

Master of Financial Technology

FNT 615 - Finance Concepts





Financial Statements Analysis

Chapter 4



Chapter 04

Intended Learning Outcomes

1. Compute a company's profits, as reflected by its income statement.
2. Determine a firm's financial position at a point in time based on its balance sheet.
3. Measure a company's cash flows.
4. Explain the purpose and importance of financial analysis.
5. Calculate and use a comprehensive set of measurements to evaluate a company's performance.
6. Describe the limitations of financial ratio analysis.

Introduction

The goal of this chapter is not to make you an accountant, but instead to provide you with the tools to **understand a firm's financial situation**.

With this knowledge, you will be able to understand the financial **consequences of a company's decisions and actions**—as well as your own.

The financial performance of a firm **matters to a lot of groups**—the company's management, its employees, and its investors, just to name a few.

This is true whether you are in the firm's marketing, finance, or human resources department.

So regardless of your position in the firm, it is in your own best interest to know the basics of financial statements—even if accounting is not your greatest love.



1. The income Statement

The Income Statement

- An **income statement**, or **profit and loss statement**, indicates the amount of profits generated by a firm over a given time period.
- In its most basic form, the income statement may be represented as follows:

$$\text{Sales} - \text{expenses} = \text{profits}$$



Result of
Operating Activities

Sales (revenue)

—

Cost of goods sold
(cost of producing or acquiring product
or service to be sold)

=

Gross profit

—

Operating expenses
(marketing and selling, general and
administrative, and depreciation expenses)

=

Operating income
(earnings before interest and taxes)

—

Result of
Borrowing
Money

Interest expense
(cost of borrowing money)

=

Earnings before taxes

—

Income tax

=

Net income

The Income Statement

- The **operating income** is the result of *management's decisions* relating only to the operations of the business and is not affected at all by how much debt the company owes.
- In other words, the firm's financing expenses, its interest expense resulting from borrowing money, have no effect on operating income.
- Rather, the operating income of a firm reports the results of the following important activities:
 1. **Sales (revenues)**, which is equal to the selling price of the products or services to be sold times the number of units sold (selling price * units sold = total sales).
 2. **Cost of goods sold**, which is the cost of producing or acquiring the goods or services that were sold.
 3. **Operating expenses**, which include:
 - a. Marketing and selling expenses (the expenses related to marketing, selling, and distributing the products or services).
 - b. The firm's overhead expenses (general and administrative expenses, and depreciation expenses).

The Income Statement

- We next determine the earnings before taxes, or taxable income, by deducting the interest expense paid on the firm's debt. Next, the firm's income taxes are calculated based on its earnings before taxes and the applicable tax rate for the amount of income reported.
- The next and final number in the income statement is the net income, or earnings available to common stockholders, which represents income that may be reinvested in the firm or distributed to its owners—provided, of course, the cash is available to do so.

Important Indicators to Stockholders

- After completing the income statement. The firm's owners (common stockholders) like to know
 - How much income the firm made on a per share basis, or what is called **earnings per share (EPS)**. We calculate earnings per share as net income divided by the number of common stock shares outstanding.
 - The amount of dividends a firm pays for each share outstanding, or the **dividends per share (DPS)**.



Common Size Income Statement

- What conclusions can we draw from income statement? To answer this question, it is helpful to look at each item in the income statement as a **percentage of sales**.
- Such a revision is called a **common-sized income statement**.
- The common-sized income statement allows us to express expenses and profits on a relative basis, so that we can more easily compare a firm's income performance across time and with competitors.
- **The profits-to-sales relationships are defined as profit margins**

