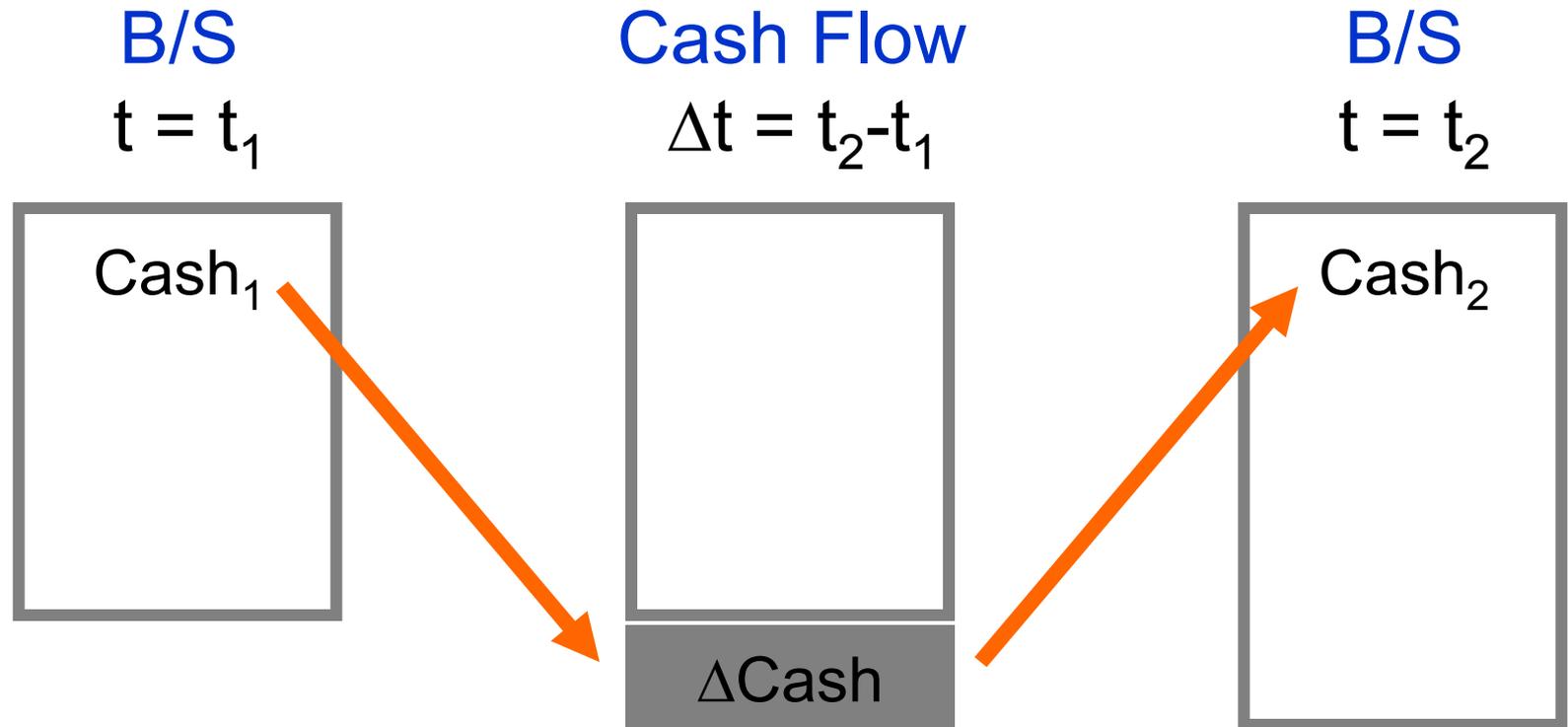
King's Shoe Store, Inc.
Comparative Balance Sheet
 As of December 31, 1999 and 2000

