

## Financial Statements

Engineering 90  
Prof. Eric Suuberg

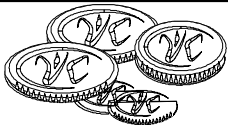
## What is a Financial Statement?

A financial statement is a quantitative way of showing how a company is doing.

Three different ways of representing the financial state of a company:

- Cash Management (can the company meet its obligations?)
- Profitability (Is it making money?) - the income statement
- Assets versus Liabilities (what is the value of the company? Who owns what?) - the balance sheet

Each one of these questions is answered by our Financial Statements.



## The Big Three

- Cash Flow Statements
  - These answer the important managerial question “do I have enough cash to run my business”
- Income Statements
  - This is the financial sheet that tells you if your company is profitable or not.
- Balance Sheets
  - How much debt do I have? How large are my assets? This sheet tells you the answer to these questions.



## Cash Flow Statements

- A report of all a firm's transactions that involve cash
- The key elements are revenues (money flowing in) and expenses (money flowing out).
- Cash flow statements compare the sum of the revenues to the sum of the expenses on a regular time basis – usually monthly.

Manning Electronics” (Engineering 9) – Did Ms. Manning have enough cash to buy that piece of equipment for her boat business?

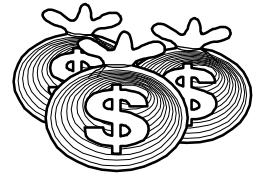
## What are Revenues?

- Sales
- Interest from firm's investments (e.g., a company savings account)
- Royalty and Licensing payments for appropriate use of firm's intellectual property

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Another source of cash inflow, but not a revenue is the cash the firm receives from borrowing money.

## What are Expenses?



There are two types of expenses:

**FIXED COSTS**

**and**

**VARIABLE COSTS**

## Fixed Costs



- Rent payments
- Salaried employees
- Capital Investments and (some) maintenance
- Utilities (phone, water, electric, etc)
- Insurance
- Taxes (on property, plant, and equipment)
- Advertising (\*)
- Others things that do not depend on number of units produced.

## Variable Costs

- Materials Cost
- Supplies
- Production Wages
- Outside / Contracted labor
- Advertising (\*)
- Sales Commissions / Distribution Costs
- Equipment Maintenance
- Other things that depend on the number of units produced (e.g. royalties paid)

## Putting it all together

So, placing the revenues at the "top" and the expenses below – you get the following three month cash flow statement for a hypothetical startup:

|                                  | Jan-00        | Feb-00        | Mar-00        |
|----------------------------------|---------------|---------------|---------------|
| <b>REVENUES (inflow)</b>         |               |               |               |
| SALES                            | \$0.00        | \$0.00        | \$1,000.00    |
| INTEREST                         |               | \$239.27      | \$167.04      |
| <b>RECEIPTS</b>                  | \$0.00        | \$239.27      | \$1,167.04    |
| <b>EXPENDITURES (outflow)</b>    |               |               |               |
| MATERIALS COST AND MFG. LABOR    | \$0.00        | \$0.00        | \$50.00       |
| SALES COMMISSIONS                | \$0.00        | \$0.00        | \$100.00      |
| <b>COST OF GOODS SOLD (COGS)</b> | \$0.00        | \$0.00        | \$150.00      |
| <b>GROSS MARGIN</b>              | \$0.00        | \$239.27      | \$1,017.04    |
| <b>EXPENSES (outflow)</b>        |               |               |               |
| SALARY AND BENEFITS OF CEO       | \$3,000.00    | \$3,000.00    | \$3,000.00    |
| SALARY AND BENEFITS OF ASSISTANT | \$2,000.00    | \$2,000.00    | \$2,000.00    |
| RENT                             | \$500.00      | \$500.00      | \$500.00      |
| TELEPHONE AND OTHER              | \$75.00       | \$75.00       | \$75.00       |
| ADVERTISING                      | \$2,000.00    | \$2,000.00    | \$2,000.00    |
| EQUIPMENT                        | \$20,000.00   | \$10,000.00   | \$10,000.00   |
| <b>TOTAL FIXED COSTS</b>         | \$27,575.00   | \$17,575.00   | \$17,575.00   |
| <b>MONTHLY CASH FLOW</b>         | (\$27,575.00) | (\$17,335.73) | (\$16,557.96) |

## Cash Flow (cont.)

"Receipts" is the sum of all the firm's sales and interest it collected that month

Gross Margin is the Receipts minus the COGS

Total Fixed Costs is the sum of all the fixed costs

Monthly Cash flow is the Gross Margin minus the Total Fixed Costs

|                                  | Jan-00        | Feb-00        | Mar-00        |
|----------------------------------|---------------|---------------|---------------|
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| INTEREST                         |               | \$239.27      | \$167.04      |
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## Simple Example

- If a company has sales of \$500/mo, COGS of \$200/mo, pays \$50/mo in salary, and has no other fixed costs, what is that firm's three month cash flow statement?

