

Understanding Your Financial Statements in partnership with NJSBDC NJCU and HCEDC



Understanding Your Financial Statements in partnership with ...



NJSBDC at New Jersey City University

Understanding Your Financial Statements in partnership with...

Presented in partnership with...



HCEDC

Hudson County
Economic Development
Corporation

Understanding Your Financial Statements

INTRODUCTIONS

1. New or existing business
2. Type of business



A Non-profit Economic Development Corporation



About Us

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A Non-Profit Economic Development Corporation

LOANS ▾

TRAINING ▾

GOV'T CONTRACTING (PTAC) ▾

BUSINESS TOOLS ▾

MEET OUR CLIENTS ▾



Are you ready to start, grow, thrive?

You can count on our loans, training & government contracting assistance for the support you need.

[Learn more about how we can help.](#)



LOANS

Small business financing for start-up and growing businesses

TRAINING

Entrepreneurial seminars and free business skills workshops

GOV'T CONTRACTING

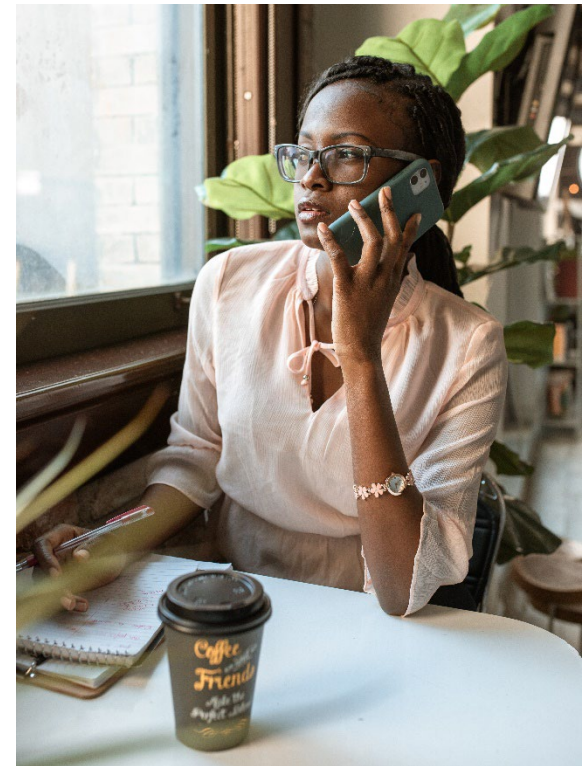
Free counseling, training and support to get you going and winning



Lending

Your business is more than a credit score to us

- Community Development Financial Institution (CDFI)
- US Small Business Administration (SBA) lender
- Microloans – up to \$50,000
- SBA 7a Community Advantage loans – up to \$250,000
- SBA 504 Commercial Real Estate & Major Equip. loans – up to \$5mil.



Training & Technical Assistance

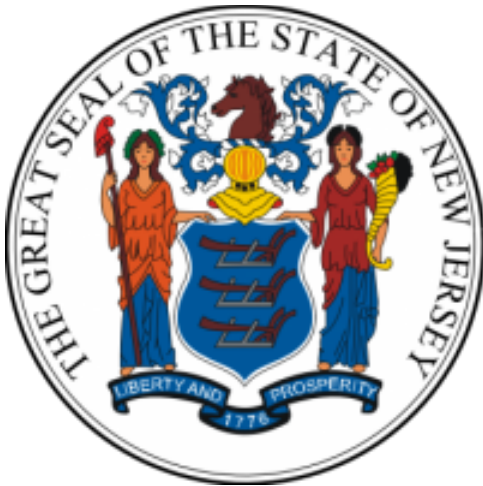
Get the business skills you need to start, grow and thrive



- Free workshops
- Business Basics
- Entrepreneurship Training Courses
- Business Mentoring (one-on-one counseling)
- Special Programs
 - Entrepreneurship as a Second Chance (ESC)
 - Virtual Incubator Program (VIP)

