

Financial Statements

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WOOD 465
February 5, 2018



By the end of this lesson you will be able to:

1. understand how to read and analyze 2 basic financial statements
 - ① Income statement
 - ② Balance sheet
2. evaluate firm profitability using the financial statements

What is Finance?

- **Finance** is a broad term that describes two related activities: (1) the actual process of acquiring needed funds and (2) how money is
- Because individuals, businesses and government entities all need funding to operate, the field is often separated into three sub-categories: personal finance, corporate finance and public finance.



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Definition of financial statement:

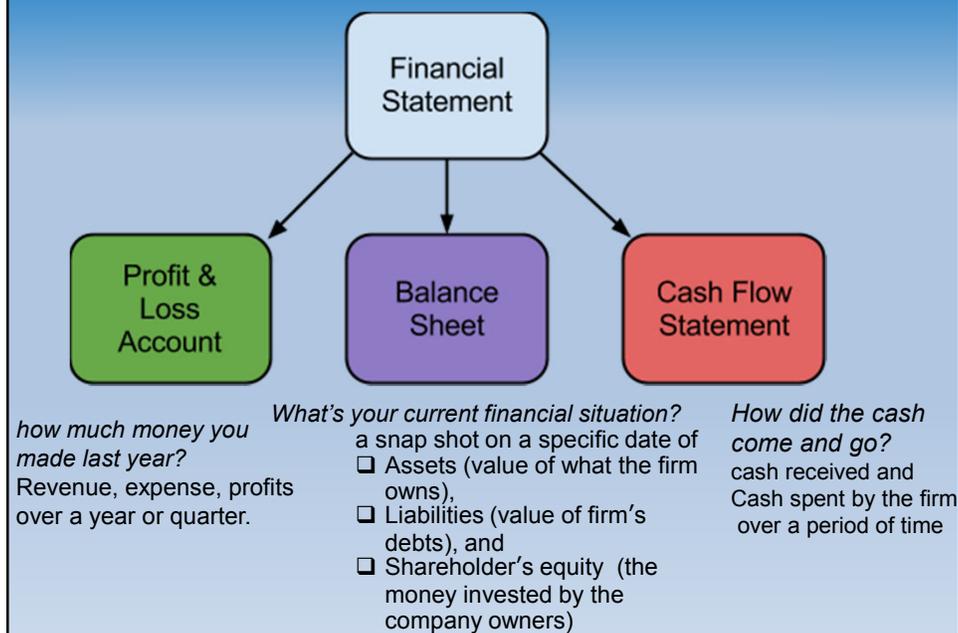
Financial statement is a formal record of the financial activities and position of a business, person, or other entity.

They will show total income, expenses, cash balances, level of debt, and much more.



But where does this information come from?

Basic financial statements:



Accounting Basics

- **Assets:** tangible and intangible items that the company owns that have value (e.g. cash, computer systems, patents, accounts rec.)
- **Liabilities:** money that the company owes to others (e.g. mortgages, vehicle loans, accounts payable)
- **Equity:** that portion of the total assets that the owners or stockholders of the company fully own; have paid for outright
- **Revenue or Income:** money the company earns from its sales of products or services, and interest and dividends earned from marketable securities
- **Expenses:** money the company spends to produce the goods or services that it sells (e.g. office supplies, utilities, advertising)

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Accounts

Accounts are the categories into which the effects of transactions are recorded, and from which financial reports are created.

5 major account categories:

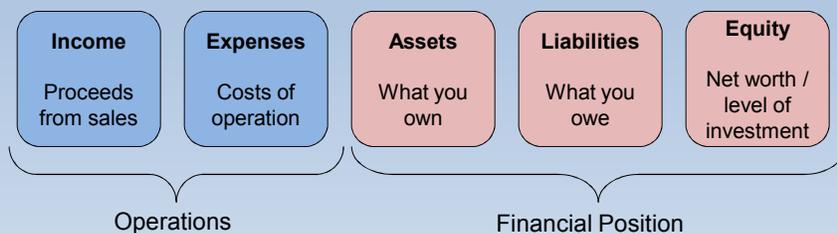


Chart of Accounts

A list of all accounts used by a business.