• Answer:

|                   | January | February | March |
|-------------------|---------|----------|-------|
| Revenues (Sales)  | \$500   | \$500    | \$500 |
| COGS              | \$200   | \$200    | \$200 |
| Salary            | \$50    | \$50     | \$50  |
| Monthly Cash Flow | \$250   | \$250    | \$250 |



## What's Missing?

- Cumulative Cash Flow numbers
- Taxes (... and accumulated depreciation)
- Net Earnings

## Cumulative Cash Flow - Cash Balance

- Just like the average person keeps their checking account balance – a firm also needs to know their cumulative cash flow or cash balance.
- It is an easy calculation – simply take the cumulative cash flow from this month and add it to the month's cash balance.
- Your very first month's cumulative cash balance is your first month's monthly cash flow added to your start-up capital (probably an initial loan or first round financing).

## EBI.... what?

### THE CHAIN OF EARNINGS

EBIDT (Earnings Before Interest, Depreciation and Tax)

↓ (- accrued depreciation)

EBIT (Earnings Before Interest and Tax)

↓ (- taxes paid once a year)

EBI

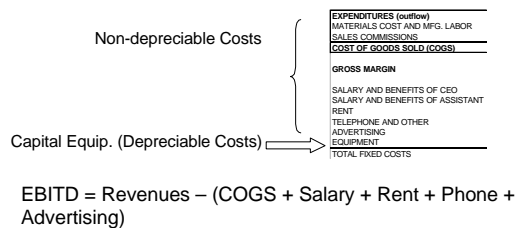
↓ (- interest payments on your debt)

TOTAL EARNINGS

## EBIDT

Your EBIDT (Earnings Before Interest Depreciation and Tax) is

Total Revenues – All Costs that are not depreciable



## Calculating Depreciation

- Continue depreciation on items purchased in earlier years, using previously established methods
- Sum up all of that fiscal year's capital expenses
- Decide which method of Depreciation your firm wants to use (Straight Line or Accelerated)
- Determine the useful lifetime for the assets
- Determine the salvage value
- Use the formulas to calculate depreciation on new equipment
- Add up all depreciation contributions

NOTE: while EBIDT may be a monthly figure – since taxes and depreciation are only calculated once a year – EBIT, EBI, and net earnings MUST be Year-End numbers.

## Calculating Taxes

- Take the EBIDT and subtract the depreciation – this yields Earnings Before Interest and Tax
- Then calculate profit (or earnings) before taxes by subtracting interest expenses.
- Then multiply the profit before taxes by your effective tax rate – that will give the corporate income taxes the firm owes.