APEX Accelerator

APEX Accelerator is your gateway to Government Contracts



- Free seminars
- One-on-one counseling
- Registrations & Certificates
- Identifying bid leads
- Marketing to purchasing agents
- Proposal development
- Regulations & Military Specifications
- Subcontracting assistance
- Government Services Administration (GSA)

Course Objectives

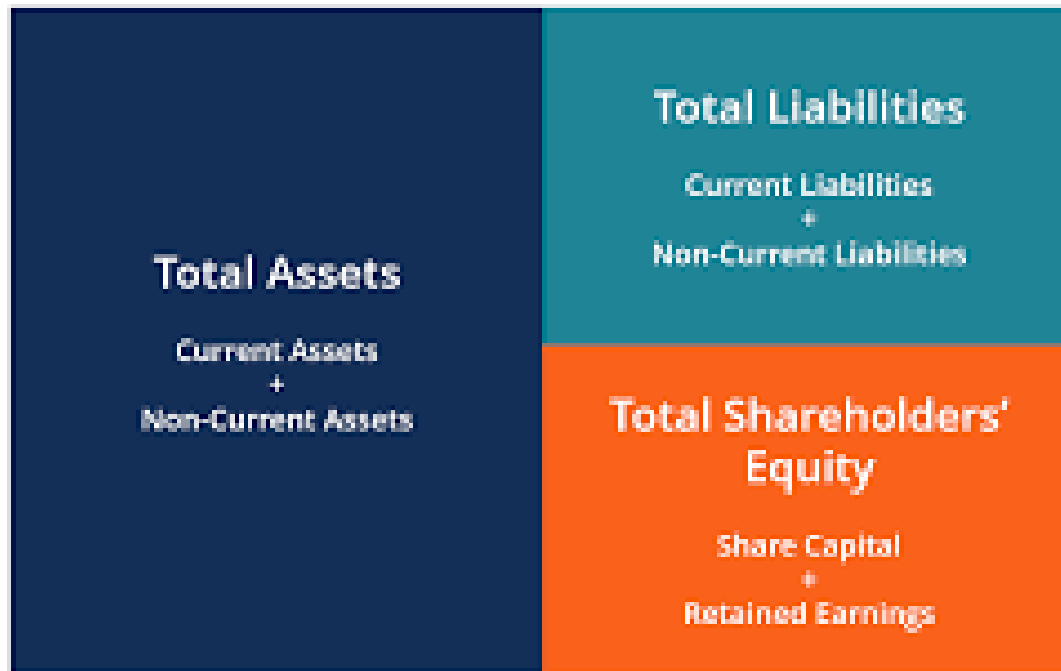
1. Define the basic types of Financial Statements
2. Learn how to interpret and make sense of your financial statements
3. Learn how to use financial statements to make key business decisions

Types of Financial Statements

- Balance Sheet
- Profit & Loss Statement
- Cash Flow Statement

The Balance Sheet

A Simple Balance Sheet



The Accounting Equation

$$\boxed{\text{Assets}} - \boxed{\text{Liabilities}} = \boxed{\text{Owner's equity}}$$

Balance Sheet shows the financial strength of your business as of a **FIXED** date (usually at close of an accounting period).
A snapshot.

Assets

An asset is an item of value owned by the company...It's the stuff you own!

Assets can be tangible or intangible.

- Cash
- Inventory
- Machinery & Equipment
- Real Estate
- Accounts Receivable
- Prepaid Expenses
- Patents
- Goodwill



Categories of Assets

Current Assets - Assets that can be converted into cash within 12 months of the balance sheet date.

Long Term Assets - Assets that can be converted into cash in a period longer than 12 months of the balance sheet date.

Assets

Dec. 31, 2019

MFG Manufacturing Company BALANCE SHEET

ASSETS

Current Assets

Cash	\$22,500
Accounts Receivable	\$25,000
Inventory	\$ 8,000
Other Current Assets	<u>\$ 3,500</u>
	\$59,000

Long Term Assets

Machinery & Equipment	\$50,000
Furniture & Fixtures	\$10,000
Less: Accum. Depreciation	<u>(\$ 6,000)</u>
	\$54,000

TOTAL ASSETS \$113,000

Liabilities

A liability is an obligation of the business...It's the stuff you owe!

