



smartwomansecurities

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# Understanding Financial Statements I

Professor **Janet O'Tousa**

Associate Teaching Professor of Accountancy

Mendoza College of Business

jotousa1@nd.edu

# Tonight's Agenda

- Introduction to Financial Statements
- Balance Sheet

# This Week's Seminar

- **After this, you should be able to:**
  - Understand the importance of financial statements
  - Be familiar with the three financial statements (balance sheet, income statement, statement of cash flows)
  - Understand why you look at each statement
  - Understand the various accounts on the balance sheet, what they mean, and how to read them

# Market Update

- Stocks sell off as rising bond yields raise fears about borrowing costs
  - DJIA fell 180 points on Friday; Nasdaq, 1.2%
- US Government bond yields rose to their highest level
  - The 10 year Treasury bond serves as a bench-mark for other loans
    - Mortgages, small business and government bonds
- Higher borrowing costs have the potential to slow economic activity
- However the rest of the economic data was quite good
- The US's performance in the third quarter close to matching the 4.2% growth rate of the prior period
- Unemployment rate is at its lowest in 49 years, 3.7%
- Market measures of inflation are holding steady (2%)
- Bond yields are rising because of growth rather than fear of inflation

# Market Update

- **Starbucks Corp.**'s incoming finance chief, Patrick Grismer, joins the coffee chain as it transitions from **a period of rapid expansion to a more mature market position.**
  - *New priorities:* In the past, investors were intrigued by the top-line growth of Starbucks and therefore less focused on the management of expenses.
  - As sales growth slows, shareholders tend to drill down on costs as they expect management to hit earnings and returns targets, analysts say.
  - *Time to lower the bar:* Mr. Grismer should jump on the chance to lower the coffee chain's long-term growth forecast.
    - “Nobody is going to penalize you for having a lower bar on paper if you consistently beat those expectations,”
      - *Barclays PLC analyst Jeffrey Bernstein said.*

# Market Update

- *Mixed feelings*: Some analysts expressed reservations over the appointment, pointing to Mr. Grismer's time at **Yum! Brands** Inc. during which the company's share price was more or less stagnant
- Also: “He was CFO at a time when there were multiple supply chain scandals that hit the China business in quick succession,”
  - *said Sara Senatore, an analyst at Sanford C. Bernstein & Co.*
- How can you keep up to date on the market?
- <https://education.wsj.com/students/>

# Review: Stock Picking

- **#1: Finding ideas through trends**
  - Newspapers, TV, roommates, internet, everyday life
  - Wall Street Journal, New York Times
  - Come up with preliminary list of companies
- **#2: Research the company**
  - What industry does it belong in? What trends impact that industry?
  - Company website, financial filings (MD&A section), talk to company mgmt, listen to conference calls
  - Porter's 5 forces tell you if it's a good business (customer power, supplier power, barriers to entry, threat of substitutes, rivalry)
- **#3: Determine how sustainable trends are (this is subjective, no easy answer)**
  - Talk to company mgmt, think independently (what makes sense?)
  - Remember trends drive revenues, and revenues drive earnings (aka EPS)!

# Next Up: Valuation

- #4: Use valuation to determine if trends are priced into the stock
- #5: Use valuation to determine future stock price
- But, before we can do this, we must learn about the financial statements
  - Balance Sheet
  - Income Statement
  - Statement of Cash Flows



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# Introduction to Financial Statements



# Financial Statements are Critical

- Helps investors determine the financial health of the company.  
**This is REALLY important.**
  - How fast have revenues grown?
    - **Income Statement**
  - How profitable is the company?
    - **Income Statement**
  - How efficiently are they growing EPS?
    - **Net income/Outstanding shares**
  - How are they financing that growth (debt & equity)?
    - **Balance Sheet**
  - Do they have adequate liquidity?
    - **Nearness to Cash**
    - **Ability to meet short term obligations**
    - **Balance Sheet**

