READING AND UNDERSTANDING FINANCIAL STATEMENTS

WHY DO YOU WANT TO UNDERSTAND FINANCIALS?

- Gives you clarity about your business's health
- Allows you to talk with confidence about your business (banks, investors, suppliers and associates)
- Helps you set future goals to grow the business
- Empowers you to feel confident
- Empowers you to feel in control

THREE IMPORTANT TYPES OF FINANCIAL STATEMENTS

- Income Statement (Profit and Loss Statement)
- Balance Sheet
- Cash Flow Statement

TREE METAPHOR

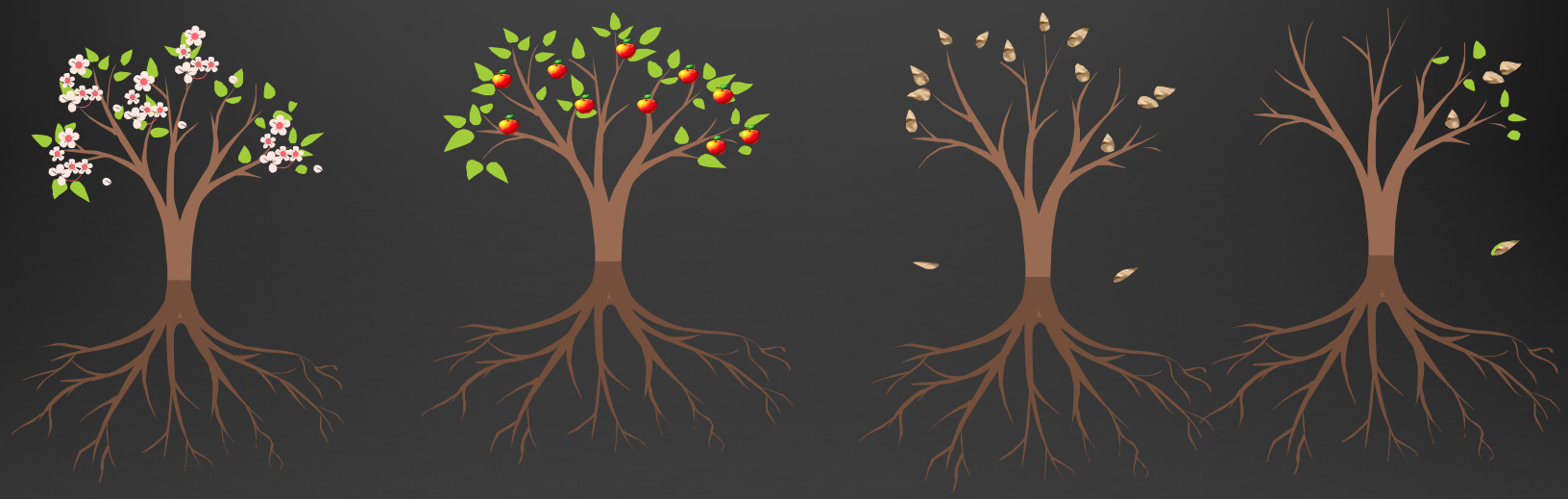
- Imagine your business as a fruit-bearing tree

INCOME STATEMENT (PROFIT AND LOSS)

- Shows total revenues (sales) less total expenses (Profit or Net Income) for a period of time
- Used to assess the operating performance of a business
  - Compare to budget and/or prior year
  - Expenses can be compared as a % of revenue
- Layout of the Income Statement
  - Steps from the top line (sales) to bottom line (net income)