- Loans
- Accounts Payable
- Credit Cards Payable
- Payroll Accrual
- Taxes Payable

HR



Categories of Liabilities

Current Liabilities - those obligations which can be expected to be liquidated or satisfied within 12 months of the balance sheet date.

Long term Liabilities - those obligations which can be expected to be liquidated or satisfied longer than 12 months of the balance sheet date.

Liabilities

Dec. 31, 2019

MFG Manufacturing Company BALANCE SHEET

LIABILITIES

Current Liabilities

Accounts Payable	\$ 5,000
Current Portion of LT Debt	\$12,000
Other Current Liabilities	<u>\$ 0</u>
	\$17,000

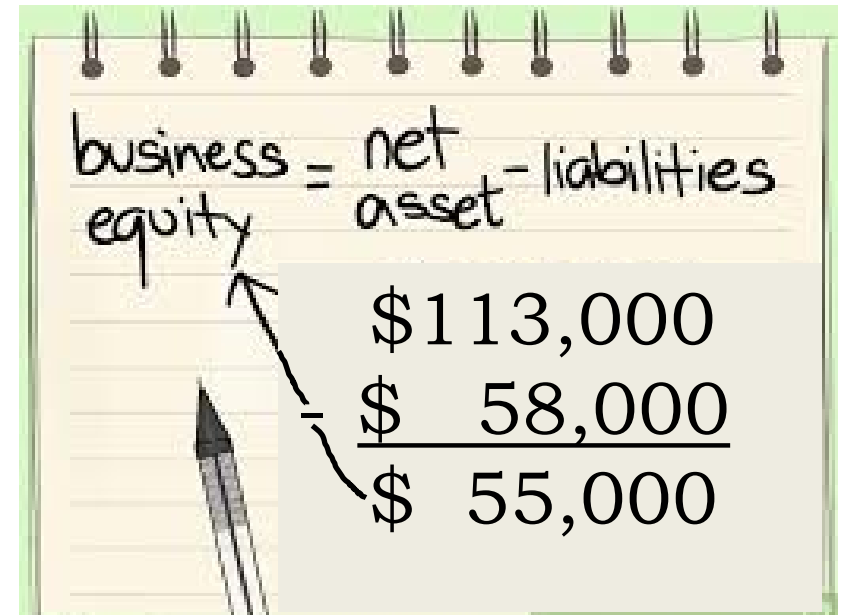
Long Term Liabilities

Long Term Debt	<u>\$41,000</u>
	\$41,000

TOTAL LIABILITIES \$ 58,000

Owners Equity

Owner's Equity is the amount of money the owner has invested and retained in the business. It's also the net value remaining after liabilities have been met.



A handwritten calculation on a notepad. The text reads: "business equity = net asset - liabilities". Below this, a calculation is shown: "\$113,000" minus "\$ 58,000" (underlined) equals "\$ 55,000". An arrow points from the word "equity" in the equation to the result "\$ 55,000".

business equity =	net asset	-	liabilities
	\$113,000		
	\$ 58,000		
	<hr/>		
	\$ 55,000		

Components of Owner's Equity

- 1 a. Paid in Capital (initial and supplemental owner investments)
- 1 b. Common Stock (issuance)

- 2. Retained Earnings

Assets = Liabilities + Owner's Equity

Dec. 31, 2019

MFG Manufacturing Company BALANCE SHEET

ASSETS

Current Assets	\$59,000	
Long Term Assets	<u>\$54,000</u>	
		\$113,000

LIABILITIES

Current Liabilities	\$17,000	
Long Term Liabilities	<u>\$41,000</u>	
	\$58,000	

OWNER'S EQUITY

Paid in Capital	\$40,000	
Retained Earnings	<u>\$15,000</u>	
	\$55,000	

Total Liabilities & Owner's Equity		\$113,000
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Profit & Loss Statement

Jan – Dec 2019

P&L Statement, or Income Statement, shows your business's financial activity over time (e.g., 1 year).

