

THE SIMPLE GUIDE TO UNDERSTANDING YOUR

FINANCIAL STATEMENTS



Trinity Valley SBDC

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Trinity Valley SBDC

SMALL BUSINESS DEVELOPMENT CENTER

Your Partner in Success

Our mission is to help start and grow business' in the five counties of Trinity Valley Community College. Whether you're just getting started or ready to expand, we're here to provide the knowledge, tools, and confidence you need to achieve your goals of a stronger, more successful business.

Who we are

We are part of the North Texas SBDC network established in 1986, which is a statewide partnership dedicated to supporting small businesses through professional advising and training. Hosted by Trinity Valley Community College, we proudly serve Henderson, Anderson, Kaufman, Rains, and Van Zandt counties.

What we do

We provide no-cost business advising, low-cost training, and access to vital resources to help new and existing businesses grow and thrive. Our experienced advising staff supports entrepreneurs and small business owners at every stage of the business life cycle—from pre-venture and startup to expansion, growth, and exit.

- **Business plans**
- **Market Research**
- **Loan Structuring & Capital Access**
- **Sales and marketing strategies**
- **Recordkeeping/QBO Training**
- **Cash Flow Analysis/Financial Analysis**
- **Organizing a Business**
- **Employer Resources**

This **Resource Book** is one of the many **no-cost** tools available to our clients. In addition, we have access to a broad range of financial, market, and demographic research reports customized for your industry and geographic location. Take advantage of our innovative services and allow the SBDC to help you **start, grow, and strengthen your business venture.**

Training Calendar

www.tvccsbdc.org/calendar

How to Sign-Up

Complete a Client Request for Advising form at tvccsbdc.org and click the "Sign-up" page

Schedule with Us

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Trinity Valley SBDC is a field center of the North Texas SBDC and is funded in part by the U.S. Small Business Administration and Trinity Valley Community College. Advising services are offered by Trinity Valley SBDC without regard to race, color, age, national origin, religion, sex, or disability. Special provisions will be made for limited English speaking individuals and those with disabilities. Those interested may contact Trinity Valley SBDC at 903-675-7403.

INTRODUCTION

Financial statements help you understand what's working and what's not in your business, so you can make better decisions, grow your profits, and keep it running strong. A single statement cannot show you everything about your financial health. Looking at several statements together helps you gain a clear picture so you can make smarter decisions about spending, investing, and running your business. Financial statements are prepared annually, but it's good to review them every month or quarter.

Many business owners don't know how to read their statements, so they rely on advisors and accountants. Their input is valuable, but you need to educate yourself. You must understand your statements to:

- realize the role money plays in every business decision
- determine if you are making a profit or losing money
- calculate your current and future financial needs and see if:
 - ▶ you have positive cash flow for short-term needs
 - ▶ your business is growing and will continue to grow

For lending purposes, financial statements help you determine:

- if you can afford to pay a loan
- the loan amount
- the loan term (number of years)
- which assets to buy vs. finance
- the collateral to secure a loan

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Balance Sheet

Shows financial position at one moment in time including assets, liabilities, and equity.

- Explained: Page **4**
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Income Statement

Shows profitability over a period of time including revenue, expenses, and profitability.

- Explained: Page **7**
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Cash Flow Statement

Cash increases and decreases over a period of time.

- Explained: Page **10**
- Example: Page **11**
- Interactive: Page **12**



Ratios

Shows the financial condition of a company using figures from the *Balance Sheet* and *Income Statement*.

- Explained/Examples: Page **13 & 14**
- Interactive: Page **15**

Click on any page number above to jump to that page.



This icon appears on pages with **Fillable Statements**

Fillable Financial Statements

Want to see how your business numbers look? Enter your figures into the *fillable financial statements* on pages 6, 9, 12, and 15, and see your numbers calculate automatically.

- Save this guidebook file to your computer (Downloads or Documents folder) and give it a new name.
- Type your business numbers in the **blue boxes**.
- Blank boxes and those with "0" will update automatically after you enter numbers.
- Save your file often. Tip: If your calculations don't update, try saving, closing, and reopening the file.
- Create multiple financial scenarios by saving several files with different numbers. Give each file a unique name (for example, "Financials_Scenario 1.pdf" and "Financials_After_Loan.pdf").
- Navigation Tip: Press the Tab key to move up or down between blue boxes. Use your mouse to click in boxes when moving across forms.

