EDFS TRAINING CONFERENCE
APRIL 2012

Evaluating Financial Statements and Business Plans

Types of Financial Information

- Balance sheets
- Profit and loss statements
- Cash Flow statements
- Income tax returns
- Projections
- Personal financial statements

Types of Financial Statements

- Audit
  - Review and reconcile ledgers
  - physical count (sampling) of inventory
  - unqualified opinion
- Review
  - statistical procedures applied to accounts
  - no actual inventory count required
  - qualified opinion
- Compilation
  - management information put into accounting format
  - no opinion expressed
- Management
  - statements prepared in-house
  - great variation in quality

Balance Sheets

- Financial snapshot
- Dated
- Sources (liabilities and net worth)and uses (assets) of funds
- Assets = Liabilities + Net Worth

Balance Sheet – What does it tell you?

How well does the business collect its accounts?

How well does the business pay its bills?

Does the business control its inventory?

Is the owner of the business committed to the business?

How long does it take for this business to generate cash?

What business collateral is securing their loans?

How old is their equipment?

Assets

- **<u>Current Assets</u>** are converted into cash within one year
  - Cash
  - Accounts Receivable (AR)
  - Notes Receivable (NR)
  - Inventory
  - Other (e.g. prepaids)

Current assets are <u>operating uses</u> of cash

Assets

- **<u>Long-Term Assets</u>** take longer than one year to be converted into cash
  - Notes Receivable
  - Fixed Assets (including leases)
    1. Machinery and Equipment (M & E)
    2. Real estate
  - Investments in subsidiaries
  - Intangibles

Liabilities

<u>Current Liabilities</u> must be paid within the next year

- Notes Payable (NP) to a bank or others
- Accounts Payable (AP)
- Accruals (ACC.)
- Current Portion of Long-Term Debt (CPLTD)

Current liabilities are <u>operating sources</u> of cash

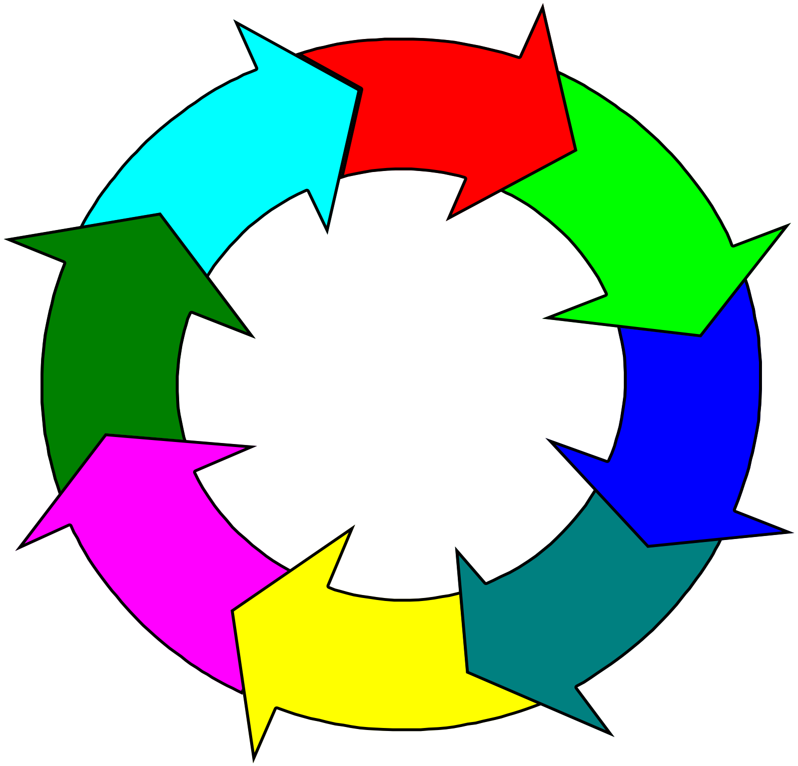
- **<u>Long Term Liabilities</u>** don’t have to be paid within twelve months