## Final Cash Flow Statement

|   | Sep-00                         | Oct-00                         | Nov-00                         | Dec-00                         |
|---|--------------------------------|--------------------------------|--------------------------------|--------------------------------|
| <b>REVENUES (inflow)</b>                        |                                |                                |                                |                                |
| SALES   | \$22,000.00 <sup>a</sup>       | \$28,000.00 <sup>a</sup>       | \$36,000.00 <sup>a</sup>       | \$46,000.00 <sup>a</sup>       |
| INTEREST  | \$30.14 <sup>a</sup>           | \$86.66 <sup>a</sup>           | \$163.62 <sup>a</sup>          | \$246.66 <sup>a</sup>          |
| <b>RECEIPTS</b>                                 | <b>\$22,030.14<sup>a</sup></b> | <b>\$28,086.66<sup>a</sup></b> | <b>\$36,163.62<sup>a</sup></b> | <b>\$46,246.66<sup>a</sup></b> |
| <b>EXPENDITURES (outflow)</b>                   |                                |                                |                                |                                |
| MATERIALS COST AND MFG. LABOR                   | \$1,100.00 <sup>a</sup>        | \$1,400.00 <sup>a</sup>        | \$1,750.00 <sup>a</sup>        | \$2,300.00 <sup>a</sup>        |
| SALES COMMISSIONS                               | \$2,300.00 <sup>a</sup>        | \$2,800.00 <sup>a</sup>        | \$3,500.00 <sup>a</sup>        | \$4,600.00 <sup>a</sup>        |
| <b>COST OF GOODS SOLD (COGS)</b>                | <b>\$3,400.00<sup>a</sup></b>  | <b>\$4,200.00<sup>a</sup></b>  | <b>\$5,250.00<sup>a</sup></b>  | <b>\$6,900.00<sup>a</sup></b>  |
| <b>GROSS MARGIN</b>                             | <b>\$18,730.14<sup>a</sup></b> | <b>\$23,886.66<sup>a</sup></b> | <b>\$28,913.62<sup>a</sup></b> | <b>\$39,346.66<sup>a</sup></b> |
| SALARY AND BENEFITS OF CEO                      | \$3,000.00 <sup>a</sup>        | \$3,000.00 <sup>a</sup>        | \$3,000.00 <sup>a</sup>        | \$3,000.00 <sup>a</sup>        |
| SALARY AND BENEFITS OF ASSISTANT                | \$2,000.00 <sup>a</sup>        | \$2,000.00 <sup>a</sup>        | \$2,000.00 <sup>a</sup>        | \$2,000.00 <sup>a</sup>        |
| RENT  | \$500.00 <sup>a</sup>          | \$500.00 <sup>a</sup>          | \$500.00 <sup>a</sup>          | \$500.00 <sup>a</sup>          |
| TELEPHONE AND OTHER                             | \$75.00 <sup>a</sup>           | \$75.00 <sup>a</sup>           | \$75.00 <sup>a</sup>           | \$75.00 <sup>a</sup>           |
| ADVERTISING                                     | \$2,000.00 <sup>a</sup>        | \$2,000.00 <sup>a</sup>        | \$2,000.00 <sup>a</sup>        | \$2,000.00 <sup>a</sup>        |
| EQUIPMENT                                       | \$0.00 <sup>a</sup>            | \$0.00 <sup>a</sup>            | \$0.00 <sup>a</sup>            | \$0.00 <sup>a</sup>            |
| <b>TOTAL FIXED COSTS</b>                        | <b>\$7,575.00<sup>a</sup></b>  | <b>\$7,575.00<sup>a</sup></b>  | <b>\$7,575.00<sup>a</sup></b>  | <b>\$7,575.00<sup>a</sup></b>  |
| <b>MONTHLY CASH FLOW</b>                        | <b>\$11,164.14<sup>a</sup></b> | <b>\$16,311.66<sup>a</sup></b> | <b>\$22,328.62<sup>a</sup></b> | <b>\$31,771.66<sup>a</sup></b> |
| <b>ENDING CASH BALANCE</b>                      | <b>\$20,507.84<sup>a</sup></b> | <b>\$36,868.50<sup>a</sup></b> | <b>\$59,197.12<sup>a</sup></b> | <b>\$90,968.77<sup>a</sup></b> |
| <b>EBIDT* PROFITS</b>                           | <b>\$11,164.14<sup>a</sup></b> | <b>\$16,311.66<sup>a</sup></b> | <b>\$22,328.62<sup>a</sup></b> | <b>\$31,771.66<sup>a</sup></b> |
| <b>CUMULATIVE EBIDT* PROFITS</b>                | <b>\$11,164.14<sup>a</sup></b> | <b>\$32,473.32<sup>a</sup></b> | <b>\$54,801.94<sup>a</sup></b> | <b>\$86,573.60<sup>a</sup></b> |
| Depreciation Expense for Tax Purposes           |                                |                                |                                |                                |
| EBIT Profits                                    | (\$14,442.16)                  | \$1,868.50                     | \$24,197.12                    | \$55,968.77                    |
| Taxes   |                                |                                |                                | \$23,160.96 <sup>a</sup>       |
| EBI Profits                                     |                                |                                |                                | \$32,807.81                    |
| <b>NET EARNINGS FOR YEAR (PROFIT AFTER TAX)</b> |                                |                                |                                | <b>\$21,507.82</b>             |

## Income Statement

- Income Statement compares the profitability of the firm to prior years
- Total (yearly) revenues minus total (yearly) expenditures

| Operating Information               |               |
|-------------------------------------|---------------|
| Net Earnings                        | \$ 172,593.77 |
| Expenses                            |               |
| Cost of Goods Sold                  | \$ 25,725.00  |
| Total Salary/Benefits               | \$ 60,000.00  |
| Advertising                         | \$ 24,000.00  |
| Rent                                | \$ 6,000.00   |
| Other                               | \$ 900.00     |
| EBITD Profits                       |               |
| Depreciation                        | \$ 4,500.00   |
| Taxes                               | \$ 23,160.95  |
| AFTER TAX PROFIT                    |               |
|                                     | \$ 28,307.82  |
| Accumulated Interest Expenses       | \$ 6,800.00   |
| Earnings After Accumulated Interest |               |
|                                     | \$ 21,507.82  |

