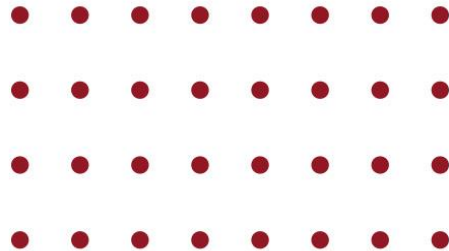


Class 2

UG3F14 Corporate Finance



Class 2 Topics and Content

I. The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:

1. The Annual Report: The Four Financial Statements
2. Interpreting the Business Financial Performance:
 - Connection between the Financial Statements

Class 2

I. *The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:*

1. The Annual Report: The Four Financial Statements

- Financial statements are reports prepared by a company's management to present the financial performance and position of the business at a point in time
- Corporations required those statements to be audited by external auditors, government agents, or other bodies ensure accuracy and for regulatory, tax, financing, or investing purposes
- A corporate annual report is a written financial summary of a company's activities during the year along with management's analysis of the company's current financial position and future plans
- They corporate annual report contains four basic financial statements, and for public companies is publicly available from several sources like regulators SEC, CNMV, Financial Conduct Authority or the business own websites

Class 2

I. *The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:*

1. The Annual Report: The Four Financial Statements

1. The balance sheet or statement of financial position shows the financial position: assets, liabilities, and stockholders' equity-of the firm on a particular date
2. The income statement presents the results of operations: revenues, expenses, net profit or loss, and net profit or loss per share-for the accounting period
3. The statement of cash flows provides information about the cash inflows and outflows from operating, financing, and investing activities during an accounting period.
4. The statement of stockholders' equity details the transactions that affect the balance sheet equity accounts during an accounting period

Class 2

I. *The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:*

1. The Annual Report: The Four Financial Statements

- Financial statements and their notes, serves as a route, and the lead to a determination of the financial health of a business
- They contain valuable information regarding the financial position of a company, the success of its operations, the policies and strategies of management, and its future performance
- Depending on the end user: investor, creditor, management, **financial manager**, competitor, supplier, regulator, the financial statement report can find and interpret the information to answer questions about the company:

Financial Management

- ✓ **Would an investment generate the expected returns?**
- ✓ **What is the degree of risk associated with the investment?**
- ✓ **Should existing investment holdings be liquidated?**
- ✓ **Will cash flows be sufficient to service cash needs (debt payment)**
- ✓ Is the company provide a good employer? (future advancement or employee benefits)
- ✓ How well does this company compete in its operating environment?
- ✓ Is this firm a good prospect as a customer?

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I. *The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:*

1. The Annual Report: The Four Financial Statements

- Financial statements and their notes contain valuable information regarding the financial position of a company, the success of its operations, the policies and strategies of management, and its future performance
- Notes to the Financial Statements:
 - Follow immediately after the four financial statements is the section “Notes to the Financial Statements” and are an integral part of the statements
 - Other notes to the financial statements present details about particular accounts: Inventory Property, Investments Long-term debt, any major acquisitions or divestitures that have occurred during the accounting period, employee retirement, stock option plans, or leasing arrangements

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I. *The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:*

1. The Annual Report: The Four Financial Statements

Example:

Starbucks Corporation

Starbucks Corporation is an American multinational chain of coffeehouses and roastery reserves headquartered in Seattle, Washington, and it is the world's largest coffeehouse chain

Ticker: SBUX (NASDAQ) \$119.13 Aug 3, 16:00 EDT

Founded: March 31, 1971,

Revenue: 23.82 billion USD (2020)

Subsidiaries: Teavana, Tata Starbucks, Seattle's Best Coffee



<https://investor.starbucks.com/financial-data/annual-reports/default.aspx>

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I. *The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:*

1. The Annual Report: The Four Financial Statements

1. *The Balance Sheet* / the Statement of Condition / the Statement of Financial Position:

- It is a summary of the financial position or condition of a business or organization at a specific moment in time
- Provides valuable information about a business firm, particularly when examined over a period of several years and evaluated in relation to the other financial statements
- A financial statement that reports a company's assets, liabilities and shareholders' equity at a specific point in time, and provides a basis for computing rates of return and evaluating its capital structure
- To add the appropriate value, the balance sheet should be compared with those of previous periods or businesses within the same industry