- Long term debt (including leases)
- Officer debt

Net Worth

- **Net Worth (NW)** or equity is the owner's investment in the business. It results from:
- The owner's initial investment in stock or capital
- Retained (undistributed) earnings of the business
- NW is the first money in and the last money out

Operating Cycle



Days Receivables

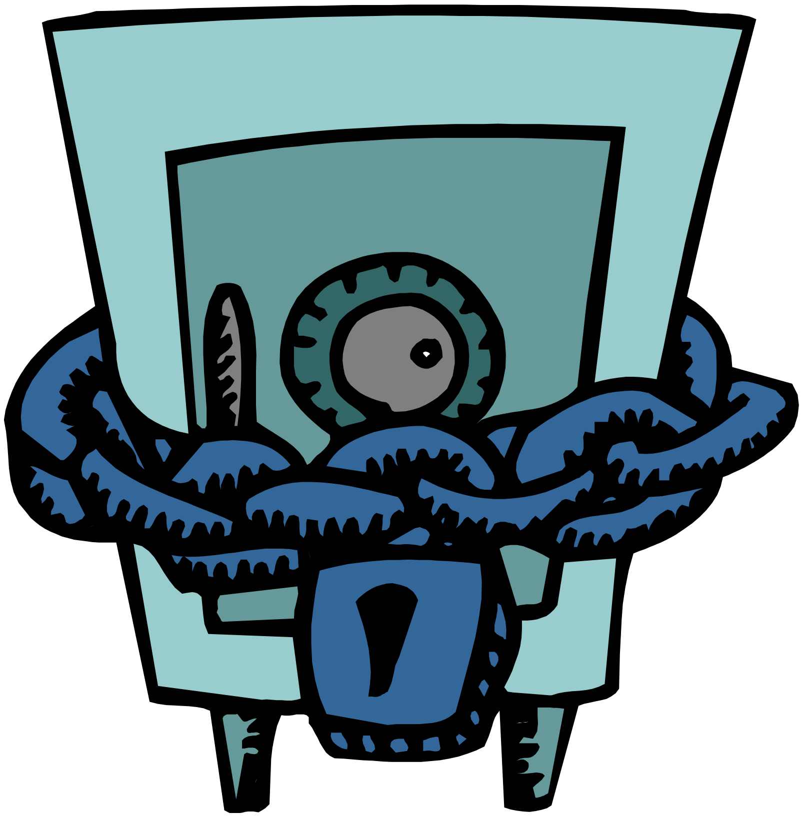
\+ Days Inventory

\- Days Payables

\- Days Accruals

= Operating Cycle

Retained Earnings



- <u>Retained Earnings</u> are the accumulated profits (or losses) of a business over its life. If a business has negative R/E, it has lost more money than it has made

Reconciliation of Net Worth

To reconcile N/W, use the following formula:

Ending Net Worth

- Profit After Tax (PAT)

- Beginning Net Worth

= New Equity (Withdrawals of Equity)

If equity has been withdrawn, ask why and to whom?

If new equity's been injected, find out by whom?

Debt to Equity Ratio

The Debt to Equity Ratio is calculated as follows:

$$\frac{\text{Total Liabilities} - \text{Sub. Officer Loans}}{\text{NW} + \text{Sub. Officer loans} - \text{Intangibles}}$$

The quality of the debt and the business' liquidity are often more important than the ratio itself

Profit and Loss Statements

- Also known as the Income Statement
- Shows how a business utilizes its resources and controls its costs
- The P & L contains fixed and variable expenses; variable expenses are usually contained in the COGS category, fixed expenses in the SGA category
- The P & L also contains the information that lenders rely upon to determine repaymentability

Profit and Loss Statements

The Profit and Loss Statement (P & L) can be distorted by:

1. Not reporting or underreporting sales
2. Misstating inventory. If inventory is overstated, profits increase; if understated, profits decrease
3. Overstating expenses

Analysis of Profit and Loss Statements

- Is the business growing?
- Does the business control its margins?
- Does the business control its overhead?
- What kind of Cash Flow does the business have?
- How does the business depreciate its assets?

