Analyzing the 3 elements of a company’s financial reports.

**BALANACE SHEET**

Analyzing a balance sheet - <https://www.youtube.com/watch?v=7THNE8xEcHk&ab_channel=DanielPronk>

* Ratio of Total-Current Assets / Total-Current Liabilities
  + Want this number to be ABOVE 1 if possible.
  + Note – “Total-Current” indicates within the next 12 months as opposed to Long-Term which indicates a time horizon greater than 12 months.
* Want to see:
  + Growth in “Total-Current Assets” and “Total Cash”
    - Want to see company is growing their cash position and their assets
  + Liabilities a bit trickier
    - If Assets are growing (outpacing) Liabilities then likely fine.
    - But, if growth of Liabilities outpaces Assets likely not.
  + Do this for **Total-Assets** and **Total Liabilities** as well [not just total-currents]
* Shareholder Equity
  + Shareholder equity = Total Assets – Total Liabilities
  + So, if stockholder equity is going down, it means the company is accepting more liabilities than they are assets.
    - Want Total Shareholder Equity to be going up.

**INCOME STATEMENT**

Analyzing an Income Statement - <https://www.youtube.com/watch?v=uVHGgSXtQmE&ab_channel=DanielPronk>

* Gross Margin – Gross Profit / Total Revenue ~ a percentage which indicates gross margin.
* Operating income = Gross Profit – Operating Expenses
* Operating Margin – Operating Income / Total Revenue ~ (good value around 15% is average)
  + The higher operating margin the better for the business.
  + Logic – we want the business to keep as much of the total revenue generated for the business.
  + Operating income is higher when gross profit is higher or when operating expenses are lower.
* Investment references
  + Reference to the “top-line” number
    - The top line of the income statement ~ the Total revenue
  + Reference to the “bottom-line” number
    - The bottom line of the income statement – the net income.
* What to look for on an INCOME STATEMENT
  + Positive number for (Operating Income or Loss) ~ obviously want operating income.
  + Positive net income
  + Look at 10-years trend in TOTAL REVENUE and NET INCOME
  + Explore how Total Revenue is trending with (Operating Income or Loss)
    - If operating income or loss is negative (loss), then where are these expenses coming from?
    - Are these expenses increasing faster than the company is generating new revenue?
    - Eg. from Uber at end of 2019
      * A “Big Red Flag” ~ Total Operating Expenses (15.535 billion) exceeded Total Revenue (14.147 billion)
        + The company was spending more than it was bringing in.

**CASH FLOW STATEMENTS**

* Purpose – meant to show the cash moving into and out of a company which shows you the health of a business and its liquidity – how well a business is able to pay off debts.
* Organizational note
  + Top number is “Net Income” ~ or the “bottom-line” from the Income statement.
  + The Cash Flow statement is organized into **FOUR** sections:
    - Operating Activities – cash flow from day-to-day operations
    - Investing Activities – cash flow from investing
    - Financing Activities – cash flow from taking on new debts or issuing dividends or new stock
    - Net change in cash and Free Cash flow
* Change in Working Capital is: (Current Assets – Current Liabilities)
  + Ak positive Change in Working capital indicates that the company took on new debt or sold an asset to raise new money.
* Accounts Receivable interpretation on the cash flow statement
  + Positive – indicates that the accounts receivable is being paid off faster than it is growing
  + Negative – indicates that the accounts receivable growing faster than it is being paid off
* Inventory
  + The amount they spend on their inventory
* **Net cash provided by operating activities** – Perhaps, the most important number
  + ABSOLUTELY want this number to be positive as a negative value indicate the company is losing money through its operation and is not generating a profit.
* Acquisitions, net
  + How much a company is spending to acquire other companies (negative on a cash flow statement)
  + If the company is spending billions investing in other companies it means they are not reinvesting cash back into their own business.
  + If a company doesn’t want to invest in itself maybe I shouldn’t either.
* **Net cash used for investing activities** 
  + Want to see the PERCENTAGE breakdown with the largest allocation going towards “Investment in property, plant, and equipment” category since this will indicate the company is investing back into itself.
* **Net cash flow from financing activities**
  + Possible Red Flag --> If the company is spending cash on “Common stock repurchased” when their cash flow statement does not support that.
    - Common stock repurchased is literally the company purchasing back shares of its own stock.
* **Net Change in Cash** = Operating Activities – Investing Activities – Financing Activities
  + Positive indicates the company has a larger cash position.
  + Negative is not necessarily a bad thing, it may indicate an acquisition which is one way to grow a business. Check: “Acquisitions, net”
* **Free Cash Flow** = Operating Cash Flow – Capital Expenditure (aka Cap. Ex. ~ the investments back into Property, Plant, and Equipment – see above)
  + This resulting value is the amount of money left-over the company can use for whatever it likes.
  + Want to see this achieving YoY growth.
* Key things to be on the lookout for in a Cash statement:
  + Net Income increasing YoY
  + Net cash provided by operating activities increasing YoY
  + “Other financing activities” ~ how much new debt the company is assuming. If ridiculously large values then paying down this debt in the future could impair growth.
  + O.P.M Company (Other People’s Money; Benjamin Graham) – the case of Uber
    - Uber has a NEGATIVE net cash flow provided by operating activities (2019). So how is it making money?
    - Uber raised money through Common stock issued (i.e., selling stock at double the value of its negative earnings).
      * Plus, it has an amount of Employee Stock options equal to its losses.
    - Since none of this money is coming from OPERATIONS at uber, it is all coming from investors who purchased the stock.