

Notre Dame Wall Street Club



Accounting Overview 2024-2025 Recruiting Cycle

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Gameplan

1

Relationship Between the Financial Statements

- 1) Income Statement
- 2) Balance Sheet
- 3) Cash Flow Statement

2

Enterprise Value (EV) vs. Equity Value

3

Net Working Capital

4

Practice Questions



1

Relationship Between the Financial Statements

- 1) Income Statement
- 2) Balance Sheet
- 3) Cash Flow Statement



Income Statement Introduction

“Operating” Items

Illustrative Income Statement	
Revenue	\$1,000
(-) Cost of Goods Sold	(500)
Gross Profit	\$500
(-) Selling, General, & Administrative	(75)
(-) Depreciation & Amortization	(50)
(-) Other Operating Expenses	(50)
Operating Profit (EBIT)	\$325
(-) Interest	(50)
Earnings Before Tax	\$275
(-) Income Tax	(58)
Net Income	\$217
<i>Assumed Tax Rate</i>	<i>21.0%</i>

The Income Statement summarizes a Company's earnings over a period of time



Income Statement Metrics

Illustrative Income Statement	
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Gross Margin:

$$(\text{Gross Profit} / \text{Revenue}) * 100$$

EBITDA:

$$\text{EBIT} + \text{D\&A}$$

Operating Margin:

$$(\text{EBIT} / \text{Revenue}) * 100$$

Net Margin:

$$(\text{Net Income} / \text{Revenue}) * 100$$



Balance Sheet Introduction

Assets	
Cash & Cash Equivalents	\$750
Accounts Receivable	250
Inventories	200
Other Current Assets	100
Total Current Assets	\$1,300
Property, Plant, & Equipment (PP&E)	\$1,000
Other Non-Current Assets	150
Total Non-Current Assets	\$1,150
Total Assets	\$2,450

Liabilities and Equity	
Accounts Payable	\$275
Deferred Revenue	100
Total Current Liabilities	\$375
Long-Term Debt	1,000
Total Non-Current Liabilities	\$1,000
Total Liabilities	\$1,375
Common Stock	\$400
Retained Earnings	675
Total Equity	\$1,075
Total Liabilities + Equity	\$2,450

Current Ratio:

Current Assets / Current Liabilities

$$\$1,300 / \$375 = \sim 3.5x$$

Quick Ratio:

(Current Assets – Inventory) /

Current Liabilities

$$\$1,100 / \$375 = \sim 2.9x$$

>1.0x is very important

The Balance Sheet summarizes a Company's financial position at a point in time



Real World: Microsoft Assets

(In millions)

June 30,	2024	2023
Assets		
Current assets:		
Cash and cash equivalents	\$ 18,315	\$ 34,704
Short-term investments	57,228	76,558
Total cash, cash equivalents, and short-term investments	75,543	111,262
Accounts receivable, net of allowance for doubtful accounts of \$830 and \$650	56,924	48,688
Inventories	1,246	2,500
Other current assets	26,021	21,807
Total current assets	159,734	184,257
Property and equipment, net of accumulated depreciation of \$76,421 and \$68,251	135,591	95,641
Operating lease right-of-use assets	18,961	14,346
Equity and other investments	14,600	9,879
Goodwill	119,220	67,886
Intangible assets, net	27,597	9,366
Other long-term assets	36,460	30,601
Total assets	\$ 512,163	\$ 411,976

The Balance Sheet summarizes a Company's financial position at a point in time



Select Asset Lines Explained

Accounts Receivable (A/R):

Microsoft has fulfilled its performance obligation, but is yet to receive cash payment

BS often shows A/R on a net basis, which subtracts “Doubtful Account” balances

Gross A/R: \$57,754

(-) Doubtful Accounts: (\$830)

Net A/R: \$56,924

Property, Plant, & Equipment (PP&E):

Physical equipment, land, and other investment assets

BS shows PP&E net of Accumulated Depreciation

Gross PP&E: \$212,011

(-) Accumulated Depreciation: (\$76,421)

Net PP&E: \$135,591



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The Balance Sheet summarizes a Company's financial position at a point in time



Select Asset Lines Explained (continued)

Goodwill:

Intangible asset that results from acquisitions of other companies

Portion of purchase price in excess of fair asset value of the acquired company

Results from things like intellectual property, brand recognition, and a loyal customer base