Is the Business Growing?

- Lenders like to lend money to growing businesses
- Compare a business' growth to the area, industry, and other variables
- Use this formula:

<u>Current year's sales – previous year's sales =</u> % inc.

previous year's sales in sales

- What is the trend? How does it compare to the area or industry? Why did the growth or decline occur? In some businesses, compare units of sales

Does the Business Control Its Margins?

- Costs of Goods Sold (COGS)
- Cost of raw materials or other inventory, direct labor, and other costs, such as shipping
- COGS/Sales = %

Does the Business Control Its Overhead?

- Sales General and Administrative Expenses (SGA)
- Fixed costs such as office salaries, rent, insurance, and interest
- SGA/Sales= %
- Growing businesses should be able to absorb some overhead costs as they grow

Does the Business Make a Profit?

- Profit after all expenses have been deducted
- Companies with no profit have to identify other sources of funds to finance their operations
- Some businesses (e.g. S-corporations) may not make any profits because of their organizational structure)

Does the Business Have Hidden Cash Flow?

- Depreciation
- Interest
- Rent (if discretionary)
- Officer’s salary (if flexible)
- Non-recurring expenses; e.g. loss from asset sale

Based on the nearest thousand

Eligible Applicant: Concrete MFG, Inc.

Balance Sheet

	Existing			6 Mos.	1 Yr.	2 Yr.	3 Yr.
Date(Mo./Day/Yr.)	12/31/01	12/31/02	12/31/03	09/30/04	12/31/04	12/31/04	12/31/05
Cash	492	496	596	463		1	
Acct. Rec.	581	459	336	922		135	
Inventory	17	141	38	38		800	
Prepaid Expenses	42	36	46	54			
land			1393	1393			
deposits							
CURRENT ASSETS	1132	1132	2409	2870	0	936	0
Net Fixed Asset	2397	2383	1108	1157		767	
Inv. In Sub.							
Notes Rec.							
Intangibles							
	196	205	212				
					0		
TOTAL ASSETS	3725	3720	3729	4027	0	1703	0
Short Term N/P- Bank						452	
Short Term N/P- Other							
Accts. Pay.	362	344	297	668			
Accruals	25	25	30	112			
Taxes (Income)				-3			
Current Portion LTD	94	187	231	231		125	
CURRENT LIABILITIES	481	556	558	1008	0	577	0
Long Term Debt	249	164	84	10		405	
Subordinated Officers Sebt	82	82	55	55			
			29	29			
TOTAL LIABILITIES	812	802	726	1102	0	982	0
Capital Stock	150	150	150	150		300	
Paid-in-Capital	12	12	12	10			
Retained Earnings	3155	3159	3246	3168		420	
(Less) Treasury Stock	-403	-403	-403	403			
TOTAL N/W	2914	2918	3005	2925	0	720	0
TOTAL LIAB. & N/W	3726	3720	3731	4027	0	1702	0
Contingent Liab.							