# Financials and Industries

- Financial statements aren't just about the numbers.
  - The numbers paint a picture, they tell the story of the industry and/or company. By learning to read them, you can learn a lot.
  - For the industry, you can see if it is a great industry with an economic moat\* or a very competitive business.
    - For example, a great industry will often times have higher margins on the income statement (more to come next week on this) or even higher returns on the money they invested (called Return on Invested Capital, which we'll also learn more about).
    - Tough industries will often have low margins, low returns, or very erratic swings in financial performance.
  - Financials for different industries vary dramatically.
    - A health care company will look much different than a railroad company.
    - Importance of comparing analytics with industry averages

# Financials Tell You A Lot

- Financial statements can tell you a lot about a company
  - For the company specifically, you can learn a lot about operations, strategy, management, etc.
    - For example, from the cash flow statement you can see where money is going – it could be going to investing, meaning the company is growing (like Chipotle, CMG) or it could be going to financing, meaning the company is mature (like Wal-Mart, WMT), or it could be going to operations, meaning the company isn't making money (like a start up).
    - You can see what a company is spending their money on – perhaps it's on employees or maybe on machines or perhaps on inventory.
    - You can also see what the company owns and how they use those assets.
    - All of these things tell you a lot and you can see how the company improves or worsens over time through their financial statements.

# Financials Help Comparisons

- Translates *activities* into objective *numbers*
  - Allows comparability across time, firms and industries
- Helps us evaluate:
  - Historical financial performance
  - Future prospects
  - Potential problems
- Every public company has to disclose financial statements.
  - Understanding financial statements offer us a good point of comparison, as well as an indication of a company's relative financial strength
  - [www.sec.gov](http://www.sec.gov)
  - Filings/Company Search/10K

# Accessing Financial Statements

All filings are on the SEC's website at: [www.sec.gov/edgar.shtml](http://www.sec.gov/edgar.shtml)

The screenshot shows three overlapping browser windows from Microsoft Internet Explorer. The top window is the "EDGAR Company Search" page, which includes a search form with fields for "Company name", "or CIK or Ticker Symbol", "or File Number", and "or State", along with checkboxes for "and/or SIC" and "and Ownership Forms". The middle window displays "Company Information: COCA COLA CO", providing details such as SIC (2080 - Beverages), State (DE), and business address. The bottom window shows a "10-K" filing document titled "FORM 10-K ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934" for The Coca-Cola Company, including the company logo and registration information.

**EDGAR Company Search**

From this page, you can search the EDGAR database for company information, including real-time filings. If more than one company name matches your search keyword(s), you will be presented with a list of possible matches from which to pick. Company filings are available for 1993 through 2006. See also our [EDGAR Full Text Search](#) (Beta Version).

Enter your search information:

Company name:

or CIK or Ticker Symbol:  (General Index Key)  
(Tickers for 9600 largest publicly traded companies)

or File Number:

or State:  (two-letter abbreviation)

and/or SIC:

and Ownership Forms  Include  Exclude  Only 3, 4, and 5?

**Company Information: COCA COLA CO**

SIC: 2080 - Beverages  
State location: DE | State of Inc.: DE | Fiscal Year End: 1231

Business Address: ONE COCA COLA PLAZA ATLANTA GA 30313 4046792121  
Mailing Address: ONE COCA COLA PLAZA 30313

Key to Descriptions  
[Paper] Paper filings are available by firm number from the [SEC Public Reference Room](#).  
[Cover] Filing contains an SEC-released cover letter or correspondence.