INDEFINITE LIFE –
Not Amortized

Intangible Assets:

Similar idea to PP&E – you just can't touch it

Definite life assets without physical substance – software, patents, trademarks

Intangibles are amortized over their useful life

Intangible Assets, Gross: \$44,509
(-) Accumulated Amortization: (\$16,912)
Intangible Assets, Net: \$27,597



Real World: Microsoft Liabilities & Equity

Liabilities and stockholders' equity			
Current liabilities:			
Accounts payable	\$	21,996	\$ 18,095
Short-term debt		6,693	0
Current portion of long-term debt		2,249	5,247
Accrued compensation		12,564	11,009
Short-term income taxes		5,017	4,152
Short-term unearned revenue		57,582	50,901
Other current liabilities		19,185	14,745
Total current liabilities		125,286	104,149
Long-term debt		42,688	41,990
Long-term income taxes		27,931	25,560
Long-term unearned revenue		2,602	2,912
Deferred income taxes		2,618	433
Operating lease liabilities		15,497	12,728
Other long-term liabilities		27,064	17,981
Total liabilities		243,686	205,753
Commitments and contingencies			
Stockholders' equity:			
Common stock and paid-in capital – shares authorized 24,000; outstanding 7,434 and 7,432		100,923	93,718
Retained earnings		173,144	118,848
Accumulated other comprehensive loss		(5,590)	(6,343)
Total stockholders' equity		268,477	206,223
Total liabilities and stockholders' equity	\$	512,163	\$ 411,976

The Balance Sheet summarizes a Company's financial position at a point in time



Select Liabilities Explained

Unearned Revenue:

Microsoft has received cash, but is yet to complete its performance obligation

Split between current and non-current elements

Example:

ND pays Microsoft \$1mm on January 1, 2024 for one-year access to Office365

Cash +\$1mm

Unearned Revenue +\$1mm ← Liability

Long-Term Debt:

Represents the portion of long-term debt (e.g., bonds) due in over a year

BS shows PP&E net of Accumulated Depreciation

Total Debt split into current and non-current portions

Current Portion LT Debt: \$2,249

(+) Long-Term Debt: \$42,688

Total Debt: \$44,937



Real World: Microsoft Liabilities & Equity

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Total stockholders' equity		268,477	206,223
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The Balance Sheet summarizes a Company's financial position at a point in time



Select Equity Items Explained

Common Stock:

Represents the par value of shares
outstanding (\$0.01)

Does not reflect market value of
shares

Additional Paid-In Capital (APIC):

Value of shares at issuance in excess
of par

Reflects market value of shares at
issuance

Example Share Issuance:

\$100 million share issuance @ \$100 per share; \$0.01 par value
1 million shares issued

Common Stock: +\$10,000

APIC: \$99.99 million



Retained Earnings

Retained Earnings Overview:

$$\text{Ending Retained Earnings} = \text{Beginning Retained Earnings} + \text{Net Income} - \text{Dividends}$$

PepsiCo Example:

Retained Earnings	<u>2023</u>	<u>2022</u>	<u>2021</u>
Balance, beginning of year	67,800	65,165	63,443
Net income attributable to PepsiCo	9,074	8,910	7,618
Cash dividends declared - common ^(a)	<u>(6,839)</u>	<u>(6,275)</u>	<u>(5,896)</u>
Balance, end of year	70,035	67,800	65,165



Statement of Cash Flows – Operating

Cash from Operations:

Begin with Net Income

- (+) D&A
- (+) Stock-Based Compensation
- (+) Other Non-Cash Operating Gains / Losses
- (+) Changes in NWC

Cash from Operations

NWC Explained:

Current Assets:

- (+) Decrease in Current Assets
- (-) Increase in Current Assets

Current Liabilities:

- (+) Increase in Current Liab.
- (-) Decrease in Current Liab.