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BALANCE SHEET

The Balance Sheet is a picture of your business, frozen for a second in time.

BALANCE SHEETS: Before and After Financing

Established companies should develop two Balance Sheets- one before the loan, and one the day after a loan closes.

New companies should include an opening Balance Sheet in the projections to reflect what it looks like the day after the loan closes.

WHAT DOES A BALANCE SHEET TELL YOU?

This statement shows what you own (assets), what you owe (liabilities), and what's left over (net value or equity in the business). The numbers change every time you receive money or give credit to a client as well as when you pay for or charge an expense.

Liabilities + Net Worth = Assets

Think of the Balance Sheet like a scale. Assets and Liabilities alone are out of balance until you add Capital, the last weight put on the scale, to make it balance.

Assets

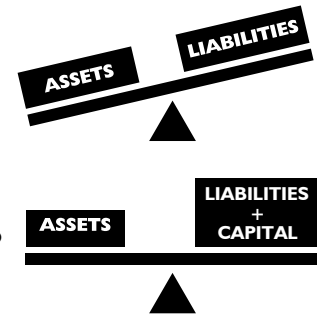
Assets are divided into two categories: current and non-current. They are listed according to how liquid or how quickly they can be turned into cash. Current assets includes cash and inventory. Non-current assets are furniture, fixtures, property and equipment. Money owed to your company (accounts receivable) is considered an asset.

Liabilities

Liabilities (debts you owe) are divided into two categories: current and non-current (or long-term).

Capital or Net Worth

The business' equity includes money the owners have invested and income kept in the business from the company's profits.



WHAT IT SHOWS YOU

- The net value of the business
- How much of your loan debt is current, and how much is long-term
- Percentages and ratios (which are extracted from the numbers) necessary to analyze your business (see pages 13-15)
- Compare two time periods to see changes in:
 - › cash › accounts payable › accounts receivable
 - › equity › inventory › retained earnings

WHAT IT WON'T SHOW YOU

- Income and expenses over a period of time. The Balance Sheet reflects one moment.
- Market value and quality of assets, but it will reflect purchase costs and depreciation
- Contingent Liabilities (financial obligations you're required to repay if you co-sign or guarantee a loan)
- Operating Lease obligations. Capital leases are shown on the Balance Sheet. Buying the item at the end of the lease, for a set price, does not appear on the Balance Sheet.



BALANCE SHEET EXAMPLE

Balance Sheet Max Music Company

ASSETS (What You Own)

Current Assets (converts to cash in one year)

Cash.....	10,000
Accounts Receivable.....	75,000
Inventory	85,000
Total Current Assets (10K+75K+85K).....	170,000

Non-Current Assets (more than one year to convert to cash)

Fixed Assets (furniture, fixtures, property, equipment).....	140,000
Less Accumulated Depreciation.....	- 25,000
Fixed Assets (net, 140K - 25K).....	115,000
Advances to Owners.....	6,000
Total Non-Current Assets (115K + 6K).....	121,000

Total Assets (170K + 121K)..... 291,000

LIABILITIES (what you owe)

Current Liabilities (due within one year)

Accounts Payable	41,000
Accrued Taxes.....	3,000
Current Portion of Long-Term Debt.....	6,000
Note Payable (due within one year).....	100,000
Total Current Liabilities.....	150,000

Long-Term Liabilities (due for more than one year)

Loan Payable.....	54,000
Total Long Term Liabilities.....	54,000
Total Liabilities (150K + 54K).....	204,000

CAPITAL OR NET WORTH (the company's equity)

Owners Investment	20,000
Retained Earnings (income kept in the business)	67,000
Total Capital or Net Worth (67K + 20K).....	87,000
Total Liabilities & Capital (204K + 87K).....	291,000

Accounts Receivable
Sales made but money owed to the company

Fixed Assets
Original Cost

Depreciation
Assets lose their value. Deductions are made according to tax rules

Advances to Owners
Money owners take, in the form of a loan, to be repaid

Accounts Payable
Purchases not paid for

Current Portion of Long-Term Debt
One year of loan payments

Loan Payable
Loan balance after one year of payments

Owners Investment
Money owners invest in the business

Retained Earnings
Money left in the business from company profits

These numbers should be the same.

