

# FINANCIAL STATEMENTS

# Objective

This topic covers different types of financial statements along with the calculation methodology for arriving at the profit of a company. A small discussion is also included dealing with the threats and opportunities and competition models.

# Types of Financial Statements

- **Balance Sheet**

- Statement of financial position at specific point in time; A balance sheet is often described as a "snapshot of a company's financial condition"
- The balance sheet is the only statement which applies to a single point in time of a business' calendar year

- **Income Statement**

- Summarizes revenues and expenses over an accounting period. Also called as profit and loss statement
- The purpose of the income statement is to show managers and investors whether the company made or lost money during the period being reported

# Types of Financial Statements

- **Cash Flow Statement** - Amount of cash generated during period is not what is shown on balance sheet. Tells you what happened to cash generated during specified period
  - Categories in Statement of Cash Flows
    - (a) Operating activities (b) Investing activities (c) Financing activities
- **Statement of Retained Earnings** - Reports how much of earnings retained in business rather than paid out in dividends over the life of the firm. Retained earnings is claim against assets

# Sources of Data

- Annual reports
  - SEC or company websites
- Published collections of data
  - e.g., Dun and Bradstreet or Robert Morris
- Investment sites on the web
  - Examples
    - <http://www.moneycontrol.com>
    - <http://www.nseindia.com>
    - <http://www.bseindia.com>

# Major Balance Sheet Items

## Assets

- Current assets:
  - Cash & securities
  - Receivables  
Ex. Work/project done for clients
  - Inventories
- Fixed assets:
  - Tangible assets  
Ex. Land, Machinery
  - Intangible assets  
Ex. Brands, Patents

## Liabilities and Equity

- Current liabilities:
  - Payables  
Ex. Services/project received from clients
  - Short-term debt
- Long-term liabilities  
Ex. Acquisition
- Shareholders' equity

# Major Income Statement Items

- $\text{Gross Profit} = \text{Sales} - \text{Costs of Goods Sold}$
- $\text{EBITDA} = \text{Gross Profit} - \text{Cash Operating Expenses}$   
(Earnings before interest tax depreciation and amortization)
- $\text{EBIT} = \text{EBDIT} - \text{Depreciation} - \text{Amortization}$
- $\text{EBT} = \text{EBIT} - \text{Interest}$
- $\text{NI or EAT} = \text{EBT} - \text{Taxes}$  (NI = Net Income)
- Net Income is a primary determinant of the firm's cashflows and, thus, the value of the firm's shares

# Strategic



## Positive

## Negative

### Internal Factors

#### Strengths

- **Technological Skills**
- **Leading Brands**
- **Distribution channels**
- **Customer Loyalty**
- **Production Quality**
- **Scale**
- **Management**

#### Weaknesses

- **Absence of important skills**
- **Weak brands**
- **Poor access to distribution**
- **low customer retention**
- **Unreliable product/ service**
- **Sub-scale**
- **Management**

### External Factors

#### Opportunities

- Changing customer tastes**
- **Liberalization of geographic markets**
- **Technological advances**
- **Changes in government politics**
- **Low personal taxes**
- **Change in population age-structure**
- **New distribution channels**

#### Threats

- Changing customer tastes**
- **Closing of geographic markets**
- **Technological advances**
- **Changes in government politics**
- **Tax increases**
- **Change in population age-structure**
- **New distribution channels**

# Porter's Five Forces Model of Competition

## Threat of New Entrants

- Barriers of entry
- Economics of scale
- Product differentiation
- Capital requirements
- Switching cost of buyers
- Access to distribution channels
- Government policies
- Incumbants' defense of market share
- Industry growth rate

## Rivalry Among Existing Firms

- Number of competitors (concentration)
- Relative size of competitors (balance)
- Industry growth rate
- Fixed cost vs. variable costs
- Product differentiation
- Capacity augmented in large increments
- Buyers' switching costs
- Diversity of competitors
- Exist barriers
- Strategic stakes

## Threat of Substitute Products

- Relative price of substitute
- Relative quality of substitute
- Switching costs to buyers

## Determinants of Supplier Power

- Supplier concentration
- Availability of substitute inputs
- Importance of suppliers' input to buyer
- Supplier's product differentiation
- Importance of industry to suppliers
- Buyers' switching cost to other input
- Suppliers' threat of forward integration
- Buyers' threat of backward integration

## Determinants of Buyer Power

- Number of buyers relative to sellers
- Product differentiation
- Switching costs of use other product
- Buyers' profit margins
- Buyers' use of multiple sources
- Buyers' threat of backward integration
- Sellers' threat of forward integration
- Importance of product to the buyer
- Buyers' volume