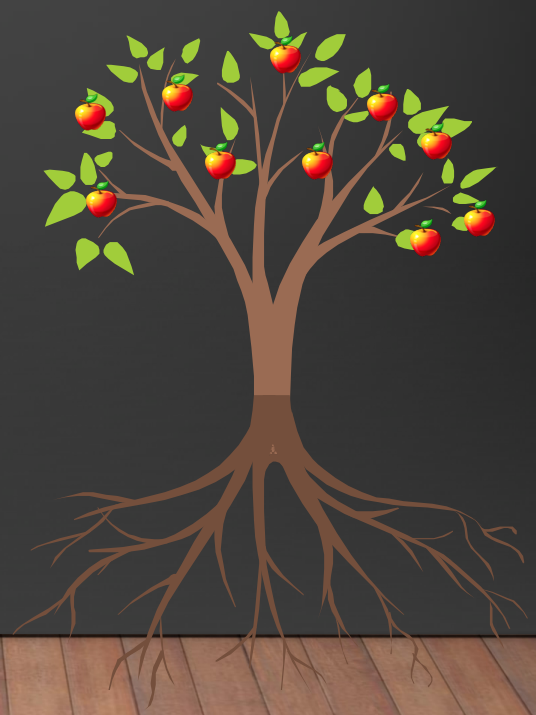
TREE METAPHOR – INCOME STATEMENT

It gets reset every year



THE INCOME STATEMENT MEASURES THE FRUITS OF YOUR BUSINESS EFFORTS.

Like a tree, your business produces an annual yield…



THE INCOME STATEMENT MEASURES THE FRUITS OF YOUR BUSINESS EFFORTS.

The Income Statement

starts at zero at the beginning

of every year

and measures the

annual yield.

THE INCOME STATEMENT MEASURES THE FRUITS OF YOUR BUSINESS EFFORTS.

At the end of each year,

net earnings (or Net Income) is added to

Retained Earnings on the Balance Sheet.

Profit =
Revenue – Expense

Olive Tree Winery

Income Statement for the Years Ended December 31, 2009 and 2008

Years Ended	*2009*	*2008*
REVENUE:		
Wine sales	350,000	275,000
Cost of wine sold	(187,500)	(137,500)
Events (net)	20,000	32,000
Gross Profit	162,500	137,500
OPERATING EXPENSES:		
Sales	42,500	38,250
Marketing	22,100	19,890
Salaries and Wages	52,000	36,450
Rent	20,000	18,000
Utilities	12,000	10,800
Operating Expenses	148,600	123,390
Operating Income (Loss)	13,900	14,110
INTEREST AND OTHER:		
Interest expense	(1,000)	(1,000)
Other income and expenses	2,000	1,500
Income Before Taxes	14,900	14,610
INCOME TAXES	3,900	1,461
Net Income (Loss)	11,000	13,149

Above the line

Department Focus

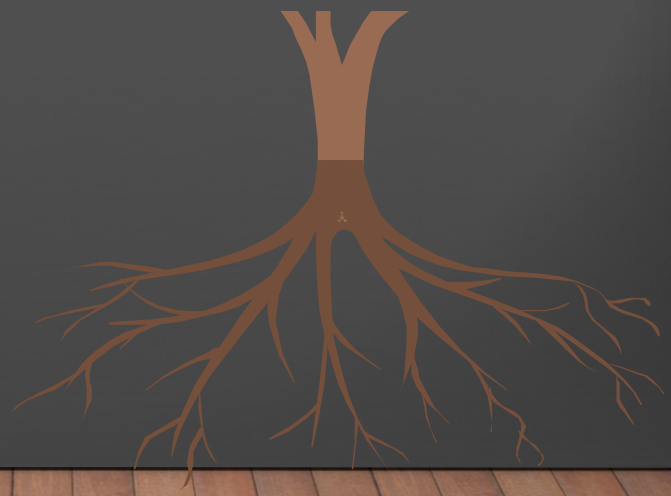
Bottom Line

BALANCE SHEET

- Shows total balances of a company's assets, liabilities, and shareholder's equity accounts at a point in time
- Assets are what the company owns
- Liabilities are what the company owes (debt)
- Shareholder's equity is the remainder of assets minus liabilities and represents the accounting net worth of the business
- Balance Sheet is prepared at the end of a period (month, quarter or year end)
- Balance sheet is a point of time