Common Size Income Statement - Example

TABLE 3.1 The Home Depot, Inc.: Income Statement (expressed in millions, except per share data, and as a percentage of sales) for the Year Ended January 30, 2011³			
Sales	\$67,977	100.0%	
Cost of goods sold	(44,693)	65.7%	
Gross profits	\$23,304	34.3%	← gross profit margin
Operating expenses:			
Marketing, general and administrative expenses	(\$15,885)	23.4%	
Depreciation expenses	(1,616)	2.4%	
Total operating expenses	(\$17,501)	25.7%	
Operating income (earnings before interest and taxes)	\$ 5,803	8.5%	← operating profit margin
Interest expense	(530)	0.8%	
Earnings before taxes (taxable income)	\$ 5,273	7.8%	
Income taxes	(1,935)	2.8%	
Net income (earnings available to common stockholders)	\$ 3,338	4.9%	← net profit margin
Additional information:			
Number of common shares outstanding	1,623		
Earnings per share (net income ÷ number of shares)	\$ 2.06		
Dividends paid to stockholders	\$ 1,569		
Dividends per share (total dividends ÷ number of shares)	\$ 0.97		

Income from operating activities. Also called operating profits, or earnings before interest and taxes (EBIT).

Cost of debt financing

Income from operating and financing activities. Also called net profits or earnings available to common shareholders.

Constructing and Analyzing Income Statement

- **Menielle, Inc. is a wholesale distributor of electronics. It sells laptops, cameras, and other electronic gadgets.**
- **Use the scrambled information below to construct an income statement, along with a common-sized income statement. Also calculate the firm's earnings per share and dividends per share.**
 - Interest expense \$ 35,000
 - Sales \$400,000
 - Cost of goods sold \$150,000
 - Common stock dividends \$ 15,000
 - Selling and marketing expenses \$ 40,000
 - Income taxes \$ 40,000
 - Administrative expenses \$ 30,000
 - Depreciation expense \$ 20,000
 - Number of shares outstanding 20,000

STEP 1: FORMULATE A SOLUTION STRATEGY

The following template provides the format of the income statement:

	Sales
Less:	Cost of goods sold
Equals:	Gross profits
Less:	Operating expenses (selling and marketing expenses + Depreciation expense + Administrative expenses)
Equals:	Operating income
Less:	Interest expense
Equals:	Earnings before taxes
Less:	Income taxes
Equals:	Net income

STEP 2: CRUNCH THE NUMBERS

Your results should be as follows:

	<u>Dollars</u>	<u>Percentage of Sales</u>
Sales	\$400,000	100.0%
Cost of goods sold	<u>(150,000)</u>	<u>37.5%</u>
Gross profit	\$250,000	62.5%
Operating expenses:		
Selling and marketing expenses	(\$ 40,000)	10.0%
Administrative expenses	(30,000)	7.5%
Depreciation expense	<u>(20,000)</u>	<u>5.0%</u>
Total operating expenses	<u>(\$ 90,000)</u>	<u>22.5%</u>
Operating income	\$160,000	40.0%
Interest expense	<u>(35,000)</u>	<u>8.8%</u>
Earnings before taxes	\$125,000	31.3%
Income taxes	<u>(40,000)</u>	<u>10.0%</u>
Net income	<u>\$ 85,000</u>	<u>21.3%</u>
Earnings per share (\$85,000 net income ÷ 20,000 shares)	\$4.25	
Dividends per share (\$15,000 dividends ÷ 20,000 shares)	\$0.75	

STEP 3: ANALYZE YOUR RESULTS

There are some important observations we can make about Menielle's income statement. First, the firm is profitable, earning a net income of \$85,000, or \$4.25 on a per share basis, and then paying \$15,000 in dividends to the shareholders, or \$0.75 per share. Also, for every \$100 of sales, Menielle earned \$62.50 in gross profits, \$40 in operating income, and \$21.30 in net income. Finally, the rate of dividends to earnings, or what is called the **dividend payout ratio**, is $\$15,000 \div \$85,000 = 17.6\%$, indicating that the firm is retaining most of its earnings to grow the business.