ACCOUNTING METHODS

The Cash Method

- Records a sale when money is collected
- Records an expense when it is paid

The Accrual Method

- Sales are made on credit, and not immediately paid for. The amount customers owe is called Accounts Receivable
- Buy items or incur expenses for the business, but pay later. The amount owed is called Accounts Payable.
- Net worth does not always translate to cash, since money can be tied up in Accounts Receivable, expenses and inventory. To get a better idea of how much cash there is at the end of the month, learn about the Cash Flow Statement (see pages 10-12).



BALANCE SHEET INTERACTIVE



Click icon for instructions

BALANCE SHEET

Statement Date _____

ASSETS

Current Assets

Cash	\$	_____
Accounts Receivable	\$	_____
Inventory (ending)	\$	_____
Total Current Assets	\$	_____

Non-Current Assets

Fixed Assets	\$	_____
Less Depreciation	\$	_____
Fixed Assets (Net)	\$	_____
Advances to Owners	\$	_____
Total Non-Current Assets	\$	_____
TOTAL ASSETS	\$	=====

LIABILITIES

Current Liabilities

Accounts Payable	\$	_____
Accrued Taxes	\$	_____
Current Portion of Long-Term Debt	\$	_____
Note Payable	\$	_____
Total Current Liabilities	\$	_____

Long-Term Liabilities

Loan & Notes Payable	\$	_____
Total Long-Term Liabilities	\$	_____
TOTAL LIABILITIES	\$	_____

CAPITAL OR NET WORTH

Owners Investment	\$	_____
Retained Earnings	\$	_____
TOTAL CAPITAL	\$	_____
TOTAL LIABILITIES & CAPITAL	\$	=====



INCOME STATEMENT

Think of the Income Statement as a "report card" for your business. It provides an overview of how the business is performing.

WHAT DOES AN INCOME STATEMENT TELL YOU?

In the day-to-day running of your business, numbers fly around at a fast pace. Bills are paid, money is taken in, and sometimes, it's hard to know how much you're actually making. The Income Statement answers that question. Other names for the Income Statement are Operating Statement, Earnings Statement, and Profit and Loss (P&L) Statement.

Since this statement reflects your business activity over time, it is developed monthly, quarterly and annually. New companies: Make estimated or projected figures for Income Statement month by month for the first year, quarterly for the second year, and one whole year for the third year.

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WHAT IT SHOWS YOU

- If sales are going up or down
- Your gross profit — how much money is left for the rest of the business after deducting what it costs to produce or purchase the product
- All expenses for the time period that the statement covers
- How much money is left to grow the business
- How much money is left for the owner(s)
- How much money is left to pay debt (principal only)
- Increases and decreases in net income

.....

WHAT IT WON'T SHOW YOU

- If your overall financial condition is weak or strong (see the Balance Sheet).
- What's tied up in Accounts Receivable (money owed to you) and Accounts Payable (money you owe).
- What you own (assets) and what you owe (liabilities).
- The ability (or inability) to pay short-term debts and bills. For example, a business could show a profit on the Income Statement but face cash flow problems when clients pay slowly, or if expenses are paid before enough money is collected. See the Cash Flow Statement on pages 10-12.
- Solvency and ability to meet long-term debt. The Income Statement focuses on profitability over a specific period, not its overall financial structure.



INCOME STATEMENT EXAMPLE

Income Statement Max Music Company

Net Sales 900,000 100%

Cost of Goods Sold (cost to make products):

Beginning Inventory 75,000 8%

Purchases (to make product) 350,000 39%

Labor (to make product only) 200,000 22%

Total (75K+350K+200K)..... 625,000 69%

Less: Ending Inventory..... - 85,000 9%

Cost of Goods Sold (625K less 85K) 540,000 60%

Gross Profit (900K less 540K) 360,000 40%

Expenses

Operating Expenses:

Selling Expenses..... 90,000 10%

General and Administrative + 170,000 19%

Total Expenses (90K + 170K)..... 260,000 29%

Operating Income (360K less 260K) 100,000 11%

Less: Interest Expense (on loans) - 20,000 2%

Profit

Net Profit before taxes (100K less 20K) 80,000 9%

Less: All Income Taxes - 27,000 3%

Net Profit (80K less 27K) 53,000 6%

Net Sales
Revenue or income. Gross sales is before returns and allowances. Net sales is after returns and allowances.