TREE METAPHOR – BALANCE SHEET

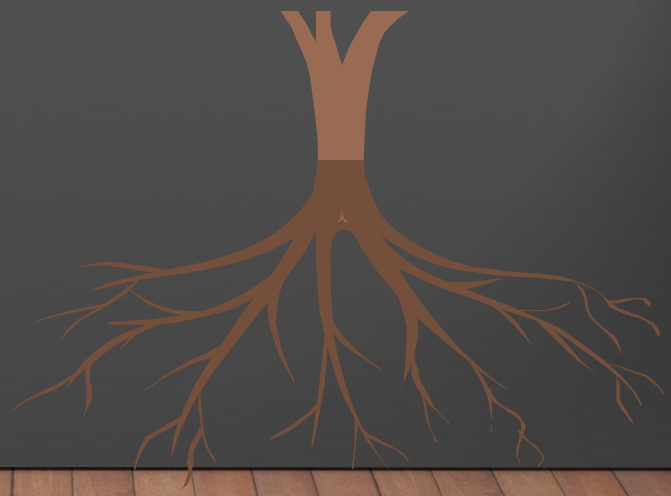
- A tree can not bear fruit without the support of a strong trunk (Balance Sheet)
- The Balance Sheet is a picture in time.
- It measures the cumulative result of your business efforts
- It sustains your business over the long haul



TREE METAPHOR – BALANCE SHEET

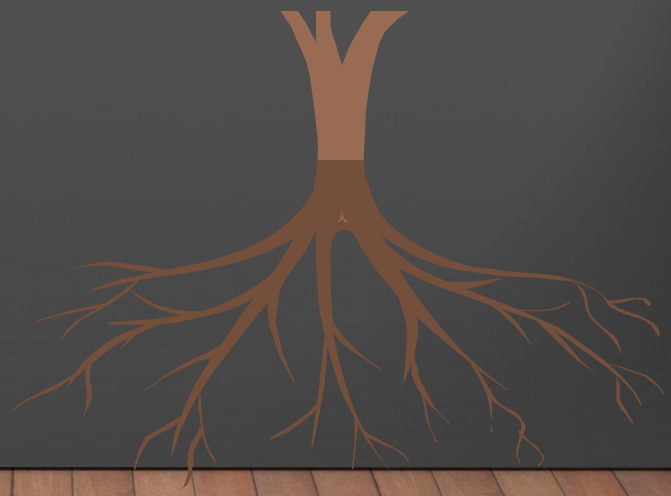
A business can not produce annual Net Income

without a solid Balance Sheet



TREE METAPHOR – BALANCE SHEET

Assets (own) –
Liabilities (owe) =
Equity (net value)



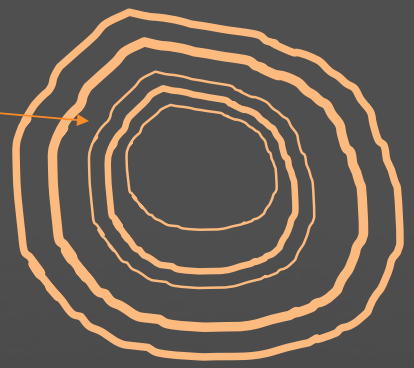
TREE METAPHOR – BALANCE SHEET

- If you slice open the trunk of a tree, you can read the story of each year in its life
- Those rings are like the equity section of the Balance Sheet.

TREE METAPHOR – BALANCE SHEET

You will find lean years…

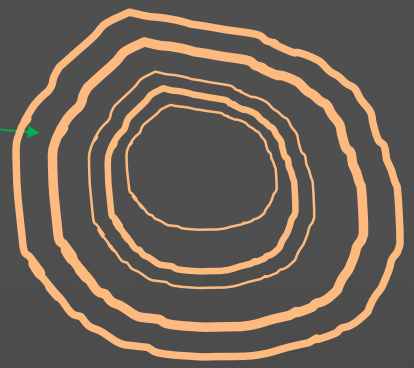
…with little or no Net Income.