Form	Formats	
8-K	<a href="#">html</a> <a href="#">text</a> 175 XB	Current report, items 3.03 and 9.01 Acc-no: 0000021344-06-000108 (34 Act)
8-K	<a href="#">html</a> <a href="#">text</a> 991 XB	Current report, items 2.02 and 9.01 Acc-no: 0001104659-06-067365 (34 Act)
4	<a href="#">html</a> <a href="#">text</a> 6 XB	Statement of changes in beneficial ownership of security Acc-no: 0000021344-06-000106
4	<a href="#">html</a> <a href="#">text</a> 6 XB	Statement of changes in beneficial ownership of security Acc-no: 0000021344-06-000105
4	<a href="#">html</a> <a href="#">text</a> 7 XB	Statement of changes in beneficial ownership of security Acc-no: 0000021344-06-000104
4	<a href="#">html</a> <a href="#">text</a> 6 XB	Statement of changes in beneficial ownership of security Acc-no: 0000021344-06-000103
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4	<a href="#">html</a> <a href="#">text</a> 7 XB	Statement of changes in beneficial ownership of security Acc-no: 0000021344-06-000098
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8-K	<a href="#">html</a> <a href="#">text</a> 122 XB	Current report, items 1.01 and 9.01 Acc-no: 0000021344-06-000086 (34 Act)
10-Q	<a href="#">html</a> <a href="#">text</a> 1 HB	Quarterly report (Sections 13 or 15(d)) Acc-no: 0001104659-06-049246 (34 Act)
8-K	<a href="#">html</a> <a href="#">text</a> 6 XB	Statement of changes in beneficial ownership of security Acc-no: 0000021344-06-000082
8-K	<a href="#">html</a> <a href="#">text</a> 960 XB	Current report, items 2.02 and 9.01 Acc-no: 0001104659-06-047391 (34 Act)
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4	<a href="#">html</a> <a href="#">text</a> 6 XB	Statement of changes in beneficial ownership of security Acc-no: 0000021344-06-000077
4	<a href="#">html</a> <a href="#">text</a> 7 XB	Statement of changes in beneficial ownership of security Acc-no: 0000021344-06-000076

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 10-K**

For the fiscal year ended December 31, 2005

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 1-2127

*The Coca-Cola Company*

(Exact name of Registrant as specified in its charter)

DELAWARE  
(State or other jurisdiction of incorporation or organization)

One Coca-Cola Plaza  
Atlanta, Georgia  
(Address of principal executive offices)

88-0628465  
(ISS Employer Identification No.)

30313  
(Zip Code)

Registrant's telephone number, including area code: (404) 676-2121

Securities registered pursuant to Section 12(b) of the Act:

Title of each class  
COMMON STOCK, \$0.25 PAR VALUE  
NEW YORK STOCK EXCHANGE

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

# Accessing Financial Statements

- How do investors get access to financial statements?
  - Public company's financial statements **MUST** be available to the public
  - Look at a company's website and find their 10K (annual report) or 10-Q (quarterly report) – this is usually found under an “Investors Relations” section or something such as “SEC Filings”
  - <https://investor.starbucks.com/>

# Company Reports

- Financials make up just one part of a company report
- Other things in the financial report include:
  - Company overview & business description
  - Accounting policies (GAAP)
  - Financial statements (and footnotes!)
  - Management discussion and analysis (MD&A)
  - Directors and executive officers' bios
  - Executive compensation
  - Update on recent merger/acquisition activity
  - Risks to the business operations
- The financial statements however are a very important piece
  - Starting point for a Valuation Analysis



# Other Important Sections

- **Other Important Components**

- Management Discussion and Analysis (MD&A)

- Management explains the business and what has taken place over the past year. It helps to hear it in their words.
- If you are new to a company, this section can be particularly helpful.

- Footnotes (they explain changes in these statements)

- Footnotes are particularly important as they will often help investors interpret the numbers, make necessary adjustments and gain a better understanding of the business functioning.
- In general, make sure you read the footnotes, especially if you don't understand a table!

# Now What Are the Statements?

- There are three main statements that tell you different things.
- We'll spend time looking at each one in depth.
  - Balance Sheet
    - Allows you to understand what the company owns (assets) and what they owe to others (liabilities) at any given point in time
  - Income Statement
    - Provides you information on how much money the company makes (revenue), what they spend their money on (expenses), and ultimately what's left over (profit) for a certain time period
  - Statement of Cash Flows (or Cash Flow Statement)
    - Explains what they've spent cash on over a period of time.



