

Unit 9: Financials

THE BIGGEST RISK OF ALL IS NOT TAKING ONE



Income statement

- ▶ Shows how much money a company made and spent over a period of time.
- ▶ Is a report that shows how much revenue a company earned over a specific time period usually for a year or some portion of the year.
- ▶ This tells you how much company earned or lost over a period of the period.
- ▶ It indicates a company's revenue, expenses and net income over a period of time.



Definitions of key terms used in income statement

- ▶ Revenue: Total income generated from the sales of goods or services
- ▶ Expenses: Costs incurred in generating revenue including operating expenses, interests and taxes
- ▶ Cost of goods sold(COGS): The direct costs attributable to the production of the goods sold by the company including materials and labor.
- ▶ Gross profit: The difference between revenue and COGS. It represents company's profit from its core business activities before deducting operating expenses.

Definitions of key terms used in income statement



- ▶ Operating expenses: The costs incurred in regular operations of the business such as salaries, rent, utilities, marketing and administrative expenses.
- ▶ Operating income (operating profit): The profit generated from a company's core business operations. Gross profit minus operating expenses.
- ▶ Non-operating income or expenses: Income and expenses not directly related to the primary business operations such as interest income, interest expenses and other non-operating expenses
- ▶ Income before Taxes: The total income earned by a company before deducting taxes

Definitions of key terms used in income statement

- ▶ Income tax expenses: The amount of taxes a company owes based on its taxable income
- ▶ Net income: represents a company's total profit after all the expenses including taxes has been deducted.
- ▶ Earnings per share (EPS): A measure of company's profitability on a per share basis calculated by dividing the net income by the average number of outstanding shares

Definitions of key terms used in income statement

- ▶ Dividends: Payments made to the shareholders as a share of company's profits typically distributed on a per share basis.
- ▶ Retained earnings: The portion of a company's net income that is re-invested in the business rather than distributed to the shareholders

COMPANY B

INCOME STATEMENT

For Year Ended September 28, 2019 (In thousands)

NET SALES	\$ 4,358,100
COST OF SALES	2,738,714
GROSS PROFIT	1,619,386
SELLING AND OPERATING EXPENSES	560,430
GENERAL AND ADMINISTRATIVE EXPENSES	293,729
TOTAL OPERATING EXPENSES	854,159
OPERATING INCOME	765,227
OTHER INCOME	960
GAIN (LOSS) ON FINANCIAL INSTRUMENTS	5,513
(LOSS) GAIN ON FOREIGN CURRENCY	(12,649)
INTEREST EXPENSE	(18,177)
INCOME BEFORE TAXES	740,874
INCOME TAX EXPENSE	257,642
NET INCOME	\$ 483,232

Cash flow statement



Cash flow statement

- ▶ Shows the exchange of money between a company and the outside world over a period of time.
- ▶ Cash flow statements report a company's inflows and outflows of cash.
- ▶ This is important because a company needs to have enough cash on hand to pay its expenses and purchase assets.
- ▶ While an income statement can tell you whether a company made a profit, a cash flow statement can tell you whether the company generated cash.

Why is cash flow statement important?

- ▶ Income and balance sheet are based on accrual accounting
- ▶ Helps us compare operating cash flow to net income that helps a company measure how well it runs its operations
- ▶ The cash flow statement reflects actual cash the company receives from its operations.

Cash flow statement

Cash flow from
operating activities

Cash flow from
investment activities

Cash flow from
financing activities



Free cash flow

- ▶ The cash remaining after deducting capital expenditures from operating cash flow.
- ▶ It indicates the amount of cash available for discretionary purposes or to distribute to the shareholders

**Sample Business, LLC
Statement of Cash Flows
For the Year Ended 12/31/22**

CASH FLOWS FROM OPERATING ACTIVITIES

Net Income	\$ 250,000.00
<i>Adjustments to Reconcile Net Income to Net Cash from Operating Activities:</i>	
Depreciation and Amortization Expense	24,000.00
Increase in Accounts Receivable	(37,000.00)
Decrease in Accounts Payable	(18,000.00)
Loss on Sale of Vehicle	8,000.00
Net Cash Flow Provided By Operating Activities	<u>227,000.00</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Capital Expenditures	(48,000.00)
Proceeds from Sale of Vehicle	33,000.00
Net Cash Flow Used In Investing Activities	<u>(15,000.00)</u>

CASH FLOWS FROM FINANCING ACTIVITIES

Cash Dividends Paid	(13,000.00)
Proceeds from Business Loan	150,000.00
Payments to Current Debt	(52,000.00)
Net Cash Flow Provided By Financing Activities	<u>85,000.00</u>

TOTAL CASH INFLOW	297,000.00
CASH AT THE BEGINNING OF THE YEAR	118,000.00
CASH AT THE END OF THE YEAR	<u><u>\$ 415,000.00</u></u>

Working capital cycle (days)



- ▶ The capital of a business which is used in its day-to-day trading operations, calculated as the current assets minus the current liabilities.
- ▶ The working capital cycle indicates the time taken for a business to convert its resources like inventory and receivables into cash. It measures the duration between when cash is paid out for resources, and the cash is received from customers.

Working capital cycle (days)

- To compute the WCC components, you must use the following formulas:

Inventory days = (Average inventory / COGS) x 365;

Average inventory = $0.5 \times (\text{beginning inventory} + \text{ending inventory})$

Accounts receivable days = (Average accounts receivable / sales revenue) x 365;

Average A/R = $0.5 \times (\text{beginning A/R} + \text{Ending A/R})$

Accounts payable days = (Average accounts payable / COGS) x 365

Average A/P = $0.5 \times (\text{Beginning A/P} + \text{Ending A/p})$

Cash conversion cycle = Inventory days + A/R days - A/P days

Numerical question

A Bricks manufacturer in Bhutan reports the data below.

- ▶ Accounts payable – Nu 560000 (avg)
- ▶ Accounts receivable – Nu 1,200,000 (avg)
- ▶ Inventory –Nu 514,000 (avg)
- ▶ Net sales – Nu 18,000,000
- ▶ Cost of goods sold – Nu11,300,000

A) Compute the number of days in the cash conversion cycle.

B) Is the company more efficient at managing cash than its competitor in India who has a cash conversion cycle of 18 days?