

Unit 9: Financials

THE BIGGEST RISK OF ALL IS NOT TAKING ONE





This unit is not to make you an accountant,
but to help you understand the
consequences of your financial decisions

Importance of financial knowledge



- ▶ A good investment opportunity requires a product or service that meets a definite customer need and creates a sustainable competitive advantage.
- ▶ To be attractive, an opportunity must generate significant profits relative to the required amount of investment.
- ▶ Therefore, projections of a venture's profits, its asset and financing requirements, and its cash flows are essential in determining whether a venture is economically feasible.
- ▶ In order to make such financial projections, an entrepreneur must have a good understanding of financial statements.

Three main financial statements

Balance sheet



Income statement



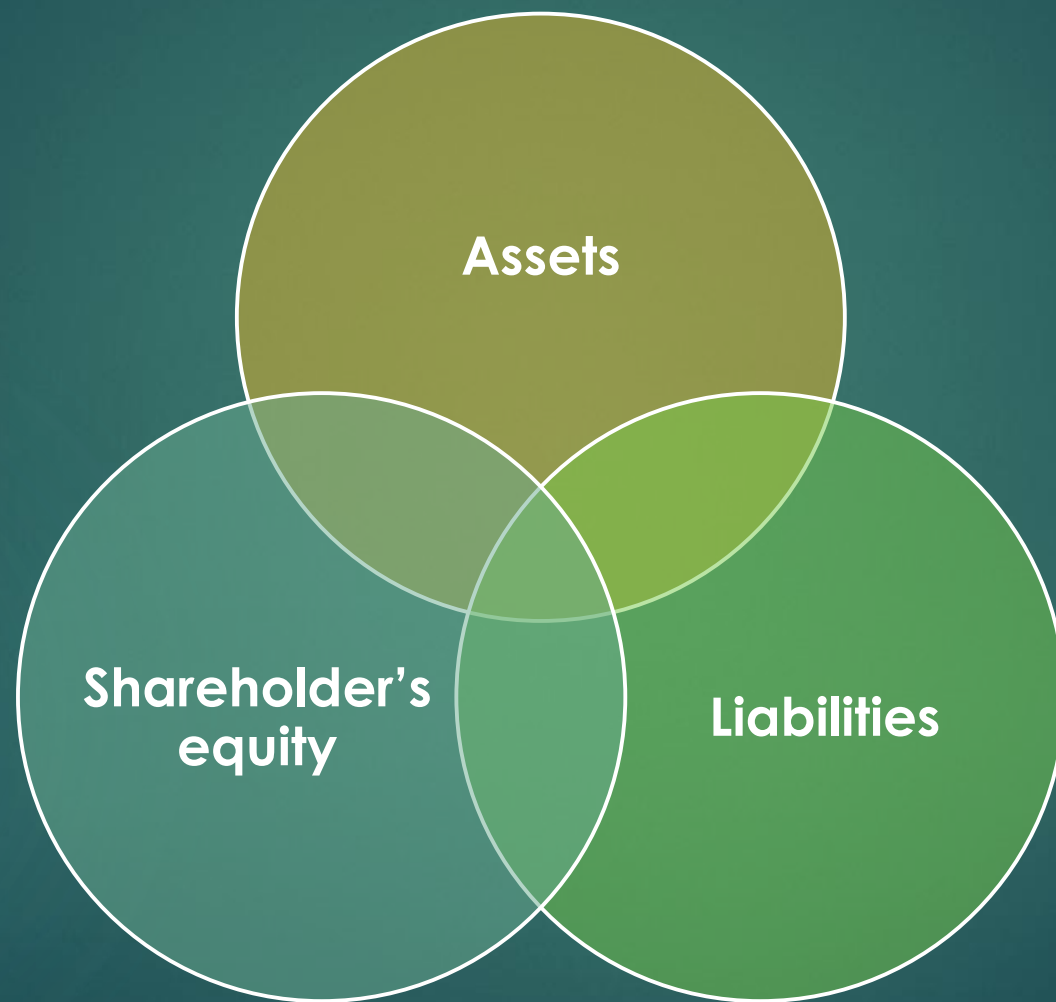
Cash flow statement



Today's focus

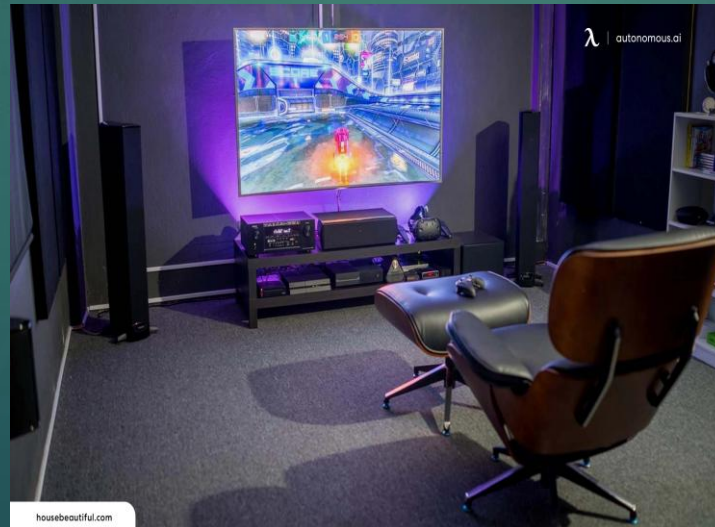


Key terms used in balance sheet



Assets

- ▶ Assets are things that a company owns that have value.
- ▶ They can be either be sold or used by the company to make products or provide services that can be sold.