| Assets | Liabilities and Shareholders' Equity | | | |
|--|--------------------------------------|----------------------|--|----------------------|
| | December 31, 2000 | December 31, 1999 | December 31, 2000 | December 31, 1999 |
| Current Assets: | | | Current Liabilities | |
| Cash | 438,500 | 30,000 | Account Payable | 90,000 |
| Account Receivable | 138,000 | 63,000 | Income Tax Payable | 138,075 |
| Raw Materials Inventory | 15,000 | 10,000 | Total Current Liabilities | 135,000 |
| Work-in-Process Inventory | 20,000 | 10,000 | Long-Term Debt | |
| Merchandise Inventory | 95,000 | 175,000 | Bonds Payable | 100,000 |
| Prepaid Insurance | 1,000 | - | Total Liabilities | 235,000 |
| Total Current Assets | 707,500 | 288,000 | | |
| Property, Plant, and Equipment | | | Shareholders' Equity | |
| Land | 100,000 | 100,000 | Common Stock (at par value) | 300,000 |
| Building and Equipment (at acquisition cost) | 535,000 | 525,000 | Additional Paid-in Capital | 200,000 |
| Less: Accumulated Depreciation | (115,000) | (85,000) | Retained Earnings | 399,425 |
| Building and Equipment (net) | 420,000 | 440,000 | Total Shareholders' Equity | 593,000 |
| Total Property, Plant, and Equipment | 520,000 | 540,000 | Total Liabilities and Shareholders' Equity | 1,227,500 |
| Total Assets | 1,227,500 | 828,000 | | 828,000 |

Cash Flow

- Market value is equal to the present value of expected future cash flows
- More difficult to manipulate than earnings
- Cash needs
 - Investors
 - Suppliers, employees, etc.
 - Debtholders

Relationship of Financial Statements



$$Cash_1 + \Delta Cash = Cash_2$$

Sources and Uses of Cash

- Operating activities
- Investment activities
- Financing activities

Operating Cash Flow

- Excludes all cash flows related to capital structures
- Excludes one-time events
- Indicative of strategic value

Investing Cash Flow

- Acquisition or disposition of non-current assets
- Investing cash flows related to ongoing operations are used as a measure of the strategic value

Financing Cash Flow

- Debt-related transactions
- Equity-related transactions
- Acquisition or sale of a business unit

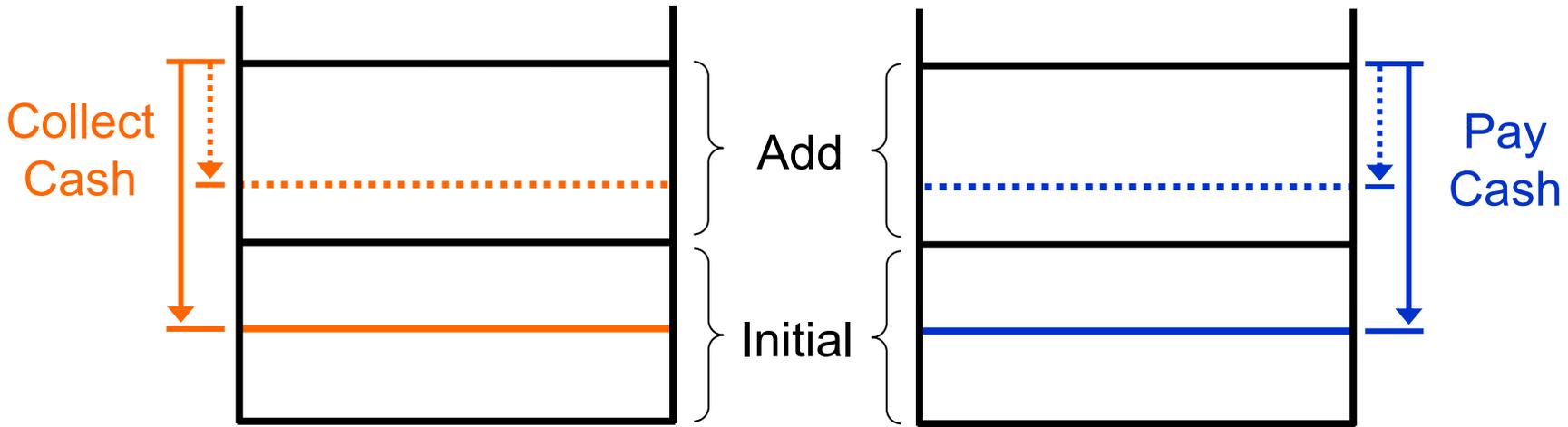
Cash Flow Statement

- Movement of cash into and out of a company
- Revenues converted to C/F
- Expenses converted to C/F
- Other sources (investing/financing) of cash
- Other uses (investing/financing) of cash