Sample Income accounts <ul style="list-style-type: none"> • Sales revenue • Other income 	Sample Expense accounts <ul style="list-style-type: none"> • Rent • Cost of Goods Sold (COGS) • Marketing • Office supplies • Payroll • Professional fees
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Sample Asset accounts <p><i>Current assets</i></p> <ul style="list-style-type: none"> • Cash • Inventory • Accounts receivable <p><i>Fixed assets</i></p> <ul style="list-style-type: none"> • Equipment • Property 	Sample Liability accounts <ul style="list-style-type: none"> • Accounts payable • Credit card payable • Loan payable 	Sample Equity accounts <ul style="list-style-type: none"> • Owner's equity • Retained earnings
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Income Statement / Profit & Loss Statement (P&L)

- Shows performance of your business over a period of time
- Summarizes all revenue generated by the business
- Summarizes all expenses incurred by the business (by category)
- Calculates the net profit or loss, or “bottom line” = Income – Expenses

My company Income Statement For the month of January 2018

Income	
Sales revenue	\$2,000
Expenses	
rent	\$ 850
utilities	75
payroll	400
insurance	25
marketing	250
Total expenses	\$ 1,600
Profit/Loss	\$400



Group Activity: Assessing **Income Statements**

First, select a company's income statement using Google Finance and answer the following questions:

1. What are the revenues of the company during the most recent reported period?
2. Have the revenues increased or decreased over the last two years/quarters?
3. What are the various components of cost?
4. How profitable was the company during this period?
5. Have the profits increased or decreased over the last two years/quarters?

Briefly share your assessments with the class.

Balance Sheet

A Balance Sheet shows:

What a business **owns**

What a business **owes**

What a business **is worth**

Balance Sheet

- **List of Assets Owned and Debts Owed**
 - **At a point in time**
 - **With dollar values attached**

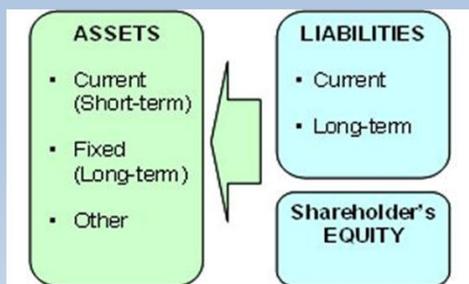
+ \$ Assets

- \$ Liabilities (Debts)

= \$ Net Worth or Equity

Balance Sheet

- Shows a snapshot of a business at a point in time
- Accumulates over the lifetime of your business
- Shows the net worth of your business
- The balance sheet always balances $\text{Assets} = \text{Liabilities} + \text{Equity}$



Balance Sheet Objectives

- Financial flexibility - ability of company to manage its cash flows (deal with emergencies or take advantage of unexpected opportunities)
- Liquidity - length of time until assets are realized or converted to cash (or until a liability has to be paid)
- Solvency – the ability of a firm to meet its debts as they come due

My company Balance Sheet As of January 31, 2018

<u>Assets:</u>		<u>Liabilities:</u>	
Cash	5,000	Accounts Payable	900
Accounts Receivable	600	Loan Payable	3,500
Inventory	900		
Equipment	1,000	Total Liabilities	4,400
Total Assets	7,500	<u>Equity:</u>	
		Owner's equity	2,700
		Retained earnings	400
		Total Equity	3,100

Link between balance sheet and income statement

- When a business operates at a profit, it increases in equity (is worth more)
- When a business operates at a loss, it decreases in equity (is worth less)

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Equipment	1,000	Equity:	
Total Assets	7,500	Owner's equity	2,700
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		Total Equity	3,100

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Income Statement | Balance Sheet