Classification of assets

a. Based on convertibility



Current assets

Non-current assets

Current assets

- ▶ Are things a company expects to convert to cash within a year.

E.g. Inventory, short term deposits and marketable securities, Account receivables

Marketable securities are financial instruments that can be easily converted into cash. Examples (stocks/shares)

Non-current assets/Fixed assets

- ▶ Are things a company does not expect to convert to cash within one year or that would take longer than one year to sell.
- ▶ Fixed assets are those assets used to operate the business but that are not available for sale, such as trucks, office furniture, land, house etc.

Classification of assets

b. Based on physical existence



Tangible assets

Intangible assets

Tangible assets

- ▶ Assets that you can see and feel (physical presence)

Example: Machine, Equipment, Buildings.



Intangible assets

- ▶ Assets that do not have physical existence

Example: Patents, Brands, Copyrights



Classification of assets

b. Based on Usage



Operating assets

Non-Operating assets

operating assets

- ▶ Assets which are necessary to conduct business operations.

Examples: Machines, buildings and equipment



Non-operating assets

- ▶ Short term investment or marketable securities that are not necessary for daily operations



What are Assets?



Examples



Liabilities

- ▶ Liabilities are the amounts of money that a company owes to others.
- ▶ E.g obligations; Money borrowed from the bank to launch a new product ,Rent for use of a building, money owed to suppliers for materials, payroll a company owes to the employees, environmental clean up costs, or taxes owed to government.
- ▶ Liabilities also include obligations to provide goods or services to customers in the future.

Current and long term liabilities


- ▶ Liabilities are generally listed on their due dates.
- ▶ Liabilities are said to be either current or long-term.
- ▶ **Current liabilities** are obligations a company expects to pay off within a year. Examples: Accounts payable, interest payable, short term loans
- ▶ **Long term liabilities** are obligations due more than one year. Bonds payable, long term notes payable, deferred tax

- ▶ Accounts payable: Represents company's obligations to pay off a short term debt to its creditors or suppliers.
- ▶ Interest payable: Amount of interest currently owed to lenders that can be paid within one year.
- ▶ Bonds payable: It is a form of debt financing issued by corporations/governments to raise capital. The issuer of bonds is obligated to pay interest expenses periodically over the borrowing term and repay the principal at maturity.
- ▶ Long term notes payable: A loan that is expected to be paid in more than one year.
- ▶ Deferred tax: The amount of income tax payable in the future.

Shareholders equity

- ▶ Shareholders' equity is sometimes called capital or net worth.
- ▶ It's the money that would be left if a company sold all of its assets and paid off all of its liabilities.
- ▶ This left over belongs to the shareholders, or the owners of the company.

They are outstanding shares, additional paid in capital, retained earnings and treasury stock.



Outstanding shares: The portion of a company's stock currently held by all its shareholders.

Additional paid in capital: Represents the excess amount paid in total by investors above the par value of a company's shares.

Retained earnings: The sum of company's earnings from prior period after deducting any dividends paid to the company's shareholders.

Dividend: distribution of profits by a corporation to its shareholders

Treasury stock: Formerly outstanding stock that has been repurchased and is being held by the company.

Balance sheet

- ▶ Show what a company owns and what it owes at a fixed point of time.
- ▶ Provides detailed information about a company's **assets**, **liabilities** and **shareholders' equity**.
- ▶
$$\text{ASSETS} = \text{LIABILITIES} + \text{SHAREHOLDERS' EQUITY}$$
- ▶ A company's assets have to be equal to the sum of its liabilities and shareholders' equity.

TEDDY FAB INC.
BALANCE SHEET
December 31, 2100

ASSETS

Current assets

Cash and cash equivalents	\$ 100,000
Accounts receivable	20,000
Inventory	15,000
Prepaid expense	4,000
Investments	10,000
Total current assets	149,000

Property and equipment

Land	24,300
Buildings and improvements	250,000
Equipment	50,000
Less accumulated depreciation	(5,000)

Other assets

Intangible assets	4,000
Less accumulated amortization	(200)

Total assets **\$ 472,100**

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities

Accounts payable	\$ 30,000
Notes payable	10,000
Accrued expenses	5,000
Deferred revenue	2,000
Total current liabilities	47,000

Long-term debt 200,000

Total liabilities **247,000**

Shareholders' Equity

Common stock	10,000
Additional paid-in capital	20,000
Retained earnings	197,100
Treasury stock	(2,000)

Total liabilities and shareholders' equity **\$ 472,100**