2. The Balance Sheet

The Balance Sheet

- A firm's balance sheet, on the other hand, provides a **snapshot of the firm's financial position** at a specific point in time, presenting its asset holdings, liabilities, and owner-supplied capital (stockholders' equity).
- In its simplest form, a balance sheet is represented by the following balance sheet equation:

$$\text{Total assets} = \text{total debt (liabilities)} + \text{total shareholders' equity}$$

- where total assets represent the resources owned by the firm, and total liabilities (debt) and total shareholders' equity indicate how those resources were financed.

ASSETS

=

LIABILITIES

+

EQUITY



=



+

CAPITAL
PROFITS
LOSSES

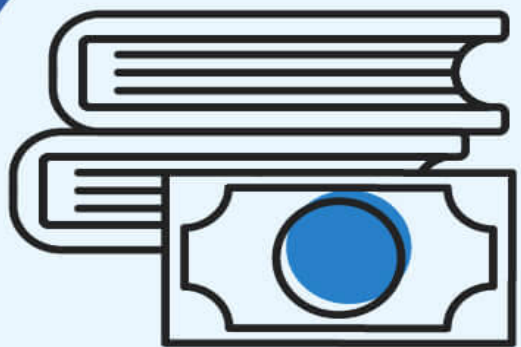
WHAT YOU
OWN

WHAT YOU
OWE

WHAT YOU
GET

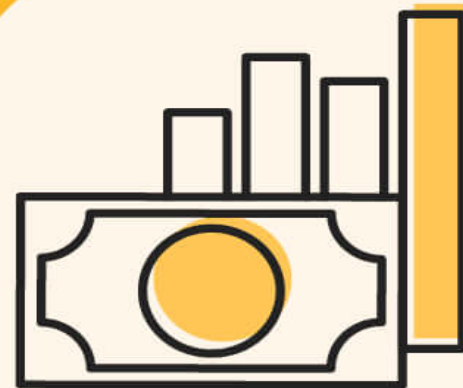
The Balance Sheet

- The conventional practice is to report the amount of a firm's various assets in the balance sheet by using the **actual cost of acquiring them**.
- Thus, the balance sheet **does not represent the current market value** of a company's assets and consequently does not reflect the value of the company itself. Rather, it **reports historical transactions at their cost**.
- Therefore, **the balance sheet reports a company's accounting book value, which is simply equal to a firm's total assets as listed in its balance sheet**.



BOOK VALUE

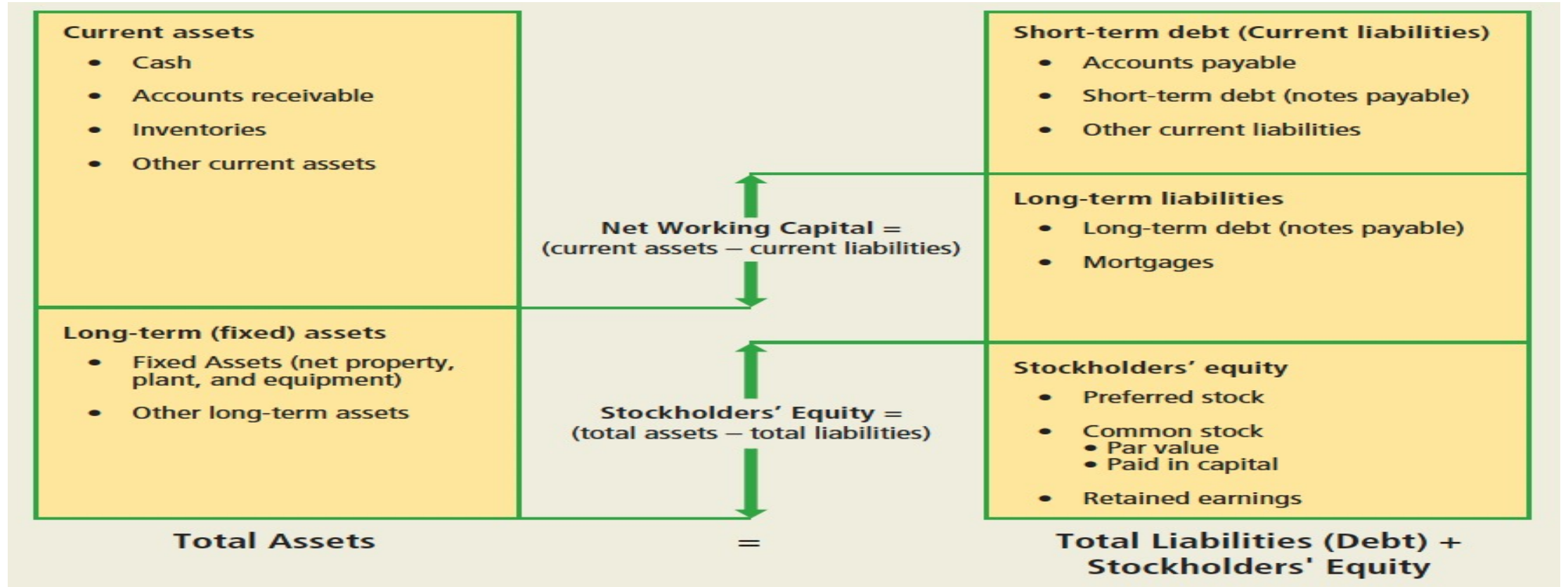
Book value is the amount you paid for an asset, minus depreciation