View: Quarterly Data | Annual Data

Current Working Capital = current assets – current liabilities

In Millions of CAD (except for per share items)	As of 2016-12-31	As of 2015-12-31	As of 2014-12-31	As of 2013-12-31
Cash & Equivalents	51.90	17.50	76.80	13.50
Short Term Investments	-	-	-	-
Cash and Short Term Investments	51.90	17.50	76.80	13.50
Accounts Receivable - Trade, Net	75.90	101.80	60.70	71.00
Receivables - Other	-	-	-	-
Total Receivables, Net	92.70	119.30	70.70	81.30
Total Inventory	166.50	163.80	143.70	128.00
Prepaid Expenses	5.10	7.50	11.20	7.20
Other Current Assets, Total	-	-	-	-
Total Current Assets	316.20	308.10	302.40	230.00
Property/Plant/Equipment, Total - Gross	1,643.70	1,605.90	1,562.10	1,513.50
Accumulated Depreciation, Total	-1,125.00	-1,073.60	-1,038.00	-985.40
Goodwill, Net	-	-	-	-
Intangibles, Net	-	-	-	-
Long Term Investments	-	-	-	-
Other Long Term Assets, Total	2.20	0.90	0.90	10.50
Total Assets	837.10	841.30	827.40	768.60
Accounts Payable	-	-	-	-
Accrued Expenses	37.40	37.50	29.90	30.00
Notes Payable/Short Term Debt	0.00	0.00	0.00	10.60
Current Port. of LT Debt/Capital Leases	-	-	-	0.00
Other Current liabilities, Total	16.10	31.10	33.70	30.40
Total Current Liabilities	125.40	144.20	123.20	129.00
Long Term Debt	50.00	50.00	50.00	50.00
Capital Lease Obligations	-	-	-	-
Total Long Term Debt	50.00	50.00	50.00	50.00
Total Debt	50.00	50.00	50.00	60.60
Deferred Income Tax	61.70	68.20	65.50	72.80
Minority Interest	-	-	-	-
Other Liabilities, Total	115.30	99.20	99.10	78.80
Total Liabilities	352.40	361.60	337.80	330.60
Redeemable Preferred Stock, Total	-	-	-	-
Preferred Stock - Non Redeemable, Net	-	-	-	-
Common Stock, Total	491.60	508.20	522.10	523.40
Additional Paid-In Capital	-	-	-	-
Retained Earnings (Accumulated Deficit)	-6.90	-28.50	-32.50	-85.40
Treasury Stock - Common	-	-	-	-
Other Equity, Total	-	-	-	-
Total Equity	484.70	479.70	489.60	438.00
Total Liabilities & Shareholders' Equity	837.10	841.30	827.40	768.60
Shares Outstanding - Common Stock Primary Issue	-	-	-	-
Total Common Shares Outstanding	66.70	68.95	70.83	71.01

Equity Growth

Balance Sheet West Fraser Timber		2015	2014
Assets			
Current assets			
Cash and short-term investments	\$ 13	\$ 21	
Receivables (note 23)	298	288	
Income taxes receivable	11	—	
Inventories (note 5)	631	586	
Prepaid expenses	18	12	
	971	907	
Property, plant and equipment (note 6)	1,609	1,469	
Timber licences (note 7)	570	530	
Goodwill and other intangibles (note 8)	369	350	
Other assets (note 9)	36	79	
Deferred income tax assets (note 18)	88	62	
	\$ 3,635	\$ 3,397	
Liabilities			
Current liabilities			
Cheques issued in excess of funds on deposit	\$ 29	\$ 36	
Operating loans (note 12)	178	103	
Payables and accrued liabilities (note 10)	351	411	
Income taxes payable	—	26	
Reforestation and decommissioning obligations (note 11)	48	40	
	606	616	
Long-term debt (note 12)	423	354	
Other liabilities (note 11)	269	244	
Deferred income tax liabilities (note 18)	190	154	
	1,488	1,368	
Shareholders' Equity			
Share capital (note 14)	579	587	
Accumulated other comprehensive earnings	164	55	
Retained earnings	1,404	1,387	
	2,147	2,029	
	\$ 3,635	\$ 3,397	

Group Activity: Assessing Balance Sheets

- First, consider each company's balance sheet independently
 - Which assets has each company invested heavily in?
 - Which expenses are significant to each company?
 - Calculate the current working capital for the most recent year/quarter?
- Briefly share your assessments with the class.