Finance Committee

Week 6 Meeting

BWIB
BRUIN WOMEN IN BUSINESS

Meeting Overview

01 3 Financial Statement Walkthroughs

Learn about the three financial statements: Income statement, balance sheet, cash flow statement

03 Q&A

Feel free to ask any questions about what we presented, or any general questions you have

02 Practice

See examples of technical questions that could be asked during interviews and get a chance to work through them on your own or in groups

01
Financial Statements

Income Statement

- Over a period of time statement
- Contains ONLY revenues and expenses (taxes, too)
- Organized with revenue on top ALWAYS with expenses BELOW
- Why does it exist?
  - shows investors the company's profitability, especially after all its COGS and more expenses.
  - also known as Profit and Loss Statement
- Breakdown:
  - **Revenue**
    - Usually sales - COGS
    - Add up to total revenue also known as gross profit
  - **Expenses**
    - All your expenses to create a total expense
    - Can then create income before taxes!
    - Add in your taxes to then create net income!

Net Income = Total Revenue (and Gains) - Total Expenses (and Losses)

Paul's Guitar Shop, Inc.
Income Statement
For the Year Ended December 31, 2015

Revenues		
Merchandise Sales	$ 24,800	
Music Lesson Income	3,000	
Total Revenues:		$ 27,800
Expenses		
Cost of Goods Sold	10,200	
Depreciation expense	2,000	
Wage expense	750	
Rent expense	500	
Interest expense	500	
Supplies expense	500	
Utilities expense	400	
Total Expenses:		14,850
Net Income		$ 12,950

BLUEGRASS CORPORATION
Comparative Income Statements
For Years Ended December 31, 2017, 2016, and 2015

	2017	2016	2015
Sales	$198,800	$166,000	$143,800
Cost of goods sold	108,890	86,175	66,200
Gross profit	89,910	79,825	77,600
Selling expenses	22,680	19,790	18,000
Administrative expenses	16,760	14,610	15,700
Total expenses	39,440	34,400	33,700
Income before taxes	50,470	45,425	43,900
Income taxes	6,050	5,910	5,300
Net income	$ 44,420	$ 39,515	$ 38,600

NESS

Balance Sheet

- Point in time statement.
- Reports assets, liabilities, and shareholders' equity.
- Assets = Liabilities + Shareholders' Equity
  - Company has to pay for everything owned by borrowing money or issuing equity for money.
- Why does it exist?
  - A snapshot of what a company owns, owes, and the amount invested by shareholders.
  - Many financial ratios are calculated from the balance sheet (debt to equity, acid test, etc.).
- Breakdown
  - **Assets**
    - Listed in order of liquidity.
    - Broken up into current (liquid within 1 year) and noncurrent assets.
  - **Liabilities**
    - Listed in order of liquidity.
    - Broken up into current (due within 1 year) and noncurrent liabilities.
  - **Owner's Equity**
    - Money attributable to shareholders/owners.
    - Typically includes retained earnings (net earnings a company either reinvests in the business or uses to pay off debt) and common stock (value of stocks issued).

Paul's Guitar Shop, Inc.
Balance Sheet
December 31, 2015

Assets			**Liabilities**	
Current Assets			Current Liabilities	
Cash		32,800	Accounts Payable	49,000
Accounts Receivable		300	Accrued Expenses	450
Prepaid Rent		1,000	Unearned Revenue	1,000
Inventory		39,800	Total Current Liabilities	50,450
			Long-term Liabilities	99,500
Total Current Assets		73,900	**Total Liabilities**	149,950
			Owner's Equity	
Long-term Assets			Owner's Equity	
Leasehold Improvements	100,000		Retained Earnings	11,950
Accumulated Depreciation	(2,000)	98,000	Common Stock	10,000
Total Long-term Assets		98,000	Total Owner's Equity	21,950
Total Assets:		171,900	**Total Liabilities and Owner's Equity**	171,900

Cash Flow Statement

- Similar to income statement in that in tracks changes over a period of time (NOT point in time)
- tracks the inflows and outflows of cash for a company
- Why does it exist?
  - you may have recorded non cash revenue, expenses, or taxes on the income statement that need to be adjusted
  - there may be additional cash inflows and outflows that did not appear on income statement
- Breakdown
  - **Cash flow from Operating Activities**
    - starts with net income at the top
    - adjusts for non cash items
    - operational balance sheet items (everyday activities of the company)
    - similar to current assets & liabilities
  - **Cash flow from Investment Activities**
    - anything related to the company's investments, acquisitions, and PP&E show up here
    - similar to long term assets
  - **Cash flow from Financing Activities**
    - items related to debt, dividends, and issuing or repurchasing shares end up here
    - similar to longer terms liabilities and equity
  - **Net changes in Cash**
  - **Beginning + Ending Cash balance**

Paul's Guitar Shop Statement of Cash Flows For the Year Ended December 31, 2015	
CASH FLOWS FROM OPERATING ACTIVITIES	
Net income	$ 12,950
Adjustments to reconcile net income to	
net cash provided by operating activities:	
Depreciation on fixed assets	2,000
(Increase) decrease in current assets:	
Accounts receivable	(300)
Inventory	(39,800)
Prepaid expenses	(1,000)
Increase (decrease) in current liabilities:	
Accounts payable	49,000
Accrue expenses and unearned revenues	1,450
NET CASH PROVIDED BY OPERATING ACTIVITIES	24,300
CASH FLOWS FROM INVESTING ACTIVITIES	
Purchase of property and equipment	(101,000)
NET CASH USED IN INVESTING ACTIVITIES	(101,000)
CASH FLOWS FROM FINANCING ACTIVITIES	
Proceeds from line of credit	-
Payments on line of credit	10,000
Proceeds from long-term debt	99,500
Payments on long-term debt	-
NET CASH PROVIDED (USED) IN FINANCING ACTIVITIES	109,500
NET INCREASE (DECREASE) IN CASH	32,800
BEGINNING CASH BALANCE	-
ENDING CASH BALANCE	$ 32,800

02

Interview Questions

Basic Explanatory Questions

- What are the 3 financial statements and why do we need them?