## Cash Flow versus Income Statements

- Note that the final Net Earnings number for both the final month of the cash flow statement is *exactly* the same as the year-end Net Earnings total for the Income Statement, reflecting the same time period

|                                     | 2001          | 2000          | 2000          |
|-------------------------------------|---------------|---------------|---------------|
| Revenue                             | \$ 172,593.77 | \$ 172,593.77 | \$ 172,593.77 |
| Expenses                            | \$ 25,725.00  | \$ 25,725.00  | \$ 25,725.00  |
| EBITD Profits                       | \$ 146,868.77 | \$ 146,868.77 | \$ 146,868.77 |
| Depreciation                        | \$ 4,500.00   | \$ 4,500.00   | \$ 4,500.00   |
| Taxes                               | \$ 23,160.95  | \$ 23,160.95  | \$ 23,160.95  |
| EBITD Profits                       | \$ 119,207.82 | \$ 119,207.82 | \$ 119,207.82 |
| Accumulated Interest Expenses       | \$ 6,800.00   | \$ 6,800.00   | \$ 6,800.00   |
| Earnings After Accumulated Interest | \$ 112,407.82 | \$ 112,407.82 | \$ 112,407.82 |

| Operating Information               |               |
|-------------------------------------|---------------|
| Net Earnings                        | \$ 172,593.77 |
| Expenses                            |               |
| Cost of Goods Sold                  | \$ 25,725.00  |
| Total Salary/Benefits               | \$ 60,000.00  |
| Advertising                         | \$ 24,000.00  |
| Rent                                | \$ 6,000.00   |
| Other                               | \$ 900.00     |
| EBITD Profits                       |               |
| Depreciation                        | \$ 4,500.00   |
| Taxes                               | \$ 23,160.95  |
| AFTER TAX PROFIT                    |               |
|                                     | \$ 28,307.82  |
| Accumulated Interest Expenses       | \$ 6,800.00   |
| Earnings After Accumulated Interest |               |
|                                     | \$ 21,507.82  |

## Comparison (cont.)

- Further the Income Statement's year-end figures for COGS, Salary, Rent, Advertising, and sales should be the 12 month totals of the cash-flows corresponding to the respective line item
- Likewise, depreciation and taxes should be equal for that fiscal year

## Balance Sheets

- Unlike Cash-Flow and Income Statements, Balance Sheets lists **ASSETS and LIABILITIES**
- Examples of Assets include:
  - Land and Capital Equipment less accrued depreciation
  - Intellectual Property (if purchased)
  - Cash on Hand (which is equal to the year end Cumulative Cash Balance)
  - Accounts Receivable
  - Inventory
  - Retained Earnings from Previous Years

## Balance Sheets (cont.)

- Examples of Liabilities include:
  - Short Term Debt (loans)
  - Long Term Debt (bond issues, etc)
  - Accounts Payable
  - Interest Payable
  - Taxes Payable
- The difference between Assets and Liabilities is your **EQUITY**

## Example of a Balance Sheet

|  | FYE 2001             | FYE 2000            |
|--|----------------------|---------------------|
| <b>ASSETS</b>                                  |                      |                     |
| <b>Current Assets</b>                          |                      |                     |
| Cash on Hand                                   | \$ 90,968.77         | \$ 85,000.00        |
| Accounts Receivable                            | \$ -                 | \$ -                |
| Inventory                                      | \$ -                 | \$ -                |
| Prepaid Expenses                               | \$ -                 | \$ -                |
| Total Current Assets                           | \$ 90,968.77         | \$ 85,000.00        |
| Property / Plant / Equipment less Depreciation | \$ 50,000.00         | \$ 0.00             |
| Other Assets                                   | \$ -                 | \$ -                |
| <b>TOTAL ASSETS</b>                            | <b>\$ 136,468.77</b> | <b>\$ 85,000.00</b> |
| <b>LIABILITIES</b>                             |                      |                     |
| <b>Current Liabilities</b>                     |                      |                     |
| Interest Payable                               | \$ 6,800.00          | \$ -                |
| Short-term loans                               | \$ -                 | \$ -                |
| Accounts Payable                               | \$ -                 | \$ -                |
| Income Taxes Payable                           | \$ 23,160.95         | \$ -                |
| Total Current Liabilities                      | \$ 29,960.95         | \$ -                |
| Long Term Debt                                 | \$ 85,000.00         | \$ 85,000.00        |
| <b>TOTAL LIABILITIES</b>                       | <b>\$ 114,960.95</b> | <b>\$ 85,000.00</b> |
| <b>TOTAL EQUITY</b>                            | <b>\$ 21,507.82</b>  | <b>\$ -</b>         |
| <b>LIABILITIES PLUS EQUITY</b>                 | <b>\$ 136,468.77</b> | <b>\$ 85,000.00</b> |

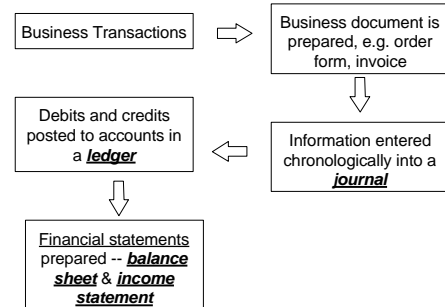
## Some Basics of Accounting

- The orderly reporting of the financial activities of a business
- Most commonly visible forms
  - Balance Sheets
  - Income Statements
- Used by management, investors, creditors, government to monitor business activity



