



# Analyzing Financial Statements and Ratios

## Chapter 2

# Accounting Basics

- ▶ Double-entry bookkeeping
- ▶ Generally accepted accounting principles (GAAP)
- ▶ T-accounts
- ▶ Credits and debits

Accounts Receivable	
Debits	Credits
(1) \$200	

  

Membership Revenue	
Debits	Credits
	(1) \$200



# Financial Statements

- ▶ The primary source of information used to evaluate the financial health and performance of an organization
- ▶ Three basic types:
  1. Balance sheet
  2. Income statement
  3. Statement of cash flows

# Balance Sheet

- ▶ A picture or snapshot of the financial condition of an organization at a specific point in time
- ▶ Three primary sections:
  1. Assets
  2. Liabilities
  3. Owners' equity



# Notes on Balance Sheets

- ▶ Assets = Liabilities + Owners' Equity

Using the Under Armour example:

$$\$2,095,083,000 = \$744,783,000 + \$1,350,300,000$$

- ▶ Assets and liabilities are listed in order of liquidity.

# Under Armour Balance Sheet—Assets

**A** See the textbook for an explanation of the various labels used throughout the financial statements.

Under Armour, Inc. and Subsidiaries		
Consolidated Balance Sheets		
(In thousands, except share data)		
	December 31, 2014	December 31, 2013
<b>Assets</b>		
<b>A</b> Current assets		
Cash and cash equivalents	\$ 593,175	\$ 347,489
Accounts receivable, net	279,835	209,952
Inventories	536,714	469,006
Prepaid expenses and other current assets	87,177	63,987
Deferred income taxes	52,498	38,377
<b>B</b> Total current assets	1,549,399	1,128,811
<b>C</b> Property and equipment, net	305,564	223,952
Goodwill	123,256	122,244
Intangible assets, net	26,230	24,097
Deferred income taxes	33,570	31,094
Other long term assets	57,064	47,543
<b>D</b> Total assets	<u>\$2,095,083</u>	<u>\$1,577,741</u>

*continued*



# Under Armour Balance Sheet— Liabilities and Stockholders' Equity

<b>Liabilities and Stockholders' Equity</b>		
<b>E</b> Current liabilities		
Revolving credit facility	\$ —	\$ 100,000
Accounts payable	210,432	165,456
Accrued expenses	147,681	133,729
Current maturities of long term debt	28,951	4,972
Other current liabilities	34,563	22,473
<b>F</b> Total current liabilities	421,627	426,630
<b>G</b> Long term debt, net of current maturities	255,250	47,951
Other long term liabilities	67,906	49,806
<b>H</b> Total liabilities	744,783	524,387
<b>I</b> Commitments and contingencies (see Note 7)		
Stockholders' equity		
<b>J</b> Class A Common Stock, \$0.0003 1/3 par value; 400,000,000 shares authorized as of December 31, 2014 and 2013; 177,295,988 shares issued and outstanding as of December 31, 2014 and 171,628,708 shares issued and outstanding as of December 31, 2013.	59	57
Class B Convertible Common Stock, \$0.0003 1/3 par value; 36,600,000 shares authorized, issued and outstanding as of December 31, 2014 and 40,000,000 shares authorized, issued and outstanding as of December 31, 2013.	12	13
<b>K</b> Additional paid-in capital	508,350	397,248
<b>L</b> Retained earnings	856,687	653,842
Accumulated other comprehensive income (loss)	(14,808)	2,194
<b>M</b> Total stockholders' equity	1,350,300	1,053,354
Total liabilities and stockholders' equity	\$2,095,083	\$1,577,741

Source: Under Armour (2014). 2014 Under Armour Annual Report.

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# Income Statement

(Statement of earnings, operating statement, or profit-and-loss statement)

- ▶ Shows an organization's income (or loss) over a specified period of time, often on an annual or quarterly basis
- ▶ Two types of accounting:

- Cash basis
- Accrual basis



Note the differences between the two and the resulting impact on the income statement.

# Under Armour Income Statement

Under Armour, Inc. and Subsidiaries  
Consolidated Statements of Income  
(In thousands, except per share amounts)

	Year Ended December 31,		
	2014	2013	2012
<b>A</b> Net revenues	\$3,084,370	\$2,332,051	\$1,834,921
<b>B</b> Cost of goods sold	1,572,164	1,195,381	955,624
Gross profit	1,512,206	1,136,670	879,297
<b>C</b> Selling, general and administrative expenses	1,158,251	871,572	670,602
<b>D</b> Income from operations	353,955	265,098	208,695
<b>E</b> Interest expense, net	(5,335)	(2,933)	(5,183)
<b>F</b> Other expense, net	(6,410)	(1,172)	(73)
Income before income taxes	342,210	260,993	203,439
Provision for income taxes	134,168	98,663	74,661
<b>G</b> Net income	<u>\$ 208,042</u>	<u>\$ 162,330</u>	<u>\$ 128,778</u>
<b>Net income available per common share</b>			
Basic	\$ 0.98	\$ 0.77	\$ 0.62
Diluted	\$ 0.95	\$ 0.75	\$ 0.61
<b>Weighted average common shares outstanding</b>			
Basic	213,227	210,696	208,686
Diluted	219,380	215,958	212,760

Source: Under Armour (2014).