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# Balance Sheet



# Balance Sheet

- Financial snapshot at a single point in time
- **Assets (what the company *owns*)**
  - economic resources that are expected to benefit future activities of the company
- **Liabilities (what the company *owes*)**
  - the company's economic obligations
- **Shareholders' equity (whatever is left)**
  - the excess of the assets over the liabilities (also called “stockholders' equity”)
- **Assets = Liabilities + Shareholders' Equity**

# Balance Sheet: Its Components

**Assets:** Economic resources that generate future value for the company

**Liabilities:** Obligations the company has to deliver something of value (usually cash or services) in the future

**Shareholders' Equity:** Remaining claims accruing to owners

# Assets

Resources that generate future value for the company

- **Current Assets:** Assets that can be converted to cash within one year
  - Cash = money company has today
  - Accounts Receivables = money owed to the company by its customers
  - Inventory = assets that will be turned into products that the company will sell for money in future
- **Non-Current Assets:** Assets that are not expected to be converted to cash within that time period: property, plants, equipment, patents, goodwill
  - Property Plant & Equipment = assets that are used to produce products

# Assets (CL)

- The following examples are for Colgate (CL)

	<u>2006</u>	<u>2005</u>
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 489.5	\$ 340.7
Receivables (net of allowances of \$46.4 and \$41.7, respectively)	1,523.2	1,309.4
Inventories	1,008.4	855.8
Other current assets	279.9	251.2
	<u>3,301.0</u>	<u>2,757.1</u>
Property, plant and equipment, net	2,696.1	2,544.1
Goodwill, net	2,081.8	1,845.7
Other intangible assets, net	831.1	783.2
Other assets	228.0	577.0
	<u>\$ 9,138.0</u>	<u>\$ 8,507.1</u>

# Liabilities

Obligations the company has to deliver something of value (usually cash or services) in the future

- **Current Liabilities:** Obligations that are expected to be paid within one year
  - Accounts Payable = money the company owes its suppliers
  - Salaries Payable = money the company owes its workers
  - Short term debt = money the company owes the bank to be paid in the next year
- **Non-Current Liabilities:** Obligations that are not expected to be paid within one year or the operating cycle, whichever is longer
  - Long term debt = money the company owes the bank to be paid after 1 year



# Liabilities (CL)

## Liabilities and Shareholders' Equity

Current Liabilities		
Notes and loans payable	\$ 174.1	\$ 171.5
Current portion of long-term debt	776.7	356.7
Accounts payable	1,039.7	876.1
Accrued income taxes	161.5	215.5
Other accruals	1,317.1	1,123.2
	<hr/>	<hr/>
Total current liabilities	3,469.1	2,743.0
Long-term debt	2,720.4	2,918.0
Deferred income taxes	309.9	554.7
Other liabilities	1,227.7	941.3
	<hr/>	<hr/>
Total liabilities	7,727.1	7,157.0

# Shareholders' Equity

Equity is the remaining claims accruing to shareholders, also the difference between assets and liabilities

- Stock and Paid-in Capital
  - Securities representing equity ownership in a corporation
- Retained Earnings
  - Earnings not paid out as dividends but reinvested in the core business or used to pay off debt
- Treasury Stock
  - Stock that the company reacquires that can be retired

# Shareholder's Equity (CL)

Shareholders' Equity		
Preference stock	222.7	253.7
Common stock, \$1 par value (1,000,000,000 shares authorized, 732,853,180 shares issued)	732.9	732.9
Additional paid-in capital	1,218.1	1,064.4
Retained earnings	9,643.7	8,968.1
Accumulated other comprehensive income	(2,081.2)	(1,804.7)
	<u>9,736.2</u>	<u>9,214.4</u>
Unearned compensation	(251.4)	(283.3)
Treasury stock, at cost	(8,073.9)	(7,581.0)
	<u>1,410.9</u>	<u>1,350.1</u>
Total shareholders' equity	<u>1,410.9</u>	<u>1,350.1</u>
Total liabilities and shareholders' equity	<u>\$ 9,138.0</u>	<u>\$ 8,507.1</u>

# Balance Sheet Example

- You & your roommates decide after graduating you want to start a bread company.
- You need money to start up the company
  - Borrow money from your parents?
  - Go to the bank to borrow money?
  - Use your life savings?
  - Sell a portion of the company to investors?