## The Process of Accounting

- An orderly recording of all financial transactions (by hand or electronically)



## Some Accounting Concepts and Terminology



- **Dual Aspect Concept**  
Embodies the notion that  
Assets = Equities or  
Assets = Liabilities + Owner's equity
- Need to always record for a transaction
  - what gets "credit" for something and what gets "charged"
- Debit (Dr) - arbitrarily the left hand side of an account
- Credit (Cr) - the right hand side
- "To debit" - make a left hand side entry
- "To credit" - make a right hand side entry

## Some Accounting Concepts and Terminology con't



- Debit balances must equal credit balances
- From conventional layout of accounting statements
  - Increases in assets are debits (decreases credits)
  - Increases in liabilities are credits
  - Increases in owner's equity are credits
  - Increases in expenses are debits
  - Increases in revenues are credits

## Some Accounting Concepts and Terminology con't

- Note that assets (desirable) and liabilities (undesirable) both increase on the debit side

| Assets       |              | Liabilities  |              |
|--------------|--------------|--------------|--------------|
| Dr           | Cr           | Dr           | Cr           |
| Increase (+) | Decrease (-) | Decrease (-) | Increase (+) |

- There is no inherent "goodness" or "badness" to the terms debits & credits

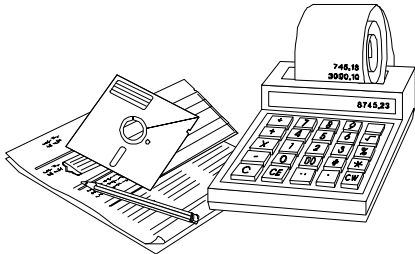
## Typical Layout of Balance Sheet



| Balance Sheet   |  |
|---|--|
| Assets  | Liabilities & Stockholder's Equity   |
| <b>Current Assets:</b> <ul style="list-style-type: none"> <li>-Cash</li> <li>-Marketable Securities</li> <li>-Accounts &amp; Notes Receivable</li> <li>-Inventory</li> </ul> <b>Fixed Assets:</b> <ul style="list-style-type: none"> <li>-Equipment</li> <li>-Building</li> <li>-Land</li> </ul> <b>Total</b> | <b>Current Liabilities:</b> <ul style="list-style-type: none"> <li>-Accounts Payable</li> <li>-Notes Payable</li> <li>-Accrued Tax</li> </ul> <b>Long-term Liabilities:</b> <ul style="list-style-type: none"> <li>-Long-term bank loans</li> <li>-Bonds</li> </ul> <b>Stockholder's Equity:</b> |

## Assets & Liabilities

- **Assets:** The economic resources of the firm. As shown on typical balance sheet
- **Liabilities:** Outside claims against the assets of the firm



## Other Concepts

- **Money Measurement Concept** - Accounting records show only facts that can be expressed in terms of money. A company's good name does not get reflected on a balance sheet, unless the company is sold and a value can be put on the good name (Goodwill)
- **Going Concern Concept** - There is a presumption of an indefinite period of operation of a company (no defined end date)
- **Cost Concept** - Assets entered in accounting records at the price paid to acquire them and are not re-evaluated (except for depreciation)
- **Conservatism** - Always select the least favorable scenario. For example, research and development (R & D) is accounted for as a straight expense, rather than an investment (it might not lead to anything.)

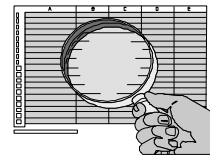
## Amortization

- The write-off of intangible long-lived assets (e.g. goodwill, trademarks, patents)
- Analogous to depreciation
- Term used broadly to cover write-off of costs over a period of years



## How do the Income Statement and Balance Sheet Relate?

| Balance Sheet<br>(December 31, 2000) |     | Income Statement<br>(December 31, 2000) |     | Balance Sheet<br>(December 31, 2000) |     |
|--------------------------------------|-----|---|-----|--------------------------------------|-----|
| <u>Assets</u>                        | xxx | Sales                                   | xxx | <u>Assets</u>                        | xxx |
|                                      |     | COGS                                    | xxx |                                      |     |
|                                      |     | Other Expense                           | xxx |                                      |     |
| <u>Equities</u>                      |     | <u>Net Income</u>                       | 200 | <u>Equities</u>                      |     |
| Liabilities                          | xxx | R. E., 2000                             | 100 | Liabilities                          | xxx |
| Common Stock                         | xxx | Less Dividends                          | 50  | Common Stock                         | xxx |
| Retained Earnings                    | 100 | New R.E.                                | 250 | Retained Earnings                    | 250 |
|                                      | xxx |   |     |                                      | xxx |



## Examples of Actual Financial Statements

Hasbro Annual Report

- 1) Cover Page
- 2) Income Statement
- 3) Balance Sheet (Assets & Liabilities)
- 4) Cash Flows
- 5) Notes
- 6) Notes
- 7) Notes