(In millions)

Year Ended June 30,	2024	2023	2022
Operations			
Net income	\$ 88,136	\$ 72,361	\$ 72,738
Adjustments to reconcile net income to net cash from operations:			
Depreciation, amortization, and other	22,287	13,861	14,460
Stock-based compensation expense	10,734	9,611	7,502
Net recognized losses (gains) on investments and derivatives	305	196	(409)
Deferred income taxes	(4,738)	(6,059)	(5,702)
Changes in operating assets and liabilities:			
Accounts receivable	(7,191)	(4,087)	(6,834)
Inventories	1,284	1,242	(1,123)
Other current assets	(1,648)	(1,991)	(709)
Other long-term assets	(6,817)	(2,833)	(2,805)
Accounts payable	3,545	(2,721)	2,943
Unearned revenue	5,348	5,535	5,109
Income taxes	1,687	(358)	696
Other current liabilities	4,867	2,272	2,344
Other long-term liabilities	749	553	825
Net cash from operations	118,548	87,582	89,035



Statement of Cash Flows – Investing

Cash from Investing:

(-) Purchases of PP&E
(+) Sales of PP&E
(-) M&A Investments
Cash from Investing

Investing

Additions to property and equipment	(44,477)	(28,107)	(23,886)
Acquisition of companies, net of cash acquired, and purchases of intangible and other assets	(69,132)	(1,670)	(22,038)
Purchases of investments	(17,732)	(37,651)	(26,456)
Maturities of investments	24,775	33,510	16,451
Sales of investments	10,894	14,354	28,443
Other, net	(1,298)	(3,116)	(2,825)
Net cash used in investing	(96,970)	(22,680)	(30,311)



Statement of Cash Flows – Financing

Cash from Financing:

(+) Debt Issuances
(-) Debt Repayments
(+) Equity Issuances
(-) Equity Repurchases
(-) Dividends Paid
Cash from Financing

Financing			
Proceeds from issuance of debt, maturities of 90 days or less, net	5,250	0	0
Proceeds from issuance of debt	24,395	0	0
Repayments of debt	(29,070)	(2,750)	(9,023)
Common stock issued	2,002	1,866	1,841
Common stock repurchased	(17,254)	(22,245)	(32,696)
Common stock cash dividends paid	(21,771)	(19,800)	(18,135)
Other, net	(1,309)	(1,006)	(863)
Net cash used in financing	(37,757)	(43,935)	(58,876)



Linking of Financial Statements

Balance Sheet reflects a point in time

Statement of Cash Flows & Income Statement represent a span of time

Beg. Balance Sheet

Beg. Cash

PP&E

Intangibles

Total Assets

Total Debt

Beg. Retained Earnings

Total Equity

Income Statement

Revenue

(-) COGS

(-) **D&A**

(-) Other Operating
Expenses

EBIT

(-) Taxes & Interest

Net Income

End Balance Sheet

End Cash

PP&E (-) **Depreciation**

Intangibles (-) **Amort.**

Total Assets

Total Debt

End Retained Earnings

Total Equity



Linking of Financial Statements

Balance Sheet reflects a point in time

Statement of Cash Flows & Income Statement represent a span of time

Income Statement

Revenue

(-) COGS

(-) D&A

(-) Other Operating
Expenses

EBIT

(-) Taxes & Interest

Net Income

Cash Flow Statement

Net Income

(+) D&A

Cash from Operations

(-) PP&E Purchase

Cash from Investing

(-) Debt Repayment

(-) Dividends Paid

Cash from Financing

Total Change in Cash



Linking of Financial Statements

Balance Sheet reflects a point in time

Statement of Cash Flows & Income Statement represent a span of time

Beg. Balance Sheet

Beg. Cash

PP&E

Intangibles

Total Assets

Total Debt

Beg. Retained Earnings

Total Equity

Cash Flow Statement

Net Income

(+) D&A

Cash from Operations

(-) PP&E Purchase

Cash from Investing

(-) Debt Repayment

(-) Dividends Paid

Cash from Financing

Total Change in Cash

End Balance Sheet

End Cash

PP&E (-) Depreciation

Intangibles (-) Amort.