MARKET VALUE

Market value is what an asset would sell for in the current market

An overview of the Balance Sheet



Types of Assets

- On the balance sheet, **assets are listed from the most liquid to the least liquid**, that is, in the order of decreasing liquidity.
- Liquidity refers to the ability to quickly convert an asset into cash without lowering the selling price.
- A highly liquid asset can be sold quickly without causing a decrease in the value of the asset, whereas an illiquid asset either cannot be easily converted to cash or can only be sold quickly at a significant discount.
- For example, cash is much more liquid than a building.
- **Liquidity is important because holding liquid assets reduces the chance that a firm will experience financial distress.** However, **liquid assets usually generate less return** than illiquid assets. For example, holding cash would earn no return at all.
- **Therefore, financial managers must choose a reasonable percentage of liquid assets so that the company can enjoy the benefits of liquidity without significantly hurting a firm's profitability.**

Current Assets

- Company's current assets, or gross working capital as it is sometimes called, are those assets that are expected to be converted into cash within 12 months.
- **Current assets includes :**
 - a. **Cash.** Every firm must have cash to conduct its business operations. A reserve of cash is needed because of the unequal flow of funds into (cash receipts) and out of (cash expenditures) the business.
 - b. **Accounts receivable.** A firm's accounts receivable are the amounts owed to the firm by its customers who buy on credit.
 - c. **Inventories.** A company's inventories consist of raw materials, work in progress, and finished goods held by the firm for eventual sale.
 - d. **Other current assets.** Other current assets include such items as prepaid expenses. For example, a company's insurance premium might be due before the actual insurance coverage begins; or the firm's rent might have to be paid in advance. These expenditures are considered assets because they represent an investment that's been made by the company. Only when, for example, the insurance premium is used up following the coverage period is the premium considered an expense.

Long-term Assets

- A company's long-term assets fall into two categories:

1. Fixed Assets (Property, Plant, and Equipment)

- A firm's fixed assets include such assets as machinery and equipment, buildings, and land. **These assets will be used over a number of years.**
- When a firm purchases a fixed asset, it does not immediately report the expenditure for the asset as an expense in its income statement. Instead, it is shown as an asset in the balance sheet.
- Some of these assets, such as machinery and equipment, will depreciate over time others may not, such as land.
- With a depreciable asset, the original cost of the asset is allocated as an expense in the income statement over the asset's expected useful life. The amount **allocated as the cost each year is shown as a depreciation expense** in the income statement. The **sum of all depreciation taken over the life of the asset to date is shown as accumulated depreciation in the balance sheet.**

- ## 2. Other Long-Term Assets:
- Other long-term assets are all of the firm's assets that are not current assets or fixed assets. They include, for example, long-term investments and intangible assets such as the company's patents, copyrights, and goodwill.