# Statement of Cash Flows

- ▶ Financial statement that tracks cash flowing into and out of an organization over a period of time
- ▶ Compared to an income statement, it provides a simpler explanation of cash generated/spent
- ▶ Three sections:
  - Operating activities
  - Investing
  - Financing

# Under Armour Statement of Cash Flows—From Operating Activities

Under Armour, Inc. and Subsidiaries			
Consolidated Statements of Cash Flows			
(In thousands)			
	Year Ended December 31,		
	2014	2013	2012
<b>A Cash flows from operating activities</b>			
Net income	\$ 208,042	\$ 162,330	\$128,778
Adjustments to reconcile net income to net cash used in operating activities			
Depreciation and amortization	72,093	50,549	43,082
Unrealized foreign currency exchange rate losses (gains)	11,739	1,905	(2,464)
Loss on disposal of property and equipment	261	332	524
Stock-based compensation	50,812	43,184	19,845
Deferred income taxes	(17,584)	(18,832)	(12,973)
Changes in reserves and allowances	31,350	13,945	13,916
Changes in operating assets and liabilities, net of effects of acquisitions:			
Accounts receivable	(101,057)	(35,960)	(53,433)
Inventories	(84,658)	(156,900)	4,699
Prepaid expenses and other assets	(33,345)	(19,049)	(4,060)
Accounts payable	49,137	14,642	35,370
Accrued expenses and other liabilities	28,856	56,481	21,966
Income taxes payable and receivable	3,387	7,443	4,511
Net cash provided by operating activities	<u>219,033</u>	<u>120,070</u>	<u>199,761</u>

*continued*



# Statement of Cash Flows— From Investing and Financing Activities, and more

<b>B Cash flows from investing activities</b>			
Purchases of property and equipment	(140,528)	(87,830)	(50,650)
Purchase of business	(10,924)	(148,097)	—
Purchases of other assets	(860)	(475)	(1,310)
Change in loans receivable	—	(1,700)	—
Change in restricted cash	—	—	5,029
Net cash used in investing activities	<u>(152,312)</u>	<u>(238,102)</u>	<u>(46,931)</u>
<b>C Cash flows from financing activities</b>			
Proceeds from revolving credit facility	—	100,000	—
Payments on revolving credit facility	(100,000)	—	—
Proceeds from term loan	250,000	—	—
Payments on term loan	(13,750)	—	(25,000)
Proceeds from long term debt	—	—	50,000
Payments on long term debt	(4,972)	(5,471)	(44,330)
Excess tax benefits from stock-based compensation arrangements	36,965	17,167	17,868
Proceeds from exercise of stock options and other stock issuances	15,776	15,099	14,776
Payments of debt financing costs	(1,713)	—	(1,017)
Net cash provided by financing activities	<u>182,306</u>	<u>126,795</u>	<u>12,297</u>
Effect of exchange rate changes on cash and cash equivalents	<u>(3,341)</u>	<u>(3,115)</u>	<u>1,330</u>
Net increase in cash and cash equivalents	<u>245,686</u>	<u>5,648</u>	<u>166,457</u>
<b>Cash and cash equivalents</b>			
Beginning of period	<u>347,489</u>	<u>341,841</u>	<u>175,384</u>
<b>D End of period</b>	<u>\$ 593,175</u>	<u>\$ 347,489</u>	<u>\$341,841</u>
<b>Non-cash investing and financing activities</b>			
Increase in accrual for property and equipment	\$ 4,922	\$ 3,786	\$ 12,137
Non-cash acquisition of business	11,233	—	—
<b>Other supplemental information</b>			
Cash paid for income taxes	103,284	85,570	57,739
Cash paid for interest, net of capitalized interest	4,146	1,505	3,306

Source: Under Armour (2014).

# Notes on Balance Sheets

- ▶ Owners' equity is often an estimate
- ▶ The terminology used differs (sometimes considerably) from one company to another



# Notes on Income Statements

- ▶ Do they truly reflect actual earnings or profit?
- ▶ Issues: Depreciation, taxation, research and development, advertising

# Financial Ratios

- ▶ Key information about a company's condition and performance
- ▶ Why financial managers engage in ratio analysis:
  - To evaluate how well a company is operating in the current time period
  - To compare current to past performance
  - To compare current and historical performance to industry standards
  - To study efficiency of operations



# Key Financial Ratios

Ratio	Description
Liquidity	
Current ratio	The organization's ability to meet its current liabilities with its current assets
Quick ratio	The organization's ability to meet its current liabilities with current assets other than inventory
Asset Management Ratios	
Total asset turnover ratio	How efficiently the organization is using its assets to make money
Inventory turnover ratio	How often the organization sells and replaces its inventory over a specified period of time

# More Financial Ratios

Ratio	Description
Leverage Ratios	
Debt ratio	How the organization finances its operation with debt and equity
Interest coverage ratio	The organization's ability to pay the interest on its debt owed
Asset Management Ratios	
Total asset turnover ratio	How efficiently the organization is using its assets to make money
Inventory turnover ratio	How often the organization sells and replaces its inventory over a specified period of time



# More Financial Ratios

Ratio	Description
Profitability Ratios	
Net profit margin	The percentage of the organization's total sales or revenues that was net profit or income
Return on equity	The return rate that the organization's owners or shareholders are receiving on their investment
Market Value Ratios	
Market value	An estimate of the organization's worth according to the stock market
Price-to-earnings ratio	An estimate of how much investors will pay for each dollar of the organization's earnings

# Calculating Your Thoughts



- ▶ If you were to invest in a sportswear company (or any company), would you use objective, evidence-based decision making to choose which company to invest in?
- ▶ Or do you think you would make your decisions in a more instinctive, “my gut says...” manner?
- ▶ Why? What would you say to someone who recommends a different method?



ANY  
QUESTIONS  
?