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I. *The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:*

1. The Annual Report: The Four Financial Statements

1. *The Balance Sheet / the Statement of Condition / the Statement of Financial Position:*

- The statement is a summary of what the firm owns (assets) and what the firm owes to outsiders (liabilities) and to internal owners (stockholders' equity)
- Most businesses use the calendar year with the accounting period ending on December 31, and prepare interim statements for each quarter Q, ending March 31, June 30, and September 30
- Purpose: To demonstrate a company's financial position and its solvency (i.e. its ability to meet long-term financial obligations).
- The account balances on a balance sheet must balance: total of all assets must equal the sum of liabilities and stockholders' equity. The balancing equation is expressed as:

$$\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$$

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I. *The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:*

1. The Annual Report: The Four Financial Statements

1. *The Balance Sheet / the Statement of Condition / the Statement of Financial Position:*

- The balance sheet answers questions like: Is the business being well managed? Are there enough assets to pay off all liabilities if needed?
- It reveals the business's current strengths and weaknesses and is useful for future financial planning
- Data Included:
 - ✓ Assets – In financial accounting, an asset is any resource owned by the business, tangible or intangible that can be owned or controlled to produce value and that is held by a company to produce positive economic value. Examples: cash, inventory, or equipment
 - ✓ Liabilities – are defined as a company's legal financial debts or obligations that arise during the course of business operations. Example: bank loans or accounts payable
 - ✓ Equity or Stockholder's Equity – is ownership. In the accounting and corporate lending world, equity (or shareholders' equity) refers to the amount of capital contributed by the owners or the difference between a company's total assets and its total liabilities

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I. The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:

1. The Annual Report: The Four Financial Statements

1. The Balance Sheet / the Statement of Condition / the Statement of Financial Position:

➤ Guide-Template Balance Sheet

Example Corporation		
Balance Sheet		
December 31, 2020		
ASSETS	LIABILITIES	
Current assets	Current liabilities	
Cash and cash equivalents	Short-term loans payable	\$ 5,000
Short-term investments	Current portion of long-term debt	15,000
Accounts receivable - net	Accounts payable	20,900
Other receivables	Accrued compensation and benefits	8,500
Inventory	Income taxes payable	6,100
Supplies	Other accrued liabilities	4,000
Prepaid expenses	Deferred revenues	1,500
Total current assets	Total current liabilities	61,000
Investments	Long-term liabilities	
	Notes payable	20,000
Property, plant & equipment - net	Bonds payable	375,000
Land	Deferred income taxes	25,000
Land improvements	Total long-term liabilities	420,000
Buildings	Total liabilities	481,000
Equipment	Commitments and contingencies (see notes)	
Less: accumulated depreciation		
Property, plant & equipment - net		
Intangible assets	STOCKHOLDERS' EQUITY	
Goodwill	Common stock	110,000
Other intangible assets	Retained earnings	220,000
Total intangible assets	Accum other comprehensive income	9,000
Other assets	Less: Treasury stock	(50,000)
	Total stockholders' equity	289,000
Total assets	Total liabilities & stockholders' equity	\$ 770,000

The accompanying notes are an integral part of this statement.

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I. *The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:*

1. The Annual Report: The Four Financial Statements

2. *The Income Statement / Statement of Earnings:*

- Business success is measured by the capacity in generating profits
- Investors, creditors, and analysts await companies' earnings reports to make decisions
- Is a financial statement that reports the operating net profit or loss for a specific period of time, it is also called the profit and loss statement (P&L)
- The Income Statement shows how well a business is performing during a particular time period in detail
- It indicates how the sales and other revenues are transformed into the net income/net profit
- How much income is coming in and where is it coming from
- How is money being spent during the time period
- Purpose of the income statement is to show how profitable a company is from their operations

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I. *The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:*

1. The Annual Report: The Four Financial Statements

2. *The Income Statement / Statement of Earnings:*

➤ Data Included:

- ✓ Income – Business revenues, for example: sales, revenue, or dividends received for the given time period
- ✓ Expenses – What a business has paid out in that time period for running the business, for example: salaries, wages, interest, rent, or taxes
- ✓ Net income / profit /earning from operations after federal and local taxes are paid
- ✓ Earnings per share of common stock