Profit and Loss Statement

	Existing			6 Mos.	1 Yr.	2 Yr.	3 Yr.
Yr. Ending	12/31/01	12/31/02	12/31/03	09/30/04	12/31/04	12/31/04	12/31/05
Sales	2804	2868	3242	2760			
-COGS	2814	2856	2947	884			
=Gross Profit	-10	12	295	1876	0	0	0
-SGA			273	1929			
=Operating Profit	-10	12	22	-53	0	0	0
-Officer(s) Salary							
-Depr. Exp.	183	175	186	172			
-Interest Expense							
-Rent							
+/- Other Inc./Exp.	-221	-166	252	120			
=EBT	28	3	88	-105	0	0	0
- Income Taxes							
= PAT	28	3	88	-105	0	0	0
OPERATING CYCLE							
+Days Receivable	74.6	57.6	37.3	120.3	#DIV/0!	#DIV/0!	#DIV/0!
+Days Inventory	2.2	17.8	4.6	15.5	#DIV/0!	#DIV/0!	#DIV/0!
-Days A/P	46.3	43.4	36.3	272.0	#DIV/0!	#DIV/0!	#DIV/0!
-Days Accrual	3.2	3.15	3.66	45.6	#DIV/0!	#DIV/0!	#DIV/0!
=OPR. CYCLE	27.3	28.9	2.0	-181.9	#DIV/0!	#DIV/0!	#DIV/0!
RATIO ANALYSIS							
Working Capital	651	576	1851	1862	0		0
Current Ratio	2.4	2.04	4.32	2.85	#DIV/0!		#DIV/0!
Quick Ratio	2.23	1.72	1.67	1.37	#DIV/0!		#DIV/0!
% of Sales Growth		2%	13%	-15%	#DIV/0!	#DIV/0!	#DIV/0!
D/EQ Ratio	0.3	0.2	0.22	0.36	#DIV/0!		#DIV/0!
RECONCILIATION N/W							
Ending N/W	2914	2918	3005	2925	0		0
-PAT	28	3	88	-105	0	0	0
-Beginning N/W		2914	2918	3005		0	
=New Equity/(Withdraw)		1	-1	25	0	0	0
CAPITAL EXPENDITURES							
End. Net Fixed Assets	2397	2383	1108	1157	0		0
+ Depreciation		175	186	172	0	0	0
- Beg. Net Fixed Asset		2397	2383	1108		0	
=Net Capital Expenditures		161	-1089	221	0	0	0
CASH FLOW							
PAT + Depreciation	211	178	274	67	0	0	0
CPLTD	94	187	231	16			0
NDS				23			
=Available for OP	305	-9	43	28	0	0	0

Evaluating Financial Statements and Business Plans

- Business Plans required for start-up businesses
- Business Plan update required for existing businesses when entering new markets or introducing new product lines
- Evaluation of marketing strategy, customer base as substantiation of projected sales.
- Evaluation of management experience
- Financial Analysis/Ratios/Credit Worthiness

Business Plans

- Are essential for both startup and existing businesses and are often the end product of business training or technical assistance
- Provide a roadmap to help guide a business' future decisions
- Are required by many lenders and investors
- Putting together a business plan is like going to the dentist

Reasons to Write a Business Plan

- To sell or convince a business owner
- To obtain financing through loans (banks) or investors
- To obtain a large contract or grant
- To attract employees
- To motivate yourself or your team

What Does a Business Plan Do for the Business Owner?

- Identifies milestones
- Identifies customers and markets
- Analyzes the competitive environment
- Provides a means of communicating to others
- Provides a means to finance

What Does a Business Plan Tell an Investor?

- Reveals capability
- Shows professionalism
- Demonstrates preparedness
- Identifies vision
- Showcases the management capability

The Economic Developer's Role

- To test the entrepreneur, both psychologically and substantively
- To provide access to resources (e.g. SBDC)
- To provide a sounding board and constructive criticism
- To serve in role of editor, not writer

Eligible Applicant: Excellent Auto

Balance Sheet

	Existing			6 Mos.	1 Yr.	2 Yr.	3 Yr.
Date(Mo./Day/Yr.)	12/31/02	12/31/03	12/31/04		12/31/05	12/31/06	12/31/07
Cash					1	5	16
Acct. Rec.					50	55	61
Inventory					35	38	42
Prepaid Expenses							
land							
deposits							
CURRENT ASSETS	0	0	0	0	86	98	119
Net Fixed Asset					175	165	156
Inv. In Sub.							
Notes Rec.							
Intangibles							
					0		
TOTAL ASSETS	0	0	0	0	261	263	275
Short Term N/P- Bank							
Short Term N/P- Other							
Accts. Pay.							
Accruals							
Taxes (Income)							
Current Portion LTD					12	13	15
CURRENT LIABILITIES	0	0	0	0	12	13	15
Long Term Debt					157	144	129
Subordinated Officers Sebt							
TOTAL LIABILITIES	0	0	0	0	169	157	144
Paid-in-Capital					85	92	107
Owner's Withdrawal					36	42	48
Retained Earnings					43	57	72
(Less) Treasury Stock							
TOTAL N/W	0	0	0	0	92	107	131
TOTAL LIAB. & N/W	0	0	0	0	261	264	275
Contingent Liab.							