Convert Income Statement numbers into percentages. Compare two time periods to see if percentages are increasing or decreasing.

Gross Profit
This is your profit margin

Selling Expenses
Salaries and expenses related to sales only

General & Administrative
All other expenses to run the company

Operating Income (or Loss)
Shows how the business performed

Net Profit
Profit left after all expenses paid



INCOME STATEMENT INTERACTIVE



Click icon for instructions

INCOME STATEMENT

Date: _____

SALES

Net Sales \$ _____

Cost of Goods Sold:

Beginning Inventory \$ _____
 Purchases \$ _____
 Labor \$ _____
 Total \$ _____

Less: Ending Inventory -\$ _____

Less: Cost of Goods Sold \$ _____

Gross Profit \$ _____

EXPENSES

Operating Expenses:

Selling Expenses \$ _____
 General and Administrative \$ _____

Total Expenses \$ _____

Operating Income \$ _____

Less: Interest Expense -\$ _____

Net Profit before Taxes \$ _____

Less: All Income Taxes -\$ _____

Net Profit \$ _____



CASH FLOW STATEMENT

What money comes in, what goes out, and what stays

WHAT DOES A CASH FLOW STATEMENT TELL YOU?

Cash is the fuel that runs your business. The Cash Flow Statement tracks liquidity, or the movement of cash in and out of your business. It shows you how much money is available to run the business.

It also shows investing activities or cash used to buy or sell long-term assets like equipment and property. The statement includes financing activities like cash from loans, investors, or owners.

The Cash Flow Statement reveals your net cash flow (an increase or decrease in your cash position). Running out of cash is disastrous, so you must always have positive “cash flow” for your expenses.

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WHAT IT SHOWS YOU

- If the business has enough money to:
 - cover day-to-day activities
 - pay debts on time
 - grow the business without negative cash flow
- When additional working capital (cash) is needed. If sales increase, so will expenses (like product costs and labor).
- Breakdown of principal and interest on loan payments. The Income Statement shows interest, not principal.
- Weaknesses (inability to generate enough cash) that must be covered with increased sales, cost reductions, and owner investments.

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WHAT IT WON'T SHOW YOU

- Profitability since a business can have positive cash flow and still be losing money. Profitability is shown in the Income Statement (pages 7-9).
- How much money is needed for unpaid bills (accounts payable), which is in the Balance Sheet (pages 4-6).
- How much money is owed to you (accounts receivable), which is in the Balance Sheet (pages 4-6).
- Current value of your equipment, property, or other assets.
- How much the business is worth and how much equity the owners hold. This is in the Balance Sheet.

New Companies

Losses are common in the first year of a start-up company. Lenders want the business break-even during the year. To always have positive cash balances, you need to cover any months that show negative balances with loans, increased sales/revenue, owner investments, and/or reduced expenses.