Total Assets

Total Debt

End Retained Earnings

Total Equity



2

Enterprise Value (EV) vs. Equity Value



Equity Value vs. Enterprise Value

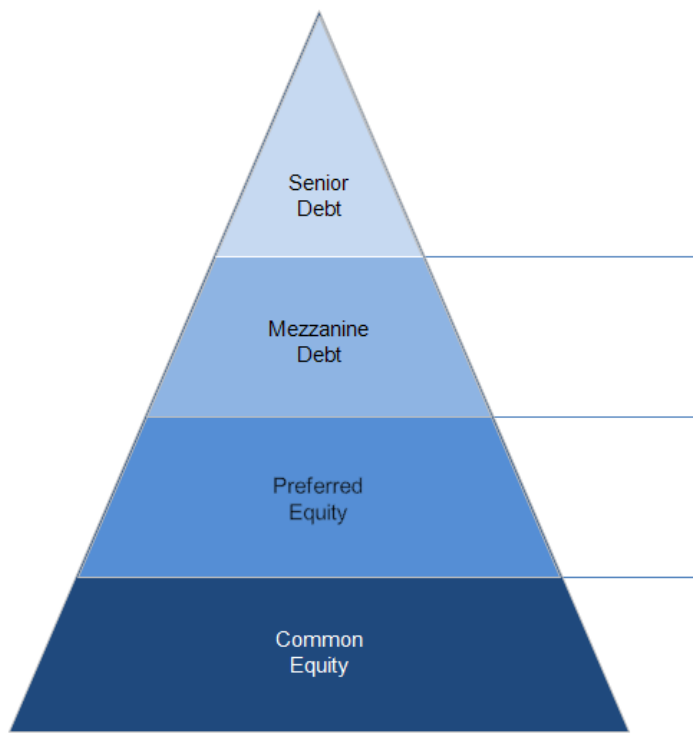
Equity Value

- What is the total value of the equity of the company? Also referred to as the Market Capitalization (# of shares x share price)

Enterprise Value

- What is the value of the whole company? How much would I need to purchase the company?

Capital Structure – Who Owns the Company?



Get paid out first =
least risky

- There are many different types of capital and providers of capital to the company
- Senior Debt holders get paid back first in the event of a bankruptcy – therefore it is the least risky position
- However, equity holders are the actual “owners” of the company, and have the most risk
- Looking at the entire pyramid to the left, the sum would be considered the enterprise value, while only a portion of the enterprise value is made up of equity

Get paid out last =
most risky



Calculating Enterprise Value

$$\text{Enterprise Value} = \text{Equity} + \text{Debt} - \text{Cash}$$

$$\text{Equity} = \text{Enterprise Value} - \text{Debt} + \text{Cash}$$

- **Equity Value:** For public companies, the equity value can be found by multiplying the # of shares outstanding by the share price. For private companies, there is not public share prices, and the equity value is usually computed by first assigning an enterprise value, and then stripping out debt and adding cash.
- **Debt Value:** The value of debt owed by the company. This can be calculated as the sum of the different pieces of debt (loans, bonds, etc.) owed by the company.
- **Cash:** The amount of cash a company has. This is always the first account on the current assets portion of the balance sheet. Balance sheets are only reported every quarter for public companies, so use the most recent value.

Example

- Dowd Industries has 100 shares outstanding with a share price of \$5. The company has \$250 in bonds and \$250 in loans outstanding, with \$100 of cash on hand. What is the enterprise value?
-



Calculating Enterprise Value

$$\text{Enterprise Value} = \text{Equity} + \text{Debt} - \text{Cash}$$

$$\text{Equity} = \text{Enterprise Value} - \text{Debt} + \text{Cash}$$

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Example

- Dowd Industries has 100 shares outstanding with a share price of \$5. The company has \$250 in bonds and \$250 in loans outstanding, with \$100 of cash on hand. What is the enterprise value?

Answer: \$900



Quick Note on Ratios

Whole Firm – Enterprise Value

- EBITDA, EBIT, and Revenue are all financial metrics that reflect value to both equity and debt holders.
- Therefore, the appropriate ratios would be EV/EBITDA, EV/EBIT, and EV/Revenue.

Shareholders – Equity Value

- Interest expense reflects the value distributed to debtholders. Therefore, Net Income reflects only the value of the equity shareholders.
- The appropriate ratio is then P/E - also equal to Market Cap/Net Income

Takeaway: Make sure the numerator and denominator in financial ratios match who has claims to the value: both should be debt holders + share holders, or just shareholders



3

Net Working Capital



What is Net Working Capital?

Net Working Capital = Current Assets – Current Liabilities

*does not include cash

What does "current" mean?

- GAAP accounting defines anything that is expected to be due or collected in the next 12 months to be "current"
- Current assets and liabilities are located on the top of each section of the balance sheet

Apple Inc.