Cash Flow

A/R

A/P



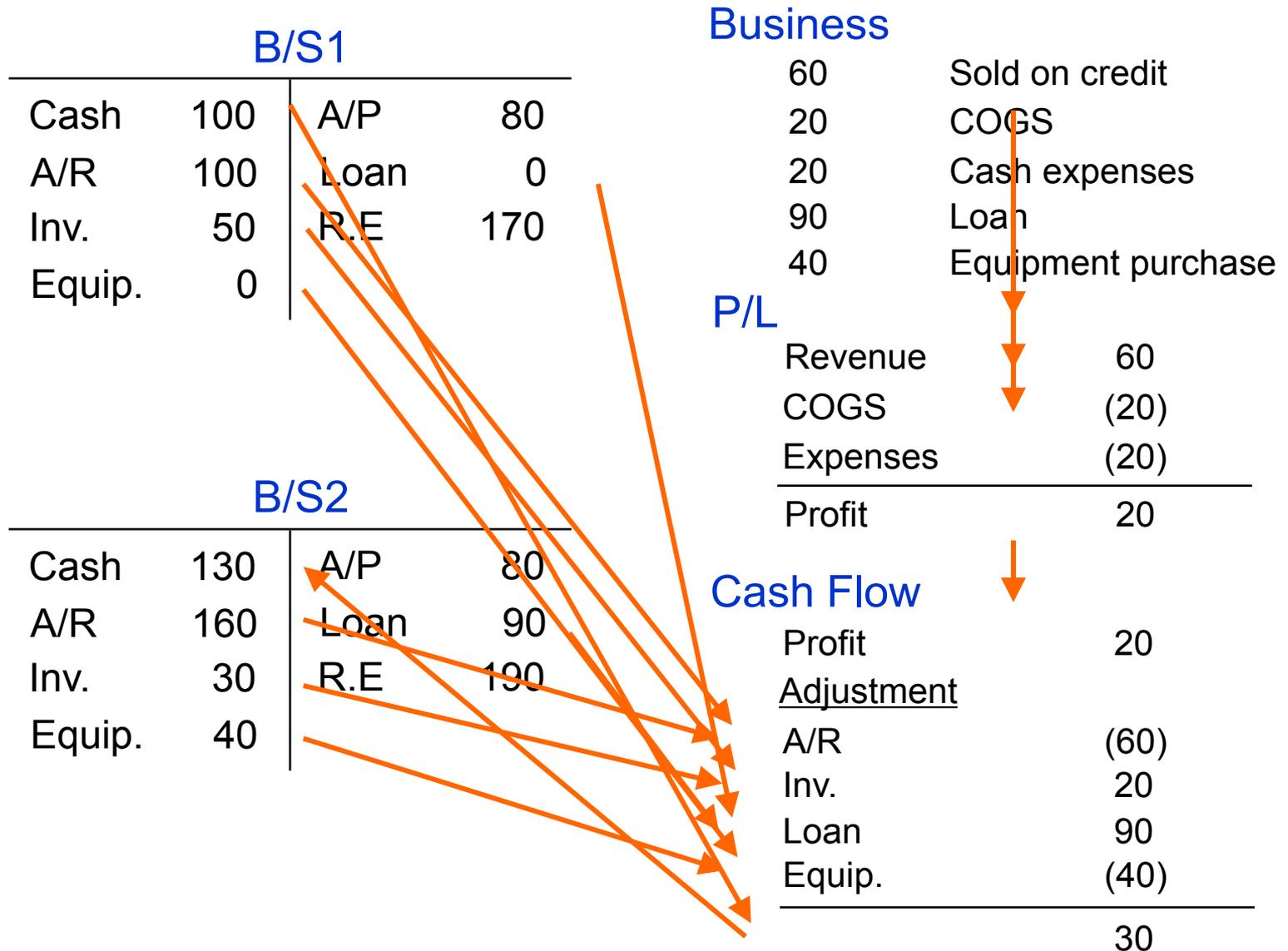
if increase, '-'

if decrease, '+'

if increase, '+'

if decrease, '-'

