LWB

Legacy Wealth Builder

INNER CIRCLE

2024

Reading Financial Statements

Understanding and Analyzing Key Financial Documents

Introduction to Financial Statements

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Objective of the Workshop:

- To equip participants with the knowledge and skills to read, understand, and analyze financial statements effectively.
- By the end of this workshop, participants will be able to evaluate a company's financial performance, assess its financial health, and understand the interplay between different financial statements.

Agenda:

- Importance of Financial Statements
- Breakdown of Income Statement, Balance Sheet, and Cash Flow Statement
- Key Terms and Definitions
- Practical Analysis Techniques
- Practical Exercises

Importance of Financial Statements in Evaluating a Company's Performance

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- Financial statements provide a structured summary of a company's financial activities, offering insights into its profitability, liquidity, and solvency.
- Key stakeholders, including investors, managers, and regulators, rely on these documents to make informed decisions.

Stakeholders:

- **Investors:** Use financial statements to assess potential returns and risks.
- **Managers:** Monitor operational efficiency and make strategic decisions.
- **Regulators:** Ensure compliance with financial reporting standards.

Deep Dive into the Income Statement

Components of the Income Statement

- **Revenue:** Total income generated from sales before any costs are deducted.
- **Expenses:** Costs incurred in the process of earning revenue.
- **Net Profit:** The bottom line, calculated as revenue minus expenses.

Key Terms in the Income Statement

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- **Gross Profit:** Revenue minus the cost of goods sold (COGS).
- **Operating Profit (EBIT):** Gross profit minus operating expenses like wages and rent.
- **Net Profit:** Operating profit minus interest, taxes, and any other non-operating items.

Analyzing Profitability and Performance

Using the Income Statement

Analyzing Profitability and Performance Using the Income Statement

Profit Margins:

- **Gross Profit Margin:** (Gross Profit / Revenue) * 100
- **Operating Profit Margin:** (Operating Profit / Revenue) * 100
- **Net Profit Margin:** (Net Profit / Revenue) * 100

Components of the Balance Sheet

Components of the Balance Sheet

- **Assets:** Resources owned by the company (e.g., cash, inventory, property).
- **Liabilities:** Obligations the company owes (e.g., loans, accounts payable).
- **Equity:** The residual interest in the assets after deducting liabilities (e.g., shareholder's equity).

Key Terms in the Balance Sheet

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- **Current Assets:** Short-term assets expected to be converted into cash within a year (e.g., inventory, receivables).
- **Fixed Assets:** Long-term assets like property, plant, and equipment.
- **Current Liabilities:** Obligations due within a year (e.g., accounts payable).
- **Long-Term Liabilities:** Obligations due beyond a year (e.g., long-term debt).
- **Shareholder's Equity:** Represents the ownership interest in the company.

Assessing Financial Health Through the Balance Sheet

Assessing Financial Health Through the Balance Sheet

Liquidity Ratios:

- **Current Ratio:** Current Assets / Current Liabilities
- **Quick Ratio:** (Current Assets - Inventory) / Current Liabilities

Solvency Ratios:

- **Debt-to-Equity Ratio:** Total Liabilities / Shareholder’s Equity

Components of the Cash Flow Statement

Components of the Cash Flow Statement

- **Operating Activities:** Cash generated from core business operations.
- **Investing Activities:** Cash used in or generated from investments in assets, such as the purchase of equipment or sale of investments.
- **Financing Activities:** Cash raised or repaid from funding sources, such as issuing shares or repaying debt.

Importance of Cash Flow in Assessing a Company's Liquidity and Solvency

Cash Flow vs. Profitability: While profitability shows the company's earnings, cash flow reveals the actual liquidity, which is crucial for meeting obligations and sustaining operations.

Analyzing Cash Generation and Usage

Through the Cash Flow Statement

Analyzing Cash Generation and Usage Through the Cash Flow Statement

Key Indicators:

- **Free Cash Flow:** Cash flow from operations minus capital expenditures.
- **Cash Flow from Operations:** Key measure of the company's ability to generate sufficient cash to maintain or expand operations.