## Cover Page



## Income Statement

| CONSOLIDATED STATEMENTS OF EARNINGS                  |             |             |             |
|--|-------------|-------------|-------------|
| Three Months Ended December 31, 1997, 1996, and 1995 | 1997        | 1996        | 1995        |
| Net income   | \$1,785,000 | \$1,122,000 | \$1,800,000 |
| Cost of sales  | (1,075,000) | (700,000)   | (1,220,000) |
| Gross profit   | \$710,000   | \$422,000   | \$580,000   |
| Expenses   |             |             |             |
| Depreciation   | \$1,000     | \$1,000     | \$1,000     |
| Research, development and engineering                | 280,000     | 280,000     | 280,000     |
| Selling  | 470,000     | 470,000     | 470,000     |
| General and administrative                           | 40,000      | 40,000      | 40,000      |
| Nonrecurring charges and discontinued operations     | 100,000     | —           | —           |
| Total expenses                                       | (861,000)   | (791,000)   | (791,000)   |
| Operating profit                                     | (151,000)   | (169,000)   | (111,000)   |
| Nonrecurring charges and expenses                    |             |             |             |
| Interest expense                                     | (1,000)     | (1,000)     | (1,000)     |
| Goodwill impairment charge                           | —           | —           | 25,000      |
| Total nonrecurring charges and expenses              | (1,000)     | (1,000)     | 24,000      |
| Earnings before income taxes                         | (152,000)   | (170,000)   | (87,000)    |
| Income taxes   | (10,000)    | (10,000)    | (10,000)    |
| Net earnings   | \$162,000   | \$160,000   | (97,000)    |
| Per share information:                               |             |             |             |
| Per share  | \$1.38      | \$1.32      | \$1.10      |
| Basic  | \$1.37      | \$1.31      | \$1.09      |
| Diluted  | \$1.31      | \$1.25      | \$1.03      |

See accompanying notes to consolidated financial statements.

## Balance Sheet (Assets & Liabilities)

| CONSOLIDATED BALANCE SHEETS                |           |           |           |
|--|-----------|-----------|-----------|
| December 31, 1997, 1996, and 1995          | 1997      | 1996      | 1995      |
| Assets                                     |           |           |           |
| Current assets                             |           |           |           |
| Cash and cash equivalents                  | \$1,000   | \$1,000   | \$1,000   |
| Accounts receivable                        | 200,000   | 200,000   | 200,000   |
| Inventory                                  | 200,000   | 200,000   | 200,000   |
| Prepaid expenses and other                 | 100,000   | 100,000   | 100,000   |
| Total current assets                       | 500,000   | 500,000   | 500,000   |
| Property, plant and equipment, net         | 200,000   | 200,000   | 200,000   |
| Other assets                               |           |           |           |
| Goodwill                                   | 400,000   | 400,000   | 400,000   |
| Intangible assets                          | 100,000   | 100,000   | 100,000   |
| Total other assets                         | 500,000   | 500,000   | 500,000   |
| Total assets                               | 1,000,000 | 1,000,000 | 1,000,000 |
| Liabilities and Shareholders' Equity       |           |           |           |
| Current liabilities                        |           |           |           |
| Accounts payable                           | \$1,000   | \$1,000   | \$1,000   |
| Accrued liabilities                        | 100,000   | 100,000   | 100,000   |
| Total current liabilities                  | 101,000   | 101,000   | 101,000   |
| Long-term liabilities                      |           |           |           |
| Debt                                       | 200,000   | 200,000   | 200,000   |
| Total long-term liabilities                | 200,000   | 200,000   | 200,000   |
| Shareholders' equity                       |           |           |           |
| Common stock                               | 100,000   | 100,000   | 100,000   |
| Retained earnings                          | 699,000   | 699,000   | 699,000   |
| Total shareholders' equity                 | 799,000   | 799,000   | 799,000   |
| Total liabilities and shareholders' equity | 1,000,000 | 1,000,000 | 1,000,000 |

See accompanying notes to consolidated financial statements.