CONSOLIDATED BALANCE SHEETS

(In millions, except number of shares, which are reflected in thousands, and par value)

	September 30, 2023	September 24, 2022
ASSETS:		
Current assets:		
Cash and cash equivalents	\$ 29,965	\$ 23,646
Marketable securities	31,590	24,658
Accounts receivable, net	29,508	28,184
Vendor non-trade receivables	31,477	32,748
Inventories	6,331	4,946
Other current assets	14,695	21,223
Total current assets	143,566	135,405
Non-current assets:		
Marketable securities	100,544	120,805
Property, plant and equipment, net	43,715	42,117
Other non-current assets	64,758	54,428
Total non-current assets	209,017	217,350
Total assets	\$ 352,583	\$ 352,755



Example Accounts

Current Assets

- Current Assets reflect any assets a company has that are expected to be used, consumed, or sold within the next 12 months

Current Asset Accounts

- **Inventory:** products a company has produced, but not yet sold, and expects to sell within the next 12 months
- **Accounts Receivable:** when a customer has bought a product and the company has recognized it as revenue, but does not have the actual cash yet
- **Pre-Paid Expenses:** when the company has paid in advance for assets, but has not used them yet (ex. Insurance plan)
- **Marketable Securities:** companies often invest their excess cash in other securities such as stocks or bonds. Since a company can convert them to cash within the next 12 months, they are considered current assets

Current Liabilities

- Current Liabilities are obligations the company owes and must pay within the next 12 months

Current Liabilities

- **Accounts Payable:** when a company has bought a product on credit but has not yet paid the cash yet. Salaries payable may be included or broken out separately
 - **Accrued Expenses:** opposite of pre-paid expenses. Has recognized or used a product/service but has not paid cash yet.
 - **Unearned Revenues:** when a customer has paid the company in advance, but the company has not delivered the product or completed the service yet
 - **Other Payables:** includes Dividends Payable, Notes Payable, Taxes Payable, and more depending on the company.
-



Applications

Implications on Cash

An increase in Net Working Capital is an outflow of cash

A decrease in Net Working Capital is an inflow of cash

Change in NWC is required to bridge from EBITDA to Free Cash Flow, and you will always see Change in NWC broken down in the operating cash flow segment of the cash flow statement

Examples

1. Buying inventory with cash > NWC increases (CA increases) and cash decreases
 2. A customer pays their accounts receivable > NWC decreases (CA decreases) and cash increases
 3. A customer pays in advance for a 1-year subscription > NWC decreases (CL increases) and cash increases
 4. You pay of a short-term loan due in 6 months > NWC increases (CL decreases) and cash decreases
-



4 Practice Questions



Practice Questions

1. Revenue increases by \$10 and the company has a 50% operating income margin and 20% effective tax rate. What are the effects on the financial statements?



Practice Questions

1. Revenue increases by \$10 and the company has a 50% operating income margin and 20% effective tax rate. What are the effects on the financial statements?

Answer:

Income Statement: If revenue increases by \$10 and there is a 50% operating margin, then operating income increases by \$5. If there is a 20% effective tax rate, then net income increases by only \$4.

Cash Flow Statement: If net income increases by \$4, then operating cash flow increases by \$4.

Balance Sheet: Cash increases by \$4 (from CFS), and retained earnings increases by \$4 (from IS).



Practice Questions

2. What is the formula for Enterprise Value? What is the Enterprise Value of a company with 50 shares outstanding and share price of \$20, \$500 of debt, and \$250 of cash.



Practice Questions

2. What is the formula for Enterprise Value? What is the Enterprise Value of a company with 50 shares outstanding and share price of \$20, \$500 of debt, and \$250 of cash.

Answer:

$$\text{EV} = \text{Equity} + \text{Debt} - \text{Cash}$$

$$\text{EV} = 50 * \$20 + \$500 - \$250 = \mathbf{\$1,250}$$



Practice Questions

3. How do the 3 financial statements link together?



Practice Questions

3. How do the 3 financial statements link together?

Answer:

Net Income from the Income Statement flows into Shareholders' Equity on the Balance Sheet, and into the top line of the Cash Flow Statement.

Changes to Balance Sheet items appear as working capital changes on the Cash Flow Statement, and investing and financing activities affect Balance Sheet items such as PP&E, Debt and Shareholders' Equity.

Final change in cash from the CFS flows through to cash on the BS.