A flow.

Includes non-cash expenses (e.g., depreciation)

MFG Manufacturing Company Profit and Loss Statement

Revenue (Sales)	\$350,000
Cost of Goods Sold	<u>\$210,000</u>
Gross Profit	\$140,000
Operating Expenses	<u>\$120,000</u>
Operating Profit, EBIT	\$ 20,000
Taxes	<u>\$ 5,000</u>
Net Profit	\$ 15,000

Gross Profit

Gross Profit (or Gross Margin)
= Revenues – Cost of Goods Sold

Revenues - the money generated by a company from sales and other business activity.

Cost of Goods Sold - costs directly related to the manufacture or production of goods for sale

Jan – Dec 2019

MFG Manufacturing Company Profit and Loss Statement

Revenue (Sales)	\$350,000
Cost of Goods Sold	<u>\$210,000</u>
Gross Profit	\$140,000
Operating Expenses	<u>\$120,000</u>
Operating Profit, EBIT	\$ 20,000
Taxes	<u>\$ 5,000</u>
Net Profit	\$ 15,000

Operating Expenses

Jan – Dec 2019

Operating Expenses

- Advertising
- Marketing materials production
- Sales force salaries
- Travel & entertainment
- Administrative salaries
- Rent
- Utilities
- Insurance
- Office supplies
- Depreciation of fixed assets...

MFG Manufacturing Company Profit and Loss Statement

Revenue (Sales)	\$350,000
Cost of Goods Sold	<u>\$210,000</u>
Gross Profit	\$140,000
Operating Expenses	<u>\$120,000</u>
Operating Profit, EBIT	\$ 20,000
Taxes	<u>\$ 5,000</u>
Net Profit	\$ 15,000

Net Income (Loss)

MFG Manufacturing Company

Profit & Loss Statement Jan – Dec 2019

Revenue	\$350
Cost of Goods Sold	<u>\$210</u>
Gross Profit	\$140
Operating Expenses	<u>\$120</u>
Operating Profit	\$ 20
Taxes	<u>\$ 5</u>
Net Profit	\$ 15

Balance Sheet 12/31/2019

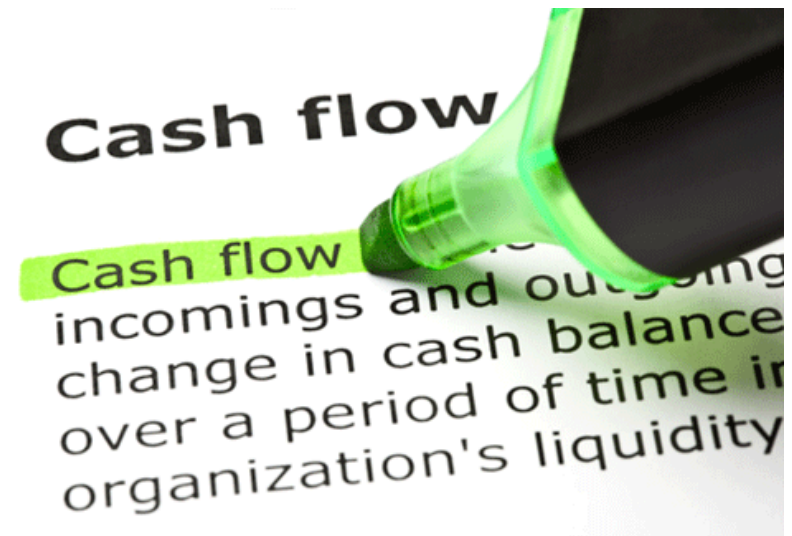
Assets	\$ 113
Liabilities	<u>\$ 58</u>
Owners Equity	\$ 55

Includes \$15 Ret. Earnings

Cash Flow Statement

The cash flow statement shows how much money flows into and out of the business during a period of time, usually a tax year (but broken down by month).