The difference between the balance sheet and income statement:

The **balance sheet** reports assets, liabilities, and equity, while the **income statement** reports revenues and expenses that leads to the net profit or loss

Class 2

I. The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:

1. The Annual Report: The Four Financial Statements

2. *The Income Statement / Statement of Earnings:*

➤ Guide-Template Income Statement

Example Corporation Income Statement Years ended December 31

(in thousands of dollars)

	<u>2020</u>	<u>2019</u>	<u>2018</u>
Net sales	\$ 3,980	\$ 3,750	\$ 3,400
Cost of sales	<u>3,100</u>	<u>2,950</u>	<u>2,700</u>
Gross profit	880	800	700
Selling, general and administrative expenses	<u>640</u>	<u>590</u>	<u>510</u>
Operating income	240	210	190
Interest expense	20	15	15
Loss on sale of equipment	<u>5</u>	<u>-</u>	<u>4</u>
Income before income taxes	215	195	171
Income tax expense	<u>50</u>	<u>40</u>	<u>36</u>
Net income	<u>\$ 165</u>	<u>\$ 155</u>	<u>\$ 135</u>

See notes to the financial statements.

<https://siskmorriscpa.com/2014/11/03/chart-of-accounts-income-statement-and-balance-sheet/>

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I. *The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:*

1. The Annual Report: The Four Financial Statements

3. *The Statement of Cash Flows:*

- The primary purpose of the statement of cash flows is to provide information about cash receipts, cash payments, and the net change in cash resulting from the operating, investing, and financing activities of a company during a particular period
- Importance: Generating sufficient cash is the key to a healthy business, and the report shows how well the business is doing in that venture
- The statement of cash flows can also be used in developing a business strategy and long term planning
- Data included:
 - ✓ Operating activities – Cash generated from the sale of products or services in the core business e.g. revenues
 - ✓ Investing activities – Cash spent on investments e.g. new equipment
 - ✓ Financing activities – Cash flow from financing such as cash from a new debt or dividends paid to investors

Class 2

I. The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:

1. The Annual Report: The Four Financial Statements
 3. The Statement of Cash Flows

- Guide-Template Statement of Cash Flows

Example Corporation	
Statement of Cash Flows	
For the year ended December 31, 2020	
Cash flows from operating activities	\$230,000
Net income	
<i>Adjustments to reconcile net income to net cash provided by operating activities:</i>	
Depreciation and amortization	63,000
Loss on sale of equipment	15,000
<i>Changes in current assets and liabilities:</i>	
Increase in accounts receivable	(21,000)
Decrease in prepaid expenses	3,000
Decrease in accounts payable	(28,000)
Net cash provided by operating activities	<u>262,000</u>
Cash flows from investing activities	
Capital expenditures	(300,000)
Proceeds from sale of equipment	40,000
Net cash used for investing activities	<u>(260,000)</u>
Cash flows from financing activities	
Proceeds from issuing debt	200,000
Dividends paid	(110,000)
Net cash provided by financing activities	<u>90,000</u>
Net increase in cash during the year	92,000
Cash at the beginning of the year	101,000
Cash at the end of the year	<u>\$193,000</u>

Notes to the financial statements.

Class 2

I. *The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:*

1. The Annual Report: The Four Financial Statements

4. *The Statement of Stockholder's Equity / Statement of Changes in Equity:*

- The equity statement gives details about the movement of owner's equity over a period of time
- The purpose of the financial statement is to explain changes in retained earnings between the prior and current balance sheet dates
- This statement demonstrates how the financial performance of the business has affected their interest during the given time period (end-user investor)
- Data Included:
 - ✓ Net profit or loss
 - ✓ Increases or decreases in share capital reserves
 - ✓ Dividend payments to stockholders
 - ✓ Other gains and losses (e.g. changes in revaluation reserve)