Practice Questions

4. How would \$10 of depreciation affect all 3 financial statements?
Assume 30% effective tax rate.



Practice Questions

4. How would \$10 of depreciation affect all 3 financial statements?
Assume 30% effective tax rate.

Answer:

Income Statement: If depreciation increases by \$10, operating income would decrease by \$10. With a tax rate of 30%, net income would decrease by \$7.

Cash Flow Statement: Net income decreases by \$7, but we add back depreciation since it is a non cash expense, so cash increases by \$3.

Balance Sheet: Retained earnings decreases by \$7, PP&E decreases by \$10 and cash increases by \$3.



Practice Questions

5. I purchase inventory for \$10 and immediately sell for \$20, but the customer has not paid me in cash yet. What are the effects on the financial statements? Assume 30% tax rate.



Practice Questions

5. I purchase inventory for \$10 and immediately sell for \$20, but the customer has not paid me in cash yet. What are the effects on the financial statements? Assume 30% tax rate.

Answer:

Income Statement: If I sell the inventory for \$20, we have \$20 of revenue and \$10 of expenses. Therefore operating income is \$10. With a tax rate of 30%, net income is \$7.

Cash Flow Statement: Net income increases by \$7. Inventory does not change if we buy and sell same period. However, we record \$20 increase in accounts receivable which is \$20 outflow, so the overall change is a decrease of \$13.

Balance Sheet: Retained earnings increases by \$7, accounts receivable increases by \$20, cash decreases by \$13.



Practice Questions

6. Garrett Industries records \$100 in net income and pays a \$50 dividend. What is the change in retained earnings? What about if he issues 20 shares for \$10/share? What about if repurchases 5 shares for \$10/share?



Practice Questions

6. Garrett Industries records \$100 in net income and pays a \$50 dividend. What is the change in retained earnings? What about if he issues 20 shares for \$10/share? What about if repurchases 5 shares for \$10/share?

Answer:

Retained Earnings = Prior Balance + Net Income – Dividends.
Change in retained earnings would be $\$100 - \$50 = +\$50$

Share repurchases and issuances do not flow through retained earnings and flow through Additional Paid in Capital or Treasury Stock accounts.



Practice Questions

7. Inventory decreases by \$20, accounts receivable increases by \$30, prepaid expenses increases by \$10, accounts payable increases by \$20, unearned revenue decreases by \$30. What is the change in NWC? Is this an inflow or outflow of cash?



Practice Questions

7. Inventory decreases by \$20, accounts receivable increases by \$30, prepaid expenses increases by \$10, accounts payable increases by \$20, unearned revenue decreases by \$30. What is the change in NWC? Is this an inflow or outflow of cash?

Answer:

Change in Current Assets: $-\$20 + \$30 + \$10 = +\20 so current assets increase by \$20 which is an outflow of cash.

Change in Current Liabilities: $\$20 - \$30 = -\$10$ so current liabilities decrease by \$10 which is an outflow of cash.

Therefore the total change in NWC is an increase of \$30 which is an outflow of cash.



Practice Questions

8. Apple sells \$100 of iPhones at a 50% gross profit margin. How does this effect the three financial statements?



Practice Questions

8. Apple sells \$100 of iPhones at a 50% gross profit margin. The Company has a 20% tax rate. How does this effect the three financial statements?

Answer:

Income Statement: \$100 of revenue, \$50 of COGS → \$50 Gross Profit. $\$50 * (1 - 20\%) = \40 of Net Income

Change in Current Assets:

1) \$50 of COGS → \$50 decrease in inventory → \$50 increase in Cash from Operations

2) \$40 of Net Income → \$40 increase in Cash from Operation

****CFO up \$90 total****

Balance Sheet: 1) Cash increase of \$90, 2) Inventory down (\$50), 3) Retained Earnings up \$40



Practice Questions

9. Brian buys a piece of equipment for \$100 and issues \$100 of bonds to pay for it. What are the effects on the financial statements? What changes if he pays cash?



Practice Questions

9. Brian buys a piece of equipment for \$100 and issues \$100 of bonds to pay for it. What are the effects on the financial statements? What changes if he pays cash?

Answer:

Income Statement: Nothing

Cash Flow Statement: Nothing happens if bonds are used. If cash is used then cash from investing activities is -\$100.

Balance Sheet: PP&E increases by \$100, Bonds Payable (Liability) increases by \$100. If cash is used then PP&E increases and cash decreases.