Long-term Assets

- To illustrate, assume that a truck purchased for \$20,000 is to be evenly depreciated over a 4-year life. The depreciation expense to be reported in the income statement for each year would be \$5,000.
- When a firm buys the truck, the \$20,000 **original cost of the asset is added to the balance sheet as a gross fixed asset**. The cumulative depreciation taken over the asset's life is reported as accumulated depreciation. We subtract the accumulated depreciation each year from the gross fixed assets to determine net fixed assets.
- It is important to understand the distinction between **gross fixed assets and net fixed assets** and how depreciation expense in the income statement relates to accumulated depreciation in the balance sheet.
- In this example, the income statements for each year and balance sheets over time would appear as follows:

Depreciation Expense in the Income Statement

	FOR THE YEAR ENDED			
	1	2	3	4
Depreciation expense	\$5,000	\$5,000	\$5,000	\$5,000

Accumulated Depreciation in the Balance Sheet

	END OF YEAR			
	1	2	3	4
Gross fixed assets	\$20,000	\$20,000	\$20,000	\$20,000
Accumulated depreciation	(5,000)	(10,000)	(15,000)	(20,000)
Net fixed assets	\$15,000	\$10,000	\$ 5,000	\$ 0

Types of Financing

- We now turn to the right side of the balance sheet labeled “Total Liabilities (Debt) + Stockholders’ Equity,” which indicates how the firm finances its assets.
- **Debt (liabilities)** is money that has been borrowed and must be repaid at some predetermined date.
- **Equity**, on the other hand, represents the shareholders’ (owners’) investment in the company.



Types of Financing

- **Debt capital is financing provided by a creditor**, it is divided into

1. Short-Term Debt (Current Liabilities) A firm's short-term debt, or current liabilities, includes borrowed money that must be repaid within the next 12 months. The sources of a firm's current debt include the following:

- a. Accounts payable.** The firm's accounts payable represent the credit that suppliers have extended to the firm when it purchased inventories. The purchasing firm may have 30, 60, or even 90 days to pay for the inventory. This form of credit extension is also called trade credit.
- b. Accrued expenses.** Accrued expenses are short-term liabilities that have been incurred in the firm's operations but not yet paid. For example, the company's employees might have done work for which they will not be paid until the following week or month, and these are recorded as accrued wages.
- c. Short-term notes.** Short-term notes represent amounts borrowed from a bank or other lending source that are due and payable within 12 months.

Types of Financing

2. Long-Term Debt

- The firm's long-term debt includes loans from banks or other sources for longer than 12 months.
- A firm might borrow money for 5 years to buy equipment, or it might borrow money for as long as 25 or 30 years to purchase real estate, such as land and buildings.
- Usually, a loan to finance real estate is called a **mortgage**, where the lender has first claim on the property in the event the borrower is unable to repay the loan.

Equity

- Equity includes the shareholders' investment—both preferred stockholders and common stockholders—in the firm.
 - a. **Preferred stockholders** generally receive a dividend that is fixed in amount. In the event of the firm being liquidated, these stockholders are paid after the firm's creditors but before the common stockholders.
 - b. **Common stockholders** are the residual owners of a business. They “own” whatever income is left over after paying all expenses. In the event the firm is liquidated, the common stockholders receive only what is left over—good or bad—after the creditors and preferred stockholders are paid.
- **The amount of a firm's common equity is equal to the sum of two items:**
 - a. The amount a company receives from selling stock to investors.
 - b. The amount of a firm's retained earnings.