Profitability (P&L Statement) determines valuation. Cash flow determines solvency.



Source: EduPristine

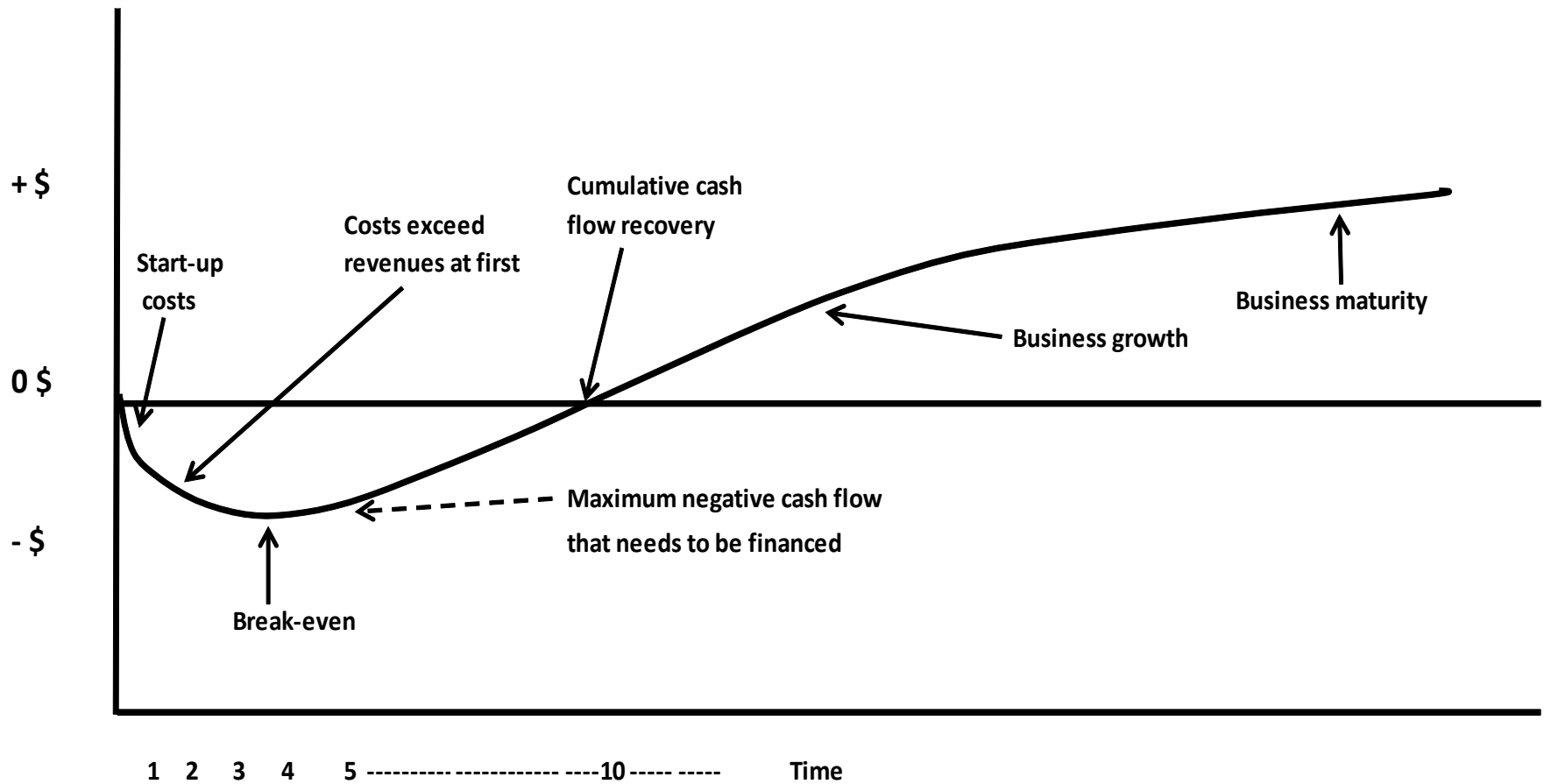
Cash Flow Statement

Cash Flow Statement deals only with *actual cash transactions*, not depreciation, amortization of goodwill or other non-cash expense items.