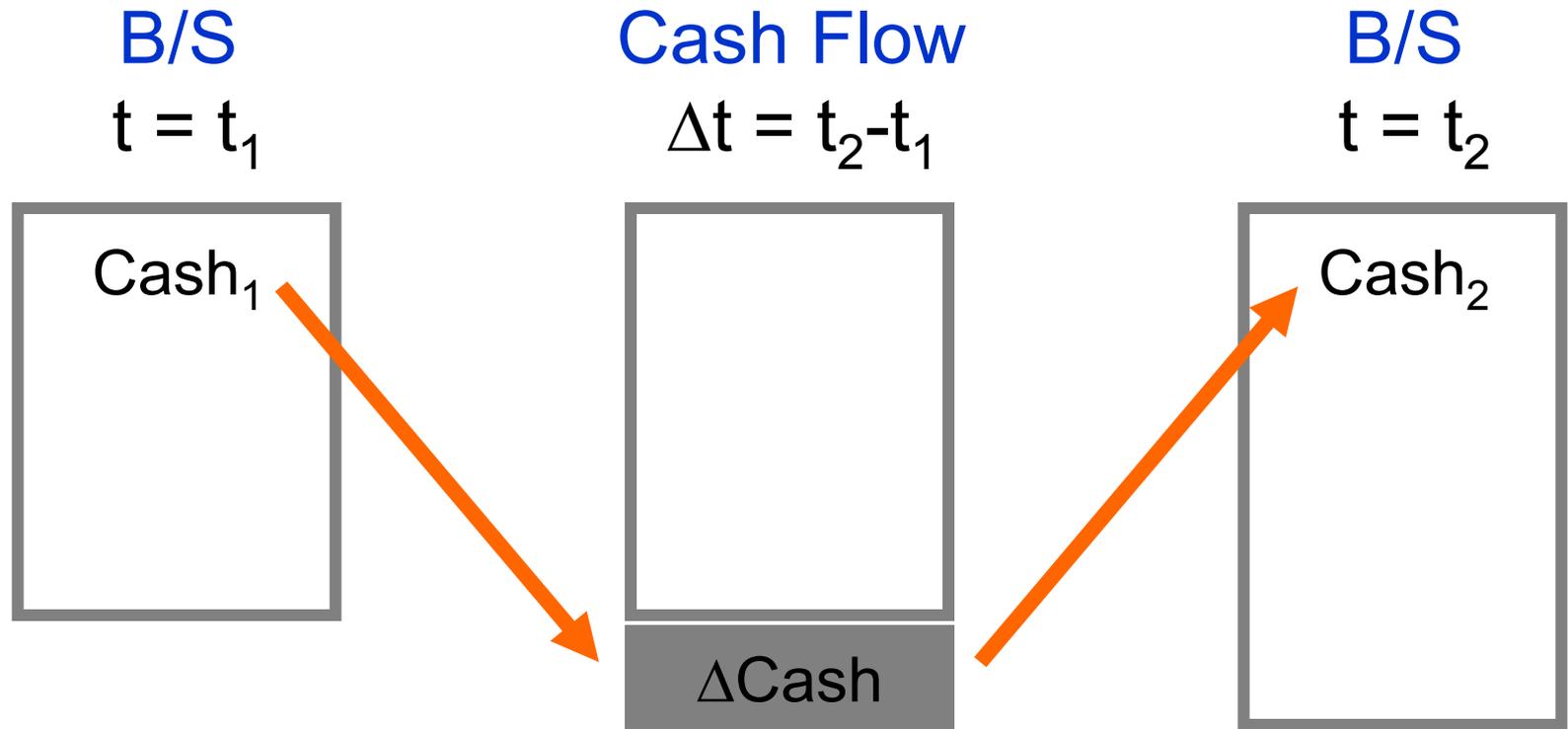
Cash Flow Calculation



Statement of Cash Flows

| | |
|---|----------------|
| Cash Flow from Operating Activities: | |
| Net Income | 256,425 |
| Noncash adjustments | |
| Depreciation | 30,000 |
| Increase in accounts receivable | (75,000) |
| Increase in Raw Materials Inventory | (5,000) |
| Increase in Work-in-Process Inventory | (10,000) |
| Decrease in Inventory | 80,000 |
| Increase in prepaid expenses | (1,000) |
| Decrease in accounts payable | (45,000) |
| Increase in tax payable | 138,075 |
| Net case increase from operating activities | <u>368,500</u> |
| Cash Flow from Investing Activities: | |
| Purchase of Building and Equipment | (10,000) |
| Net cash increase from Investing activities | (10,000) |
| Cash Flow from Financing Activities: | |
| Issuance of Common Stocks | 50,000 |
| Net cash increase from Financing activities | <u>50,000</u> |
| Increase in Cash during 2000 | 408,500 |
| Beginning Cash Balance | <u>30,000</u> |
| Ending Cash balance | <u>438,500</u> |

Relationship of Financial Statements



$$\text{Cash}_1 + \Delta\text{Cash} = \text{Cash}_2$$
$$\$30,000 + \$408,500 = \$438,500$$

Balance Sheet

King's Shoe Store, Inc.
Comparative Balance Sheet
 As of December 31, 1999 and 2000

| Assets | Liabilities and Shareholders' Equity | | | |
|--|--------------------------------------|----------------------|--|------------------------|
| | December 31, 2000 | December 31, 1999 | December 31, 2000 | December 31, 1999 |
| Current Assets: | | | Current Liabilities | |
| Cash | 438,500 | 30,000 | Account Payable | 90,000 135,000 |
| Account Receivable | 138,000 | 63,000 | Income Tax Payable | 138,075 - |
| Raw Materials Inventory | 15,000 | 10,000 | Total Current Liabilities | 228,075 135,000 |
| Work-in-Process Inventory | 20,000 | 10,000 | Long-Term Debt | |