Common Stock

- This amount may simply be shown as common stock in the balance sheet or it may be divided into **par value** (an arbitrary amount a firm puts on each share of stock when it is sold, frequently a penny or a dollar) and **paid-in capital** above par (also called capital surplus).
- Paid-in capital is the amount of money above par value a firm receives when it issues new shares to investors.
- For instance, if a company sells a new issue of common stock for \$50 per share and sets the par value of the stock at \$1 per share, then the \$49 (\$50-\$1) would be shown as paid-in capital. So, if it sold 1 million shares, the total paid-in capital would be \$49 million (\$49 * 1 million shares).
- Finally, the amount of common stock issued will be offset by any stock that has been repurchased by the company from its shareholders, which is shown as **treasury stock**.

Common Stock

- To illustrate how a company might record an issuance of common stock, assume that a firm issues 1,000 shares of common stock for \$100 per share.
- The company has a policy of assigning a \$1 par value to each share of stock. (It could just as easily have chosen a par value of a penny a share.)
- The remaining \$99 per share would be added to paid-in capital. Thus, the total increase in the common equity in the balance sheet would appear as follows:

Par value ($\$1 \times 1,000$ shares)	\$ 1,000
Paid-in capital ($\$99 \times 1,000$ shares)	<u>99,000</u>
Total increase in common stock	<u><u>\$100,000</u></u>

Retained Earnings

- Retained earnings is the net income that has been retained in the business rather than being distributed to the shareholders over the life of the company; in other words, the cumulative total of all the net income over the firm's life less the common stock dividends that have been paid over these years.
- More simply, retained earnings at the end of a given year is determined as follows:

Beginning retained earnings + net income for the year – dividends paid during the year = ending retained earnings

- To conclude, the common stockholders' equity can be represented as follows:

$$\text{Common equity} = \text{common shareholders' investment} + \overbrace{\text{cumulative profits} - \text{cumulative dividends paid to common stockholders}}^{\text{earnings retained within the business}}$$

TABLE 3-2 The Home Depot, Inc. Balance Sheets (\$ millions) for Years Ended January 31, 2010 and January 30, 2011

Year ended	Dollar Value			Common-Sized Balance Sheets	
	(Col. 1) Jan 31, 2010	(Col. 2) Jan 30, 2011	(Col. 3) 2010–2011 Changes (Col. 2 — Col. 1)	(Col. 4) Jan 31, 2010 (Col. 1 ÷ Total Assets)	(Col. 5) Jan 30, 2011 (Col. 2 ÷ Total Assets)
ASSETS					
Cash	\$ 1,421	\$ 545	(\$ 876)	3.5%	1.4%
Accounts receivable	964	1,085	121	2.4%	2.7%
Inventories	10,188	10,625	437	24.9%	26.5%
Other current assets	1,327	1,224	(103)	3.2%	3.1%
Total current assets	\$13,900	\$13,479	(\$ 421)	34.0%	33.6%
Gross fixed assets	\$37,345	\$38,471	\$1,126	91.4%	95.9%
Accumulated depreciation	(11,795)	(13,411)	(1,616)	—28.9%	—33.4%
Net fixed assets	\$25,550	\$25,060	(\$ 490)	62.5%	62.5%
Other assets	1,427	1,586	159	3.5%	4.0%
Total assets	<u>\$40,877</u>	<u>\$40,125</u>	<u>(\$ 752)</u>	<u>100.0%</u>	<u>100.0%</u>
LIABILITIES (DEBT) AND EQUITY					
Accounts payable	\$ 9,343	\$ 9,080	(\$ 263)	22.9%	22.6%
Short-term notes payable	1,020	1,042	22	2.5%	2.6%
Total current liabilities	\$10,363	\$10,122	(\$ 241)	25.4%	25.2%
Long-term debt	11,121	11,114	(7)	27.2%	27.7%
Total liabilities	\$21,484	\$21,236	(\$ 248)	52.6%	52.9%
Common stock:					
Par value ⁹	\$ 86	\$ 86	\$ 0	0.2%	0.2%
Additional paid-in capital (capital surplus)	6,666	7,001	335	16.3%	17.4%
Total common stock sold	\$ 6,752	\$ 7,087	\$ 335	16.5%	17.7%
Treasury stock (stock repurchased)	(585)	(3,193)	(2,608)	—1.4%	—8.0%
Total common stock	\$ 6,167	\$ 3,894	(\$2,273)	15.1%	9.7%
Retained earnings	13,226	14,995	1,769	32.4%	37.4%
Total common equity	\$19,393	\$18,889	(\$ 504)	47.4%	47.1%
Total liabilities and equity	<u>\$40,877</u>	<u>\$40,125</u>	<u>(\$ 752)</u>	<u>100.0%</u>	<u>100.0%</u>