TREE METAPHOR – BALANCE SHEET

And strong years…

…with plentiful Net Income



TREE METAPHOR – BALANCE SHEET

Accumulated Retained Earnings

=

Equity

Olive Tree Winery

Balance Sheet as of December 31, 2009 and 2008

	2009	2008
ASSETS		
CURRENT ASSETS:		
Cash [1]	25,650	29,350
Accounts receivable	38,150	35,000
Wine inventory	284,350	269,650
Other current assets	10,000	19,000
Current Assets	358,150	353,000
PROPERTY AND EQUIPMENT	325,000	297,000
Accumulated depreciation	(15,000)	(4,850)
Property and Equipment, net	310,000	292,150
OTHER ASSETS	10,000	17,000
Assets	678,150	662,150
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
Accounts payable and accruals	10,000	2,000
Credit line	25,000	9,650
Current portion of long-term debt	7,650	1,000
Current Liabilities	42,650	12,650
LONG-TERM DEBT	200,000	225,000
Liabilities	242,650	237,650
STOCKHOLDERS' EQUITY	435,500	424,500
Liabilities and Equity	678,150	662,150

Equity = Assets – Liabilities

What you Own

What you Owe

Accumulated Earnings

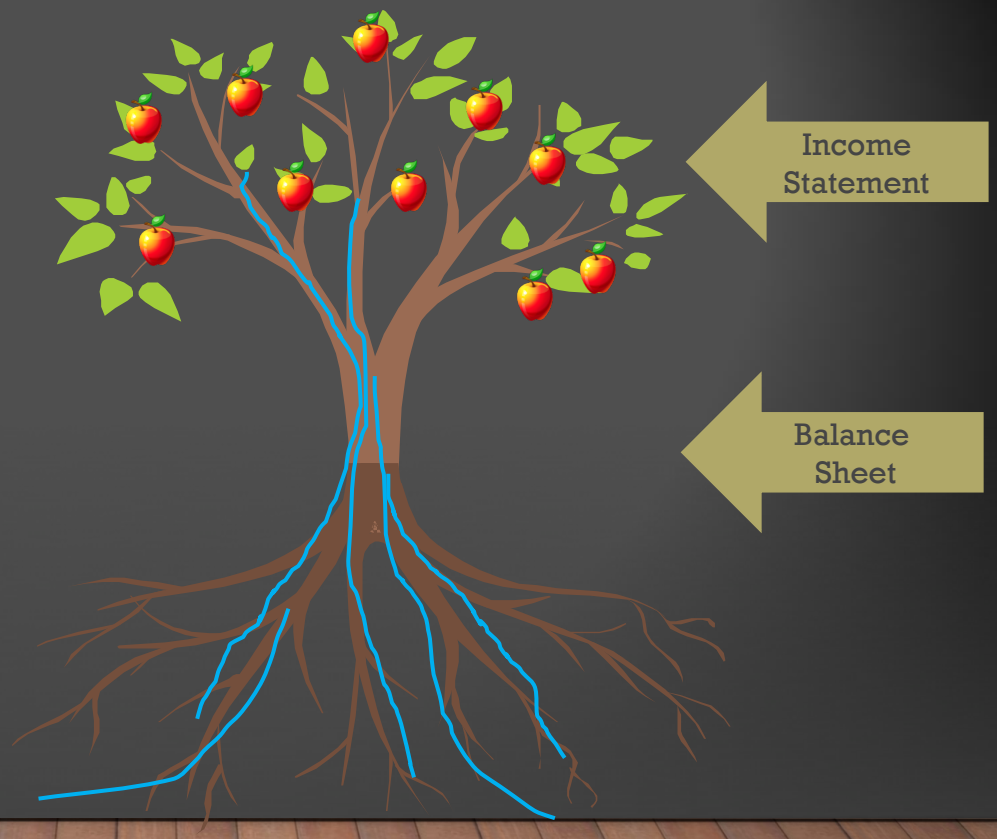
TREE METAPHOR – CASH FLOW STATEMENT

- Without water, no tree can survive for long.
- No business can survive without cash.
- Cash Flow Statement captures how money comes into a business and where it goes once it is there.
- Cash Flow Statement shows were the water goes in the business.