Prepared on a monthly basis for the next year (or more)

Analyze and revise quarterly to reflect actual performance vs. projections

Typical Cash Flow Curve



Sources and Uses of Cash

Sources of Cash

- Cash on hand
- Revenue from sales (product and service)
- Assets to be liquidated, if any
- Loan injections
- Owner or investor equity contributions

Uses of Cash

- Inventory purchases
- Variable expenses (sales and marketing-related)
- Fixed expenses (general, administrative, overhead)

Cash Flow Statement

	<u>Startup (12/31/18)</u>	<u>January</u>	<u>February</u>
Beginning Cash Balance	\$ 0	\$ 36,500	\$ 8,000
CASH IN FLOW			
Sales Receipts		\$ 0	\$ 25,000
Loans	\$ 60,000		
Other – Owner’s Equity Investment	<u>\$ 40,000</u>		
TOTAL CASH IN FLOW	\$100,000	\$ 0	\$ 25,000
CASH OUT FLOW			
Advertising		\$ 900	\$ 900
Capital Purchases	\$ 60,000		
Raw Materials		\$ 8,000	\$ 5,000
Payroll		\$ 15,600	\$ 15,600
Loan Principal and Interest		\$ 1,300	\$ 1,300
Rent	\$ 3,500	\$ 1,750	\$ 1,750
Utilities		<u>\$ 950</u>	<u>\$ 950</u>
TOTAL CASH OUT FLOW	\$ 63,500	\$ 28,500	\$ 25,500
CASH BALANCE	\$ 36,500	\$ 8,000	\$ 7,500

All Businesses Experience Cash Flow Shortages Periodically

...which is why cash flow management is so important.

And why projecting future cash flow prepares you to cover the shortfalls *in advance*.

Possible Causes for Low Cash Flow

- Carrying too much inventory or wrong inventory
- Slow/inadequate accounts receivable collection procedures
- Liberal customer credit terms
- Lack of bank financing for working capital needs
- Undercapitalized: low equity, high debt possibly due to:
 - insufficient initial investment
 - too much profit distributed to owners
- Low profits or even losses possibly due to seasonality &/or management decisions

Strategies for Managing Cash Flow in Ongoing Business Operations

1. Push Out Payables
2. Collect Accounts Receivable Faster
3. Secure Sufficient Short-Term Financing
4. Use Long-Term Financing Effectively

Analyzing Your Financial Statements with Ratios



- Profitability ratios
- Asset Management ratios
- Liquidity ratios
- Debt Management ratios

Profit Margin on Sales

Shows the percentage of net profit for every dollar of sales

$$\frac{\text{Net Profit}}{\text{Net Sales}}$$

$$\frac{\$15,000}{\$350,000} = .043\%$$

The higher the number the better

Accounts Receivable Turnover

Calculates how many days worth of sales you have in your accounts receivable at a given time.

$$\frac{\text{Accounts Receivable (Annual)} \times 365}{\text{Sales}}$$

$$\frac{\$25,000 \times 365 = \$9,125,000}{\$350,000} = 26 \text{ days}$$

Should be within a reasonable range of the terms you give your customers.

Current Ratio

A quick measure of liquidity of a firm. It represents the margin of safety or cushion available to the creditors.

$$\frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\frac{\$59,000}{\$17,000} = 3.5 : 1$$

A current ratio of 2:1 is considered normal

Debt to Equity (or Leverage) Ratio

A measure of a company's financial leverage.
Shows how much money owners have invested in the business vs. lenders.

$$\frac{\text{Total Liabilities}}{\text{Owners Equity}}$$

$$\frac{\$58,000}{\$65,000} = 1.05$$

Lenders use to determine if company has enough equity.
Lower is better (3 or less is preferred)

Understanding Financial Statements



Questions? Comments? Feedback?

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