Changes in Home Depot's Balance Sheet

- Looking at the changes in the balance sheets for Home Depot, we observe the following:

1. The **firm's total assets decreased** \$752 million, going from \$40.877 billion in assets to \$40.125 billion. Why the decrease? Two primary reasons: the reduction in current assets and in net fixed assets.

a. Decrease in current assets. The most significant reduction in current assets by far came from the company's decrease in cash in the amount of \$876 million. The decrease in cash was offset in part by the increases in accounts receivable, and especially inventories.

b. Decrease in fixed assets. The reduction in the net fixed assets in the amount of \$490 million came from two offsetting changes: purchasing new fixed assets (increase in gross fixed assets) in the amount of \$1.126 billion, but taking \$1.616 billion in depreciation of the fixed assets. So we see that the change in a firm's net fixed assets is driven by (1) how much the firm spends on new fixed assets and (2) how much depreciation expense it takes on the fixed assets in place.

Changes in Home Depot's Balance Sheet

- 2. We next review the changes in the firm's debt and equity, which amounts to a \$752 million decrease, exactly the amount of the decrease in total assets—as it must be. (Remember, total assets = total debt + total equity) Primarily this change is the consequence of the following actions:
 - a. Paying off \$263 million owed to suppliers (reduction in accounts payable).
 - b. Repurchasing stock from its shareholders in the amount of \$2.608 billion (increase in treasury stock) less \$335 million the firm received from issuing new stock.
 - c. Retaining \$1.769 billion of the firm's profits within the business (increase in retained earnings).

Home Depot's Common-Sized Balance Sheet

- Finally, we can gain additional perspective on a company's financial position by looking at each item on the balance sheet as a percentage of total assets (and total debt and equity). A balance sheet expressed this way is called a common-sized balance sheet. Based on the percentages, we can observe that:
 - Inventories make up most of the current assets, amounting to about one-fourth of all the assets owned by the company.
 - The company's total assets consist of about one-third current assets and two-thirds fixed assets.
 - Approximately one-half of Home Depot's financing comes from debt, with the remaining half coming from equity. To be more precise, we can calculate the debt ratio, which is the percentage of a company's assets financed by debt. For Home Depot, the debt ratios on January 31, 2010 and January 30, 2011, respectively, were 52.6 percent and 52.9 percent:

	FISCAL YEAR ENDED	
	JANUARY 31, 2010	JANUARY 30, 2011
Debt ratio = $\frac{\text{total debt}}{\text{total assets}}$	$\frac{\$21,484M}{\$40,877M} = 52.6\%$	$\frac{\$21,236M}{\$40,125M} = 52.9\%$

- The debt ratio is an important measure to lenders and investors because it indicates the amount of financial risk the company is bearing—the more debt a company uses to finance its assets, the greater is its financial risk.

Home Depot's Common-Sized Balance Sheet

- Earlier we noted that the term current assets is also referred to as gross working capital. These two terms are used interchangeably.