Class 2

I. The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:

1. The Annual Report: The Four Financial Statements

4. The Statement of Stockholder's Equity / Statement of Changes in Equity:

➤ Guide-Template Stockholder's Equity

PEPPER CORPORATION					
Statement of Stockholders' Equity					
For the Year Ending December 31, 20X9					
	Common Stock, \$1 Par	Paid-in Capital in Excess of Par	Retained Earnings	Treasury Stock	Total Stockholders' Equity
Balance on January 1	\$20,000,000	\$25,000,000	\$11,000,000	\$(5,000,000)	\$51,000,000
Issued shares for cash	3,000,000	12,000,000			15,000,000
Purchase of treasury stock				(2,000,000)	(2,000,000)
Net income			4,000,000		4,000,000
Cash dividends			(1,500,000)		(1,500,000)
Stock dividends	1,150,000	4,600,000	(5,750,000)		
Balance on December 31	<u>\$24,150,000</u>	<u>\$41,600,000</u>	<u>\$ 7,750,000</u>	<u>\$(7,000,000)</u>	<u>\$66,500,000</u>

<https://www.google.com/search?q=statement+of+changes+in+equity>

Class 2

1. The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:

2. Interpreting the Business Financial Performance: Connection between Financial Statements

- It is necessary to specify the objective of the analysis or who is the interest party when analyzing a firm's financial statements: management, investors, market analysts, and creditors
- Financial analysts rely on historical financial data to analyze the performance of a company in order to forecast about its future direction of the company's stock price.
- Financial statement analysis from Financial Management relates to all of the questions raised by creditors and investors because these user groups must be satisfied for the firm to obtain capital as needed, in addition to its employees, the general public, regulators, and the financial press:
 - ✓ How well has the firm performed and why?
 - ✓ What operating areas have contributed to success and which have not?
 - ✓ What are the strengths and weaknesses of the company's financial position?
 - ✓ What changes should be implemented to improve future performance?

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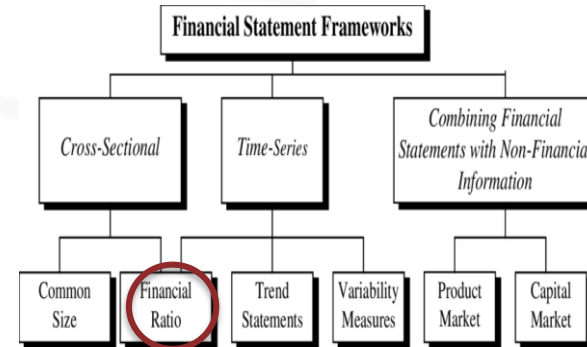
- 1. *The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:***
 - 2. Interpreting the Business Financial Performance: Connection between Financial Statements*
 - End-users use financial statement analysis to:
 1. Compare the business with itself by analyzing how the firm has change over time
 2. Compare the business with similar businesses (competitors / industry) using a common set of data (financial ratios)

Class 2

I. The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:

2. Interpreting the Business Financial Performance: Connection between Financial Statements

- Financial Statement Analysis is the process of understanding the fundamentals of the company by reviewing its financial statements: Income Statement, Balance Sheet and Cash Flows Financial Statement Analysis can be performed in a structured way using different frameworks
- Foster's Classification of Financial Statement Analysis Techniques
 - ✓ The first goal of Financial Statement Analysis is the Cross-sectional analysis - the study of firms in a specific economic sector like Financial Ratio Analysis techniques to compare firms



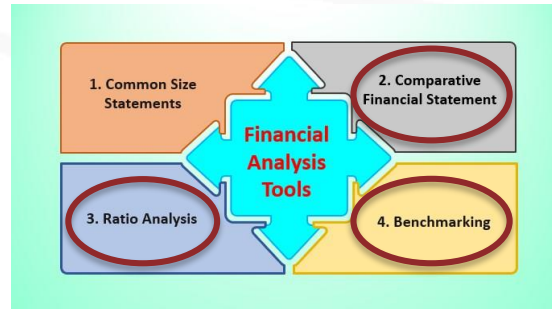
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I. *The role of Financial Information for Decision Making: Understanding the Business from its Financial Statements:*

2. *Interpreting the Business Financial Performance: Connection between Financial Statements*

- Financial Statement Analysis is the process of understanding the fundamentals of the company by reviewing its financial statements: Income Statement, Balance Sheet and Cash Flows Financial Statement Analysis can be performed in a structured way using different frameworks
- Some financial analysis tools includes comparison between periods, ratio analysis or industry benchmark



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We will be expanding in the topic in the next class:

The role of Financial Information for Decision Making - Understanding the Business from its Financial Statements:

Interpreting the Business Financial Performance: Connection between Financial Statements