TREE METAPHOR – CASH FLOW STATEMENT

How much cash was consumed by the Income Statement?

How much cash was consumed in growing the Balance Sheet?



TREE METAPHOR – CASH FLOW STATEMENT

The Cash Flow Statement connects the Income Statement to the Balance Sheet.

"If I produced Net Income this year, where did the money go?"

The answer is on the Statement of Cash Flows.

Olive Tree Winery

Statement of Cash Flows for Year Ended December 31, 2009

	2009
OPERATING CASH FLOW:	
Net Income	11,000
AR increase	(3,150)
Other Current Assets	9,000
Inventory increase	(14,700)
AP increase	8,000
Operating Cash Flow	10,150
INVESTING	
Other Assets	7,000
Property And Equipment	(17,850)
Cash Increase (Decrease)	(10,850)
FINANCING	
Long-term debt	(18,350)
Credit line	15,350
Cash Increase (Decrease)	(3,000)
CASH BALANCE, beginning of year	29,350
CASH BALANCE, end of year	25,650

From the Income Statement

Operating cash flow keeps the business running

Changes in the Current Assets and Current Liabilities on the Balance Sheet are added or subtracted from Net Income

Investment in fixed assets

Financing business or fixed assets through debt

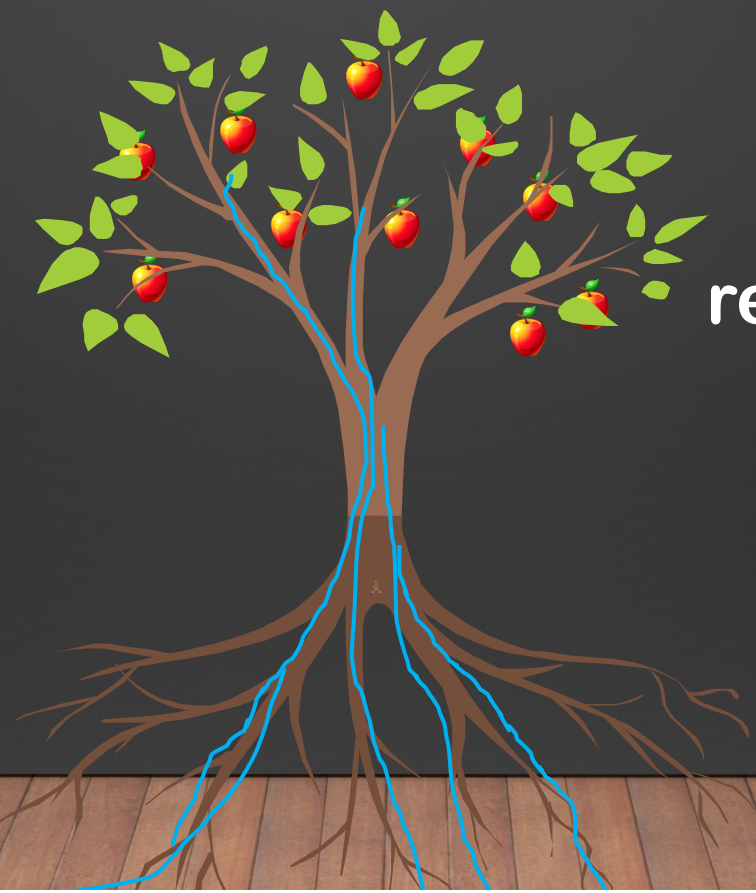
From the Balance Sheet

FINANCIAL STATEMENTS

Income Statement

Balance Sheet

Cash Flow Statement



Success in business requires a focus on all three financial statements.

QUESTIONS?

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