| Merchandise Inventory | 95,000 | 175,000 | Bonds Payable | 100,000 100,000 |
| Prepaid Insurance | 1,000 | - | Total Liabilities | 328,075 235,000 |
| Total Current Assets | 707,500 | 288,000 | | |
| Property, Plant, and Equipment | | | Shareholders' Equity | |
| Land | 100,000 | 100,000 | Common Stock (at par value) | 300,000 250,000 |
| Building and Equipment (at acquisition cost) | 535,000 | 525,000 | Additional Paid-in Capital | 200,000 200,000 |
| Less: Accumulated Depreciation | (115,000) | (85,000) | Retained Earnings | 399,425 143,000 |
| Building and Equipment (net) | 420,000 | 440,000 | Total Shareholders' Equity | 899,425 593,000 |
| Total Property, Plant, and Equipment | 520,000 | 540,000 | Total Liabilities and Shareholders' Equity | 1,227,500 828,000 |
| Total Assets | 1,227,500 | 828,000 | | |

Financial Ratios

1. Profitability
 - ROA
 - ROE
 - Profit Margin
2. Activity
 - Asset Turnover
 - Days Receivable
 - Inventory Turnover
3. Leverage
 - Current ratio
 - Debt-to-Equity

Example: Compound

$$\text{ROE} = \frac{\text{Income}}{\text{Equity}} \equiv \frac{\text{Income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Assets}} \times \frac{\text{Assets}}{\text{Equity}}$$

Financial Ratios

| | |
|---------------|-----------|
| Net Income | 256,425 |
| Total Assets | 1,227,500 |
| Sales Revenue | 625,000 |
| Total Assets | 1,227,500 |
| | 828,000 |

Profitability Ratios

Return on Assets (ROA) = (Net Income / Total Assets) x 100 = **20 %**

Return on Equity (ROE) = (Net Income / Shareholders' Equity) x 100 = **30 %**

Profit Margin = (Net Income / Sales Revenue) x 100 = **40 %**

Activity Ratios

Asset Turnover = Sales Revenue / [(Beginning Assets + Ending Assets) / 2] = **0.6**

Days of Receivables = (Receivables / Sales Revenue) x Days in Period = **80**

Inventory Turnover = Cost of Good Sold / [(Beginning Inventory + Ending Inventory) / 2] = **0.7**