Profit and Loss Statement

	Existing			6 Mos.	1 Yr.	2 Yr.	3 Yr.
Yr. Ending	12/31/02	12/31/03	12/31/04		12/31/05	12/31/06	12/31/07
Sales					500	550	605
-COGS					318	349	385
=Gross Profit	0	0	0	0	182	201	220
-SGA					111	117	122
=Operating Profit	0	0	0	0	71	84	98
-Officer(s) Salary							
-Depr. Exp.					10	10	10
-Interest Expense					18	17	16
-Rent							
+/- Other Inc./Exp.							
=EBT	0	0	0	0	43	57	72
- Income Taxes							
= PAT	0	0	0	0	43	57	72
OPERATING CYCLE							
+Days Receivable	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	36.0	36.00	36.3
+Days Inventory	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	39.6	39.2	39.3
-Days A/P	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	0.0	0.00	0.0
-Days Accrual	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	0	0	0
=OPR. CYCLE	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	75.6	75.2	75.6
RATIO ANALYSIS							
Working Capital	0	0	0	0	74	85	104
Current Ratio	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	7.17	7.5	7.93
Quick Ratio	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	4.25	4.6	5.1
% of Sales Growth		#DIV/0!	#DIV/0!	#DIV/0!	100%	9%	9%
D/EQ Ratio	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	1.84	12.08	1.10
RECONCILIATION N/W							
Ending N/W	0	0	0	0	92	107	131
-PAT	0	0	0	0	43	57	72
-Beginning N/W		0	0	0		92	107
=New Equity/(Withdraw)		0	0	0	49	-42	-48
CAPITAL EXPENDITURES							
End. Net Fixed Assets	0	0	0	0	175	165	156
+ Depreciation		0	0	0	10	10	10
- Beg. Net Fixed Asset		0	0	0		175	165
=Net Capital Expenditures		0	0	0	185	0	1
CASH FLOW							
PAT + Depreciation	0	0	0	0	53	67	82
CPLTD	0	0	0	16	12	13	15
NDS				23			
=Available for OP	0	0	0	-39	41	54	97

LOAN PRESENTATION SUMMARY

COMPANY NAME:	EXCELLENT AUTO		
FORM OF BUSINESS:	SOLE PROPRIETORSHP		
OWNERSHIP:	JOHN MCCOMB, 100%		
PRINCIPALS:	JOHN MCCOMB OWNER		
ADDRESS:	ROUTE 688 , R.R #2	**CITY:**	OAKTOWN, FRANKLIN COUNTY, PA
PHONE:	555-123-4567 (WORK)	**FAX:**	000-000-0000
NAICS:	441120 USED CAR DEALER		
NATURE OF BUSINESS:	USED CAR DEALER		
LEGISLATIVE DISTRICTS:	HOUSE: 25 SENATE: 75 CONGRESSIONAL: 5		
CREDIT HISTORY:			

FUND SOURCES

COMMERCIAL BANK LOAN	**$130,000.00**	**6.00%**	**10 YEARS**
MICRO LOAN	**$ 50,000.00**	**7.00%**	**10 YEARS**
EQUITY	**$ 85,000.00**		

USE OF FUNDS

Acquisition of land and building with renovation of building, acquisition of equipment, inventory and working capital necessary to the start-up of used car dealership. .

JOB IMPACT

JOBS CREATED: 4 **RETAINED:**

COST PER JOB CREATED/RETAINED: $ 12,500.00

MARKETING STRATEGY

Excellent Auto will advertise in local newspapers, direct mailings, special promotions, signs, and yellow pages of the loan telephone directory. Weekly newspaper advertising to build name recognition. Location conducive to signage and visual advertising based on traffic count.