CASH FLOW STATEMENT EXAMPLE

Max Music Company Cash Flow Statement

	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
CASH IN													
A. Cash On Hand (Beginning of month)	10,000	6,900	21,700	26,200	39,700	53,400	57,800	76,200	98,800	118,300	140,800	168,500	
B. Cash Receipts													
1. Cash Sales	2,000	5,000	5,000	5,000	10,000	10,000	15,000	15,000	10,000	10,000	15,000	15,000	117,000
2. Collections from Credit Accounts	30,000	75,000	75,000	80,000	85,000	85,000	90,000	90,000	85,000	85,000	80,000	80,000	940,000
3. Loan or Other Cash injection (Specify)													
C. Total Cash Receipts (B1+B2+B3)	32,000	80,000	80,000	85,000	95,000	95,000	105,000	105,000	95,000	95,000	95,000	95,000	1,057,000
D. Total Cash Available (A+C, before cash paid)	42,000	86,900	101,700	111,200	134,700	148,400	162,800	181,200	193,800	213,300	235,800	263,500	
E. Cash Paid Out													
1. Purchases (ex: Merchandise)	0	30,000	40,000	40,000	45,000	45,000	45,000	40,000	40,000	40,000	35,000	35,000	435,000
2. Gross Wages (excludes withdrawals)	10,000	10,000	10,000	10,000	10,000	15,000	15,000	15,000	10,000	10,000	10,000	10,000	135,000
3. Payroll Expenses (Taxes, etc.)	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12,000
4. Outside Services	800	700	800	800	800	900	900	900	800	800	800	700	9,700
5. Supplies (Office and operating)	400	400	400	400	400	400	400	400	400	400	400	300	4,700
6. Repairs and maintenance	400	400	400	400	400	400	400	400	400	400	400	300	4,700
7. Advertising	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	48,000
8. Car, Delivery and Travel	2,000	2,000	3,000	2,000	2,000	2,000	3,000	3,000	2,000	2,000	2,000	2,000	27,000
9. Professional Services (Accounting, legal, etc.)	1,000	0	0	1,000	0	0	0	0	0	1,000	0	0	3,000
10. Rent	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	24,000
11. Telephone	300	300	300	300	300	300	300	300	300	300	300	300	3,600
12. Utilities	400	400	400	400	400	400	400	400	400	400	400	400	4,800
13. Insurance	0	400	400	400	400	400	400	400	400	400	400	0	4,000
14. Taxes (real estate, etc.)	0	800	0	0	800	0	0	800	0	0	800	0	3,200
15. Interest (on loans)	500	500	500	500	500	500	500	500	500	500	500	500	6,000
16. Other/Miscellaneous Expenses (Specify)	0	0	0	0	0	0	0	0	0	0	0	0	0
17. Subtotal	22,800	52,900	63,200	63,200	68,000	72,300	73,300	69,100	62,200	63,200	58,000	56,500	724,700
F. Other Operating Costs													
1. Loan Principal Payment	300	300	300	300	300	300	300	300	300	300	300	300	3,600
2. Capital Purchases (ex: Buy a computer)	0	0	0	0	0	5,000	0	0	0	0	0	0	5,000
3. Other Start-up Costs (specify)	0	0	0	0	0	0	0	0	0	0	0	0	0
4. Reserve and/or Escrow (ex: Pay \$100K loan)	10,000	10,000	10,000	5,000	10,000	10,000	10,000	10,000	10,000	5,000	5,000	5,000	100,000
5. Owner's Withdrawal	2,000	2,000	2,000	3,000	3,000	3,000	3,000	3,000	3,000	4,000	4,000	4,000	36,000
G. Total Cash Paid Out (E17 + F1 through F5)	35,100	65,200	75,500	71,500	81,300	90,600	86,600	82,400	75,500	72,500	67,300	65,800	
H. Cash Position (End of month, D minus G)	6,900	21,700	26,200	39,700	53,400	57,800	76,200	98,800	118,300	140,800	168,500	197,700	
CASH OUT													

Cash Position

This company always has positive cash flow.





CASH FLOW STATEMENT INTERACTIVE



Click icon for instructions

	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
A. Cash On Hand (Beginning of month)													
B. Cash Receipts													
1. Cash Sales													
2. Collections from Credit Accounts													
3. Loan or Other Cash injection (Specify)													
C. Total Cash Receipts (B1+B2+B3)													
D. Total Cash Available (A+C, before cash paid)													
E. Cash Paid Out													
1. Purchases (ex: Merchandise)													
2. Gross Wages (excludes withdrawals)													
3. Payroll Expenses (Taxes, etc.)													
4. Outside Services													
5. Supplies (Office and operating)													
6. Repairs and maintenance													
7. Advertising													
8. Car, Delivery and Travel													
9. Professional Services (Accounting, legal, etc.)													
10. Rent													
11. Telephone													
12. Utilities													
13. Insurance													
14. Taxes (real estate, etc.)													
15. Interest (on loans)													
16. Other/Miscellaneous Expenses (Specify)													
17. Subtotal													
F. Other Operating Costs													
1. Loan Principal Payment													
2. Capital Purchases (ex: Buy a computer)													
3. Other Start-up Costs (specify)													
4. Reserve and/or Escrow (ex: Pay \$100K loan)													
5. Owner's Withdrawal													
G. Total Cash Paid Out (E17 + F1 through F5)													
H. Cash Position (End of month, D minus G)													



RATIOS

Business ratios analyze your financial health by identifying strengths and weaknesses. Ratios transform raw numbers from your Income Statement and Balance Sheet into more meaningful numbers.