The 3 major financial statements are the Income Statement, Balance Sheet, and Cash Flow Statement.

The **Income Statement** shows the company's revenue, expenses, and taxes over a period and ends with Net Income, which represents the company's after-tax profits.

The **Balance Sheet** shows the company's Assets – its resources – as well as how it paid for those resources – its Liabilities and Equity – at a specific point in time. Assets must equal Liabilities plus Equity.

The **Cash Flow Statement** begins with Net Income, adjusts for non-cash items and changes in operating assets and liabilities (working capital), and then shows the company's cash from Investing or Financing activities; the last lines show the net change in cash and the company's ending cash balance.

You need these statements because there is a big difference between a company's Net Income and the cash it generates – the Income Statement alone doesn't tell what its cash flow is.

Remember the key valuation formula:

Company Value = Cash Flow / (Discount Rate – Cash Flow Growth Rate)

The 3 financial statements let you estimate the "Cash Flow" part, which helps you value the company more accurately.

How Are the 3 Statements Linked Together?

- Net income from the bottom of the income statement links to the balance sheet and the cash flow statement. For the balance sheet, it links to the retained earnings. For the cash flow statement, the net income flows to the top of the statement for the cash from operations section.

What is the most important financial statement?

- The Cash Flow Statement is the most important single statement because it tells you how much company is generating. The Income Statement is misleading because it includes non-cash revenue and expenses and excludes cash spending such as Capital Expenditures.

What if you could only use 2 statements to assess a company's prospects, which ones would you choose?

- You would use the Income Statement and Balance Sheet because you can create the Cash Flow Statement from both of those (assuming there are "Beginning" and "Ending" Balance Sheets hat correspond to the same period shown on the Income Statement).

Walk me through how a company's financial statements change when a company's operating expenses increase by $100

- Income Statement: Operating Expenses are up by $100, so Pre-Tax Income is down by $100 and Net Income is down by $60 at a 40% tax rate.
- Cash Flow: net income is down by $60. No other changes results in net cash down by $60 at the bottom of the statement
- Balance Sheet: Cash is down by $60, so Asset side is down by $60. Retained earnings is down by $60 on L&E side because net income is down by $60 so balance sheet stays balanced

A company's depreciation increases by $10, what happens to the three financial statements?

- Income Statement: pre-tax income falls by $10, and net income falls by $6, assuming a 40% tax rate
- Cash Flow: net income is down by $6. Depreciation has to get added back since it is a non-cash expense, so cash flow is up by $4, and net cash is up by $4 at the bottom
- Balance Sheet: Cash is up by $4, but PP&E is down by $10 due to the added depreciation, so assets side is down by $6. The L&E side is also down by $6 because net income fell by $6, which reduces retained earnings and balances the sides

More difficult multistep question: Your company wants to boost its EPS artificially, so it decides to issue debt and use the proceeds to buy back shares. Initially, the company has 100 shares outstanding at $100 per share, and a Net Income of $2,000.

What happens IMMEDIATELY after your company raises $1,000 in long-term debt and uses it to repurchase $1,000 in stocks?

- Income Statement: No changes
- Cash Flow: the $1,000 debt issuance boosts cash flow by $1,000 but the $1,000 stock repurchase reduces cash flow by $1,000 so no net cash flow change
- Balance Sheet: No changes in asset side. On L&E side debt is up by $1,000 but treasury stock within equity is down by $1,000 so balances out

What happens after a year passes if the company pays 5% interest on debt and repays 10% of the principal.

- Income Statement: The company records 5% x $1,000 or $50 in interest expense, and so its pre-tax income falls by $50. At a 40% tax rate, its net income falls by $30. The company now has 90 shares outstanding rather than 100, and has net income of $1,970 instead of $2,000
- Cash flow statement: Net income is down by $30, and the company also has to repay 10% of the prinicpal, or $100, so cash is down by $130 at the bottom.
- Balance Sheet: cash is down by $130, so assets side is down by $130. On the L&E side, retained earnings is down by $30 because of reduced net income, and debt is down by $100 because of the principal repayment, so the L&E side is down by $130 total, so both sides balance.

Join Us

With active membership (attend a minimum of 7 events and $5 quarterly dues), perks include:

- Access to our database of resources (including our previous presentation decks, resume templates, books, meeting recordings, and more.)
- Priority in applying for committee projects
- The ability to apply for board positions
- Early access to limited capacity events
- A feature on the website and social platforms (ie Linkedin)

BWIB
BRUIN WOMEN IN BUSINESS

If you have any questions, please feel free to reach out!

Join our slack channel to keep updated!

- general
- #financecommittee

Thank you.