Net working capital = current asset - current liabilities

- Thus, net working capital compares the amount of current assets (assets that should convert into cash within the next 12 months) to the current liabilities (debt that must be paid within 12 months).
- The larger the net working capital a firm has, the more able the firm will be to pay its debt as it comes due.
- Thus, the amount of net working capital is important to a company's lenders, who are always concerned about a company's ability to repay its loans.

Home Depot's Common-Sized Balance Sheet

- For Home Depot, net working capital is computed as follows:

	FISCAL YEAR ENDED	
	JANUARY 31, 2010	JANUARY 30, 2011
Gross working capital	\$13,900	\$13,479
Current liabilities	<u>(10,363)</u>	<u>(10,122)</u>
Net working capital	<u>\$ 3,537</u>	<u>\$ 3,357</u>

Example

- **Given the information below for Menielle, Inc., construct a balance sheet and a common-sized balance sheet. As a percent of assets, what are the firm's largest investments and sources of financing?**

Gross fixed assets \$75,000

Cash \$10,000

Other assets \$15,000

Accounts payable \$40,000

Retained earnings \$15,000

Accumulated depreciation \$20,000

Accounts receivable \$ 50,000

Long-term bank note \$ 5,000

Mortgage \$ 20,000

Common stock \$100,000

Inventories \$ 70,000

Short-term notes \$ 20,000

STEP 1: FORMULATE A SOLUTION STRATEGY

The balance sheet can be visualized as follows:

Current assets	Current liabilities
+ Long-term (fixed) assets	+ Long-term liabilities
	+ Shareholders' equity
= Total assets	= Total liabilities + Shareholders' equity

STEP 2: CRUNCH THE NUMBERS

Your results should be as follows:

Balance Sheet

Assets:

Cash	\$ 10,000
Accounts receivable	50,000
Inventories	<u>70,000</u>
Total current assets	\$130,000
Gross fixed assets	\$ 75,000
Accumulated depreciation	<u>(20,000)</u>
Net fixed assets	\$ 55,000
Other assets	<u>15,000</u>
Total assets	<u><u>\$200,000</u></u>

Liabilities and Equities:

Accounts payable	\$ 40,000
Short-term notes	<u>20,000</u>
Total short-term debt	\$ 60,000
Long-term bank note	\$ 5,000
Mortgage	<u>20,000</u>
Total long-term debt	\$ 25,000
Total debt	\$ 85,000
Common stock	100,000
Retained earnings	<u>15,000</u>
Total equity	<u><u>\$115,000</u></u>
Total debt and equity	<u><u>\$200,000</u></u>

Common-Sized Balance Sheet

Assets:

Cash	5.0%
Accounts receivable	25.0%
Inventories	<u>35.0%</u>
Total current assets	65.0%
Gross fixed assets	37.5%
Accumulated depreciation	<u>(10.0%)</u>
Net fixed assets	27.5%
Other assets	<u>7.5%</u>
Total assets	<u><u>100.0%</u></u>

Liabilities and Equities:

Accounts payable	20.0%
Short-term notes	<u>10.0%</u>
Total short-term debt	30.0%
Long-term bank note	2.5%
Mortgage	<u>10.0%</u>
Total long-term debt	12.5%
Total debt	42.5%
Common stock	50.0%
Retained earnings	<u>7.5%</u>
Total equity	<u><u>57.5%</u></u>
Total debt and equity	<u><u>100.0%</u></u>

STEP 3: ANALYZE YOUR RESULTS

We see that the firm has invested a total of \$200,000 in its assets, comprised of \$130,000 in current assets (65% of total assets), \$55,000 in fixed assets (27.5% of total assets), and \$15,000 in other assets (7.5% of total assets). Second, the firm has \$130,000 tied up in current assets and \$60,000 in current liabilities, leaving the firm with a net working capital position of $\$130,000 - \$60,000 = \$70,000$. Third, the firm uses more equity (57.5% of total assets) than debt (42.5% of total assets) to finance its business.