Interrelationship Between the Income Statement, Balance Sheet, and Cash Flow Statement

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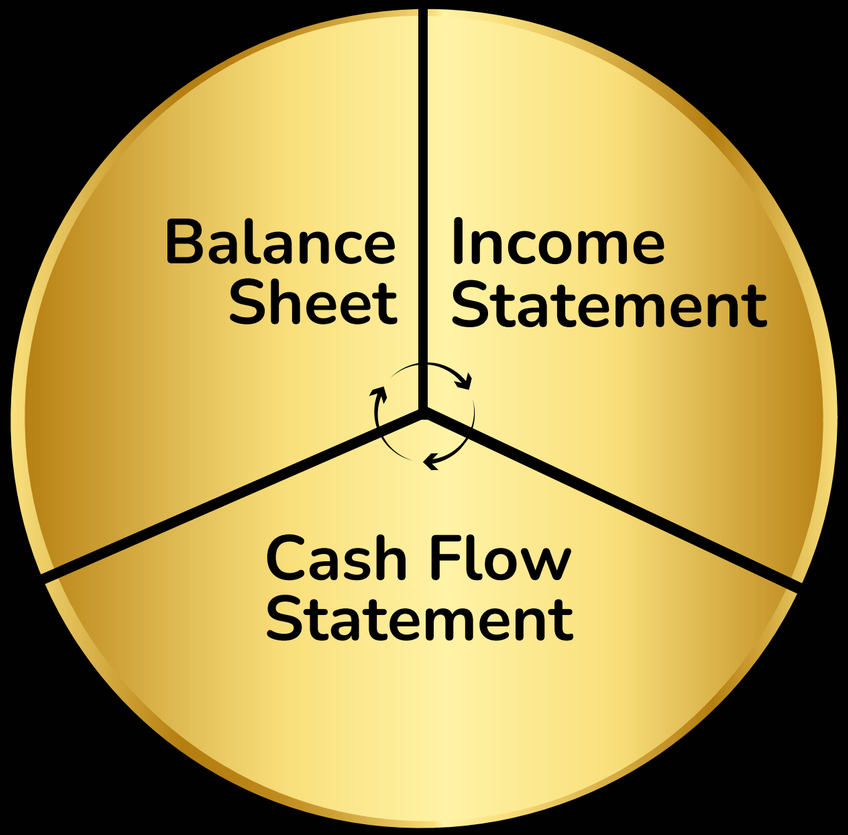

Interrelationship Between the Income Statement, Balance Sheet, and Cash Flow Statement

How They Connect:

- The income statement shows profitability, which affects retained earnings in the balance sheet.
- Changes in the balance sheet's assets and liabilities directly affect the cash flow statement.
- Annual change in cash is added to the opening Cash balance to reflect the ending Cash balance on the Balance Sheet.

Recap and Key Takeaways

Recap and Key Takeaways

Summary of Key Points:

- Income Statement: We learned that the income statement is like a report card, showing how much money a company made or lost over a specific period. It’s where you find out if a company is profitable by looking at its revenues, costs, and expenses.

Recap and Key Takeaways

Summary of Key Points:

- Balance Sheet: The balance sheet gives us a snapshot of what the company owns (assets), what it owes (liabilities), and what’s left over for the owners (equity). It’s a key tool for assessing the company’s financial stability at any given moment.

Recap and Key Takeaways

Summary of Key Points:

- Cash Flow Statement: This statement shows us the real cash moving in and out of the business. It’s crucial because it reveals whether a company can pay its bills and invest in its future, even if it shows a profit on the income statement.

Recap and Key Takeaways

Summary of Key Points:

- Interrelationships: We saw how these three statements are interconnected. Changes in one affect the others, and together, they provide a complete view of a company's financial situation.