They help you see how efficiently your business is operating, its profitability, and how well you are managing debt.

Ratios make it easier to identify problems and make informed decisions, whether you are looking for funding, planning for growth, or trying to improve day-to-day operations.

The ratios are broken down into four categories: Asset Management, Liquidity, Debt Management, and Profitability.

Asset Management Ratios

How effectively are you managing your assets?

Accounts Receivable Turnover

Number Source: Balance Sheet & Income Statement

FORMULA

$$\frac{\text{Accounts Receivable } (\$75,000 \times 365 \text{ days})}{\text{Net Sales Figure}} = \frac{\$27,375,000}{\$900,000} = 30.4$$

It takes 30 days to collect bills

Note: This shows how many days it takes to collect money owed to you. Lower answer is better.

Inventory Turnover

Number Source: Balance Sheet & Income Statement

FORMULA

$$\frac{\text{Inventory Figure } (\$85,000 \times 365 \text{ days})}{\text{Cost of Goods Sold}} = \frac{\$31,025,000}{\$540,000} = 57.4$$

57 days to turnover or sell the inventory

Note: Shows how many days it takes you to turnover (or sell) your inventory. Lower answer is better.

Liquidity Ratios

How "cash rich" is a company? Liquidity ratios show a company's ability to turn an asset into cash.

Working Capital

Number Source: Balance Sheet

FORMULA

$$\text{Current Assets} - \text{Current Liabilities} = \text{Working Capital}$$

$$\$170,000 - \$150,000 = \$20,000$$

Shows if a company has enough cash to pay bills. Answer must be positive

Note: Shows if a company has enough cash to pay bills. This example shows an excess amount after paying all current liabilities. The answer must be positive. More money is needed to meet expenses if the answer is a negative number. Higher number is better.

Quick or Acid Test Ratio

Number Source: Balance Sheet

FORMULA

$$\frac{\text{Total Current Assets of } \$170,000 \text{ less Inventory of } \$85,000}{\text{Total Current Liabilities}} = \frac{\$85,000}{\$150,000} = 0.56$$

Eliminates inventory from current assets and cash. "Quick" means items can be turned into cash.

Note: Inventory may become no longer useful. This ratio eliminates "quick" because it includes items that can be turned into cash. Answer should be 1 or more.

Current Ratio

Number Source: Balance Sheet

FORMULA

$$\frac{\text{Total Current Assets}}{\text{Total Current Liabilities}} = \frac{\$170,000}{\$150,000} = 1.13$$

A company's short-term debt paying ability.

Note: Tests a company's short-term ability to pay debt. There is \$1.31 available to pay every \$1 of liabilities. Higher numbers are better (2 or more).



RATIOS

Ratios should be compared to prior years, acceptable lending ranges, and industry averages.

Industry ratios are averages. Some firms are above, and some firms are below these numbers. Differences are due to the age of the company, locations, and operations.

A ratio of 38% compared to an industry average of 39% seems like a small difference. If sales are \$4 million, 1% is \$40,000. If net profits are \$100,000, then \$40,000 is important.

Debt Management Ratios

Shows how much money owners have invested in the business versus lenders.

Leverage or Debt-to-Worth

Number Source:
Balance Sheet

FORMULA

The company is leveraged 2.34 times. For every \$1 owners have invested, lenders and creditors have invested \$2.34

$$\frac{\text{Total Liabilities}}{\text{Total Capital}} = 2.34$$

Total Liabilities: \$204,000
Total Capital: \$87,000

Note: Determines if a company has enough equity. Lower answers are better. Answer of 3 or lower is preferred.

Accounts Payable Turnover

Number Source:
Balance Sheet &
Income Statement

FORMULA

Accounts Payable at \$41,000 x 365 day Accounts Payable are paid every 43 days

$$\frac{\text{Accounts Payable at } \$41,000 \times 365 \text{ day}}{\text{Purchases}} = 42.75$$

Purchases: \$350,000

Note: Shows how quickly a company pays its bills. Lower numbers are better.

Profitability Ratios

Shows company's ability to make a profit.