## Cash Flows

| CONSOLIDATED STATEMENTS OF CASH FLOWS   |             |             |             |
|---|-------------|-------------|-------------|
| Three Months Ended December 31, 1997, 1996, and 1995                              | 1997        | 1996        | 1995        |
| Operating activities  |             |             |             |
| Net income  | \$1,785,000 | \$1,122,000 | \$1,800,000 |
| Adjustments to reconcile net income to net cash provided by operating activities: |             |             |             |
| Depreciation  | 1,000       | 1,000       | 1,000       |
| Goodwill impairment charge  | —           | —           | 25,000      |
| Nonrecurring charges and expenses   | 1,000       | 1,000       | —           |
| Changes in operating assets and liabilities:                                      |             |             |             |
| Accounts receivable   | (100,000)   | (100,000)   | (100,000)   |
| Inventory   | (100,000)   | (100,000)   | (100,000)   |
| Prepaid expenses and other  | (100,000)   | (100,000)   | (100,000)   |
| Accounts payable  | 100,000     | 100,000     | 100,000     |
| Accrued liabilities   | 100,000     | 100,000     | 100,000     |
| Total changes in operating assets and liabilities                                 | (100,000)   | (100,000)   | (100,000)   |
| Net cash provided by operating activities   | \$1,686,000 | \$1,023,000 | \$1,625,000 |
| Investing activities  |             |             |             |
| Purchase of property, plant and equipment   | (100,000)   | (100,000)   | (100,000)   |
| Acquisition of intangible assets  | (100,000)   | (100,000)   | (100,000)   |
| Other   | —           | —           | —           |
| Net cash used in investing activities   | (200,000)   | (200,000)   | (200,000)   |
| Financing activities  |             |             |             |
| Issuance of common stock  | 100,000     | 100,000     | 100,000     |
| Payment of dividends  | (100,000)   | (100,000)   | (100,000)   |
| Other   | —           | —           | —           |
| Net cash provided by financing activities   | —           | —           | —           |
| Net change in cash  | \$1,486,000 | \$823,000   | \$1,425,000 |
| Cash at beginning of period   | 100,000     | 100,000     | 100,000     |
| Cash at end of period   | \$1,586,000 | \$923,000   | \$1,525,000 |

## Notes

| CONSOLIDATED STATEMENTS OF CASH FLOWS   |             |             |             |
|---|-------------|-------------|-------------|
| Three Months Ended December 31, 1997, 1996, and 1995                              | 1997        | 1996        | 1995        |
| Operating activities  |             |             |             |
| Net income  | \$1,785,000 | \$1,122,000 | \$1,800,000 |
| Adjustments to reconcile net income to net cash provided by operating activities: |             |             |             |
| Depreciation  | 1,000       | 1,000       | 1,000       |
| Goodwill impairment charge  | —           | —           | 25,000      |
| Nonrecurring charges and expenses   | 1,000       | 1,000       | —           |
| Changes in operating assets and liabilities:                                      |             |             |             |
| Accounts receivable   | (100,000)   | (100,000)   | (100,000)   |
| Inventory   | (100,000)   | (100,000)   | (100,000)   |
| Prepaid expenses and other  | (100,000)   | (100,000)   | (100,000)   |
| Accounts payable  | 100,000     | 100,000     | 100,000     |
| Accrued liabilities   | 100,000     | 100,000     | 100,000     |
| Total changes in operating assets and liabilities                                 | (100,000)   | (100,000)   | (100,000)   |
| Net cash provided by operating activities   | \$1,686,000 | \$1,023,000 | \$1,625,000 |
| Investing activities  |             |             |             |
| Purchase of property, plant and equipment   | (100,000)   | (100,000)   | (100,000)   |
| Acquisition of intangible assets  | (100,000)   | (100,000)   | (100,000)   |
| Other   | —           | —           | —           |
| Net cash used in investing activities   | (200,000)   | (200,000)   | (200,000)   |
| Financing activities  |             |             |             |
| Issuance of common stock  | 100,000     | 100,000     | 100,000     |
| Payment of dividends  | (100,000)   | (100,000)   | (100,000)   |
| Other   | —           | —           | —           |
| Net cash provided by financing activities   | —           | —           | —           |
| Net change in cash  | \$1,486,000 | \$823,000   | \$1,425,000 |
| Cash at beginning of period   | 100,000     | 100,000     | 100,000     |
| Cash at end of period   | \$1,586,000 | \$923,000   | \$1,525,000 |