Excellent Auto

FINANCIAL PLAN

Closing Costs	$ -	0%
Inventory	$35,000.00	13%
Other		
TOTAL	$ 265,000.00	100%

Debt Service

Source	**Amount**	**Use**	**Debt Service**
My Bank	$130,000.00	R/E	$ 17,719.00
		M/E	$ -
Equity	$85,000	Use	$ -
Source	$ -	Use	$ -
Source	$ -	Use	$ -
TOTAL	$ 215,000.00		$ 17,719.00

Total Project Cost:	$ 265,000.00	
Available Funding:	$ 215,000.00	
Loan Request:	$ 50,000.00	$6,965.00

Total Debt Service	$24,684.00

Excellent Auto

Cash Flow Analysis

	2002	2003	2004	Projected 2005	Proj. 2006	Proj. 2007
Net Income				$ 43	$ 57	$ 72
Depreciation				$ 10	$ 10	$ 10
Interest Expense				$ 18	$ 17	$ 16
(Taxes)	$ -	$ -	$ -	$ -	$ -	$ -
Net Cash Flow	$ -	$ -	$ -	$ 71	$ 84	$ 98
CPLTD						
(Debt Service)	$ -	$ -	$ -	$ 25	$ 25	$ 25
Available for OP	$ -	$ -	$ -	$ 46	$ 59	$ 73

Collateral Analysis

	Value	Previous Liens	Available
R/E	$ 125,000	$ 130,000	$ (5,000)
M/E	$ 60,000	$50,000	$ 10,000
A/R	$ 50,000		$ 50,000
Inventory	$35,000	$ -	$ 35,000
Collateral	$ 270,000	$ 180,000	$ 90,000

Loan To Value: 120% of Loan Amount

A loan of $50,000 would require collateral value of $60000.00. This can be achieved by securing a second mortgage position on the real estate to be acquired and renovated and a blanket lien on all business assets subordinate to bank mortgage and line in the amount of $130,000.00

INCOME ANALYSIS

	2002	2003	2004	Proj. 2005	Proj. 2006	Proj. 2007
Total Assets	$ -	$ -	$ -	$ 261	$ 264	$ 275
Total Liabilities	$ -	$ -	$ -	$ 169	$ 157	$ 144
Net Equity	$ -	$ -	$ -	$ 92	$ 107	$ 131
Current Assets	$ -	$ -	$ -	$ 86	$ 98	$ 119
Current Liabilities	$ -	$ -	$ -	$ 12	$ 13	$ 15
Working Capital	$ -	$ -	$ -	$ 74	$ 85	$ 104
Current Ratio	#DIV/0!	#DIV/0!	#DIV/0!	7.17	7.54	7.93
D/E Ratio	#DIV/0!	#DIV/0!	#DIV/0!	1.84	1.47	1.10

GUARANTORS

NAME(S) AND John McComb

CREDIT SCORES: 658

ASSETS: 165,000.00

LIABILITIES: 78,700.00

NET WORTH: 96,300.00

INCOME: 33,700.00

BALANCE SHEET ANALYSIS:

	2002	2003	2004	Proj. 2005	Proj. 2006	Proj. 2007
Total Assets	$ -	$ -	$ -	$ 261	$ 264	$ 275
Total Liabilities	$ -	$ -	$ -	$ 169	$ 157	$ 144
Net Equity	$ -	$ -	$ -	$ 92	$ 107	$ 131
Current Assets	$ -	$ -	$ -	$ 86	$ 98	$ 119
Current Liabilities	$ -	$ -	$ -	$ 12	$ 13	$ 15
Working Capital	$ -	$ -	$ -	$ 74	$ 85	$ 104
Current Ratio	#DIV/0!	#DIV/0!	#DIV/0!	7.17	7.54	7.93
D/E Ratio	#DIV/0!	#DIV/0!	#DIV/0!	1.84	1.47	1.10

Evaluating Financial Statements and Business Plans

- Prepared for EDFS 2012 Training Conference

- Patricia Brennen, Loan Program Director
- North Central PA Regional Planning & Development Commission
- 651 Montmorenci Road
- Ridgway, PA 15853

- 814-773-3162X3045
- Pbrennen@ncentral.com