Profit Margin on Sales

Number Source:
Income Statement

FORMULA

Net Profit The profit margin is 5.9%

$$\frac{\text{Net Profit}}{\text{Net Sales}} = .588$$

Net Profit: \$53,000
Net Sales: \$900,000

Note: Shows the percentage of net profit for every dollar of sales. The higher the number, the better. If the profit margin is too small:
1. prices are too low
2. cost of goods is too high
3. expenses are too high

Cash Flow to Current Maturities (Debt Service) Ratio

Number Source:
Balance Sheet &
Income Statement

FORMULA

Net Profit of \$53,000 + Depreciation of \$13,000 (amount created for this example) For every dollar of payments, \$11 is available to pay it

$$\frac{\text{Net Profit of } \$53,000 + \text{Depreciation of } \$13,000}{\text{Current Portion of Long Term Debt}} = \$11$$

Current Portion of Long Term Debt: \$6,000

Note: Shows your ability to pay term debts after owner withdrawals. New businesses use one year's worth of loan payments. Answer should be 1 or higher.

..... GLOSSARY

Ability to Pay. Ability to pay loans from future business' profits.

Accounts Payable (A/P). Expenses incurred from purchases made on credit.

Accounts Receivable (A/R). Sales made but money not collected. Credit is granted.

Assets. What a company owns.

Available Credit. The unused portion of a line of credit.

Balloon. A stop point or early maturity of a loan.

Business Credit. Loans made to businesses in the form of a term loan or a line of credit.

Business Plan. An overview of a new or existing company which is used to obtain financing.

Capacity. Borrower's ability to handle a certain level of debt.

Commercial Mortgage. A loan on business' real estate. Rates and terms are negotiated and the interest rate is usually related to the prime rate.

Cost of Goods Sold. Cost to make a product, including materials, labor, and related overhead.

Credit Rating. Credit rating as determined by a credit reporting agency.

Credit Scoring. A process used to approve or reject commercial loan applications, based on ratios and other factors.

Current Assets. Assets that can be converted into cash in one year.

Current Liabilities. Liabilities due within one year.

Depreciation. Except for land, assets wear out. They are devalued or depreciated every year.

Draw Down. Taking an advance on a line of credit.

Equity. The book value of a business. Assets minus liabilities.

Fair Market Value (FMV). The price of an asset, product or service in a current, competitive market.

Fixed Assets. Assets including furniture, fixtures, equipment, machinery, and real estate.

Gross Profit. Gross sales less cost of goods sold. Also called gross margin.

Gross Sales. Revenue or income from sales before returns and allowances.

Intangible Asset. Have no physical properties but represent something of value (for example, patents and trademarks).

Inventory. Assets held for resale. May be in the form of raw materials, work in progress, or finished goods.

Liquid Collateral. Collateral that can be converted to cash quickly.

Line of Credit (LOC). A short-term loan (usually used to finance accounts receivable and/or inventory)

Liquid Asset. Asset that can be turned into cash quickly, within one year

Long-Term Liabilities. Expenses, loans, and payables due after one year

Net Profit. Money left after all expenses have been paid. Used to pay loan principal and to grow the company.

Net Sales. Revenue or income from sales after returns and allowances are deducted.

Net Worth. Assets less liabilities. Show equity value.

Non-Current Assets. Assets that take one year or more to turn into cash.

Operating Lease. Leases which allow you to buy the item at the end of the lease, for a set price. These leases do not appear on the **Balance Sheet**.

Owners' Investment. The money owners have invested in a business.

Prime Rate. The rate of interest lenders give to Business owners are charged the prime rate plus a percentage.

Pro Forma. Projecting or forecasting future income, expenses, and cash flow.

Retained Earnings. Net profits accumulated through the company's life and reported in the net worth or equity section of the balance sheet.

Secured Loan. Loan secured by collateral (which will be liquidated if the borrower defaults on the loan).

Tangible Asset. Real property (machinery, equipment, furniture and fixtures).

Term. A loan's maturity, stated in months or years.

Term Loan. Loan, usually given in one lump sum at the closing. Repayment is monthly over a stated term.

Trend Analysis. Analysis of financial statements and ratios to determine the financial strength over time.

Working Capital. Difference between current assets and current liabilities. An indication of liquidity and the ability to meet current obligations.