# Balance Sheet Example cont'd

- You borrow \$500M from the bank and sell shares in the public market for another \$500M

<b>ASSETS</b>	<b>LIABILITIES &amp; EQUITY</b>
<b>Cash: \$1B</b>	<b>Debt: \$500M</b> <b>Shareholders' Equity: \$500M</b>
<b>Total Assets: \$1B</b>	<b>Total Liabilities &amp; Equity: \$1B</b>

# Balance Sheet Example cont'd

- Use cash to buy stuff to help you make bread: a bread plant, ingredients (flour, eggs), an office, etc

ASSETS	LIABILITIES & EQUITY
<u>Current Assets:</u>  Cash: \$100M Inventory: \$200M	Debt: \$500M  Shareholders' Equity: \$500M
<u>Long Term Assets:</u>  Property Plant & Equipment: \$700M	
<b>Total Assets: \$1B</b>	<b>Total Liabilities &amp; Equity: \$1B</b>

# Example: Balance Sheet (CL)

**COLGATE-PALMOLIVE COMPANY**  
**Consolidated Balance Sheets**  
**As of December 31,**  
*(Dollars in Millions Except Per Share Amounts)*

	<u>2006</u>	<u>2005</u>
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 489.5	\$ 340.7
Receivables (net of allowances of \$46.4 and \$41.7, respectively)	1,523.2	1,309.4
Inventories	1,008.4	855.8
Other current assets	279.9	251.2
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Goodwill, net	2,081.8	1,845.7
Other intangible assets, net	831.1	783.2
Other assets	228.0	577.0
<b>Total assets</b>	<u>\$ 9,138.0</u>	<u>\$ 8,507.1</u>
<b>Liabilities and Shareholders' Equity</b>		
<b>Current Liabilities</b>		
Notes and loans payable	\$ 174.1	\$ 171.5
Current portion of long-term debt	776.7	356.7
Accounts payable	1,039.7	876.1
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Long-term debt	2,720.4	2,918.0
Deferred income taxes	309.9	554.7
Other liabilities	1,227.7	941.3
<b>Total liabilities</b>	<u>7,727.1</u>	<u>7,157.0</u>
Commitments and contingent liabilities	—	—
<b>Shareholders' Equity</b>		
Preference stock	222.7	253.7
Common stock, \$1 par value (1,000,000,000 shares authorized, 732,853,180 shares issued)	732.9	732.9
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# The Balance Sheet

- **Its usefulness**

- Gives information about the liquidity of a company
- Tells us how “asset intensive” a company is or how many assets (machines, buildings, equipment) are necessary
- Tells us about the ability of a company to meet its long-term fixed expenses and to accomplish long-term growth

- **Its limitations**

- Assets are recorded at historical cost rather than at market value (what you paid, not what it’s “worth” or the price at which you could sell the asset)
- Resources such as employee skills and reputation are **NOT** recorded on balance sheet



# Seminar Recap

- Financials paint a picture about a company and industry – they're more than just numbers!
- Use balance sheets to assess a company's financial position at a point in time
- Assets are what a company owns. Liabilities are what a company owes.
- Accounts within each category help you understand more about the business' operations.

# Coming Up

## Week 6:

- Interpreting the story the numbers are telling
- Learning about the income statement
- Understanding the cash flow statement

## Week 7:

- Understanding important financial metrics
- Calculating financial ratios
- Analyzing what ratios mean about a company or industry

## Week 8:

- Putting it all together with an investment recommendation

## Weeks 9-10:

- Guest lectures/presentations