## Notes

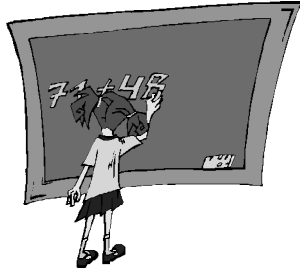
| CONSOLIDATED STATEMENTS OF CASH FLOWS   |             |             |             |
|---|-------------|-------------|-------------|
| Three Months Ended December 31, 1997, 1996, and 1995                              | 1997        | 1996        | 1995        |
| Operating activities  |             |             |             |
| Net income  | \$1,785,000 | \$1,122,000 | \$1,800,000 |
| Adjustments to reconcile net income to net cash provided by operating activities: |             |             |             |
| Depreciation  | 1,000       | 1,000       | 1,000       |
| Goodwill impairment charge  | —           | —           | 25,000      |
| Nonrecurring charges and expenses   | 1,000       | 1,000       | —           |
| Changes in operating assets and liabilities:                                      |             |             |             |
| Accounts receivable   | (100,000)   | (100,000)   | (100,000)   |
| Inventory   | (100,000)   | (100,000)   | (100,000)   |
| Prepaid expenses and other  | (100,000)   | (100,000)   | (100,000)   |
| Accounts payable  | 100,000     | 100,000     | 100,000     |
| Accrued liabilities   | 100,000     | 100,000     | 100,000     |
| Total changes in operating assets and liabilities                                 | (100,000)   | (100,000)   | (100,000)   |
| Net cash provided by operating activities   | \$1,686,000 | \$1,023,000 | \$1,625,000 |
| Investing activities  |             |             |             |
| Purchase of property, plant and equipment   | (100,000)   | (100,000)   | (100,000)   |
| Acquisition of intangible assets  | (100,000)   | (100,000)   | (100,000)   |
| Other   | —           | —           | —           |
| Net cash used in investing activities   | (200,000)   | (200,000)   | (200,000)   |
| Financing activities  |             |             |             |
| Issuance of common stock  | 100,000     | 100,000     | 100,000     |
| Payment of dividends  | (100,000)   | (100,000)   | (100,000)   |
| Other   | —           | —           | —           |
| Net cash provided by financing activities   | —           | —           | —           |
| Net change in cash  | \$1,486,000 | \$823,000   | \$1,425,000 |
| Cash at beginning of period   | 100,000     | 100,000     | 100,000     |
| Cash at end of period   | \$1,586,000 | \$923,000   | \$1,525,000 |

## Notes

| CONSOLIDATED STATEMENTS OF CASH FLOWS   |             |             |             |
|---|-------------|-------------|-------------|
| Three Months Ended December 31, 1997, 1996, and 1995                              | 1997        | 1996        | 1995        |
| Operating activities  |             |             |             |
| Net income  | \$1,785,000 | \$1,122,000 | \$1,800,000 |
| Adjustments to reconcile net income to net cash provided by operating activities: |             |             |             |
| Depreciation  | 1,000       | 1,000       | 1,000       |
| Goodwill impairment charge  | —           | —           | 25,000      |
| Nonrecurring charges and expenses   | 1,000       | 1,000       | —           |
| Changes in operating assets and liabilities:                                      |             |             |             |
| Accounts receivable   | (100,000)   | (100,000)   | (100,000)   |
| Inventory   | (100,000)   | (100,000)   | (100,000)   |
| Prepaid expenses and other  | (100,000)   | (100,000)   | (100,000)   |
| Accounts payable  | 100,000     | 100,000     | 100,000     |
| Accrued liabilities   | 100,000     | 100,000     | 100,000     |
| Total changes in operating assets and liabilities                                 | (100,000)   | (100,000)   | (100,000)   |
| Net cash provided by operating activities   | \$1,686,000 | \$1,023,000 | \$1,625,000 |
| Investing activities  |             |             |             |
| Purchase of property, plant and equipment   | (100,000)   | (100,000)   | (100,000)   |
| Acquisition of intangible assets  | (100,000)   | (100,000)   | (100,000)   |
| Other   | —           | —           | —           |
| Net cash used in investing activities   | (200,000)   | (200,000)   | (200,000)   |
| Financing activities  |             |             |             |
| Issuance of common stock  | 100,000     | 100,000     | 100,000     |
| Payment of dividends  | (100,000)   | (100,000)   | (100,000)   |
| Other   | —           | —           | —           |
| Net cash provided by financing activities   | —           | —           | —           |
| Net change in cash  | \$1,486,000 | \$823,000   | \$1,425,000 |
| Cash at beginning of period   | 100,000     | 100,000     | 100,000     |
| Cash at end of period   | \$1,586,000 | \$923,000   | \$1,525,000 |

## Ratios

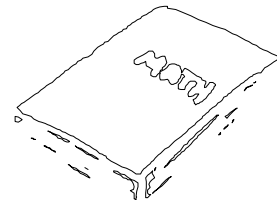
Quick evaluations of the economic health of a company, from balance sheet or income statement amounts



## Current Ratio

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

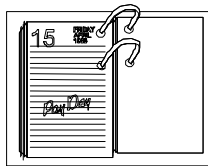
A value of 2 is good, unity could spell trouble



## Acid-test or Quick Ratio

$$\frac{\text{Cash \& temporary investments + A/R}}{\text{Current Liabilities}}$$

- No inventories
- Can you pay your bills in the short term, if the market for your product goes bad?



## Profit Margin

$$\text{Profit Margin} = \frac{\text{Net Income}}{\text{Total Sales}}$$

$$\text{Return on Stockholder's Equity} = \frac{\text{Net Income}}{\text{Stockholder Equity}}$$

## Earnings Per Share (EPS)

$$\frac{\text{Net Income}}{\text{No. of shares of common stock}}$$

$$\text{Inventory turnover} = \frac{\text{Sales}}{\text{Average Inventory}}$$

### Long term debt to equity

- High ratio probably means low dividends

### Price to Earnings

- Probably most familiar to stock investors