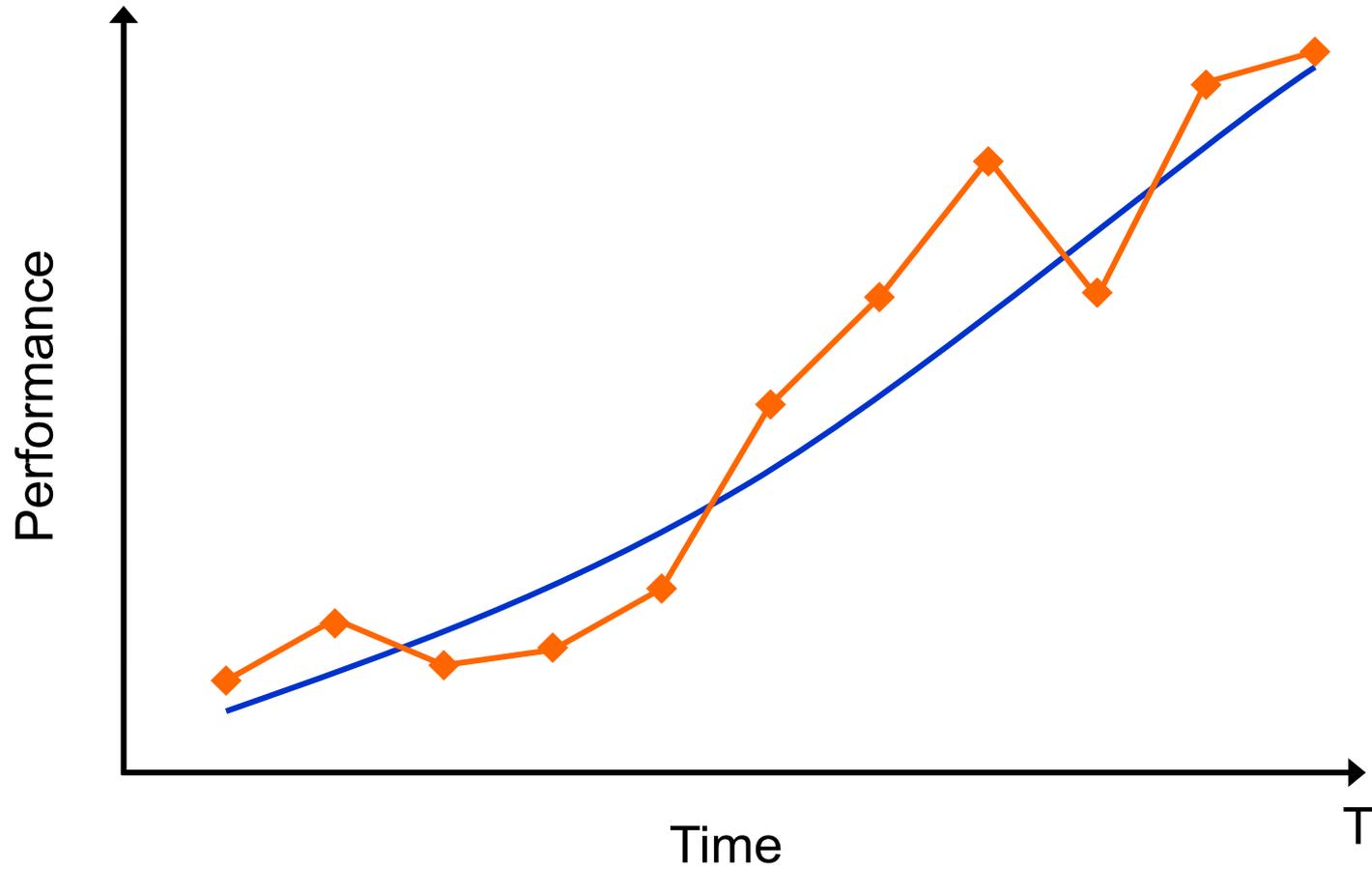
Leverage Ratios

| | |
|---------------------------|---------|
| Total Current Assets | 707,500 |
| Total Current Liabilities | 228,075 |

Current Ratio = Current Assets / Current Liabilities = **3**

Debt-to-Equity Ratio = Total Liabilities / Shareholders' Equity = **0.4**

The Long Views



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