



UNDERSTANDING FINANCIAL STATEMENTS PRIOR TO INVESTING



Business Angel Investment Education: Session 101
Basic on financial statements: Finance Considerations before writing a check
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Angel investments & Start-ups



- ❑ Angel investments are fueled by the desire to help entrepreneurs succeed and the possibility of making money.
 - ❑ Startup equity investors are buying a % of the company from the founders in perpetuity which could amount to a lot of money
- ❑ Investors should consult the numbers, key company statistics and financial documents.
 - ❑ Numbers help disclosure a business performance, competitive positioning, and potential risks.
 - ❑ Perform an analysis to determine the company potential growth and value.
- ❑ Due diligence: is the investigation and analysis the investor performs to see if an investment opportunity meets the investor's criteria for funding.
 - ❑ Gain the understanding of the company and its business as well as determining the suitability of the investment for the portfolio.

What is a Financial Statement?

A financial statement shows you where a company's money came from, where it went and where it is now.¹



Balance Sheet



Income Statement



Cash Flow Statement

What is a Balance sheets (B/S)?



Balance Sheet



- ❑ Balance sheets helps to show if a company is financially healthy. $\text{Assets} = \text{Liabilities} + \text{Equity}$. You Business's net worth.
- ❑ It shows what your business owns (assets), what it owes (liabilities), and what money is left over for the owners (owner's equity).



Income Statement



- ❑ It measures profitability and not cash flow. $\text{Income} = \text{Revenues} - \text{Expenses}$
- ❑ Summary of a company's revenues and expenses during a month, quarter or year.



Cash Flow Statement



- ❑ It shows how changes in B/S accounts and P/L affect cash, and breaks the analysis down to operating, investing, and financing activities.
- ❑ A healthy operating cash flow means it can finance more of its growth internally, without borrowing.



Balance
Sheet

What is a Balance sheets (B/S)?

Accounts	Description	31-Dec-18
1 Assets	What the company owns is called assets: Cash (Bank), A/R, inventory, equipment	
2 Cash		\$ -
3 Accounts Receivable		\$ 100
4 Total Asset		\$ 100
5 Liability and owners's equity	What it owes is called liabilities: Loans, A/P	
6 Accounts Payable		\$ 50
7 Owner's equity (shareholders)	What is worth is called owners equity or shareholders equity. The equity shows the accumulation of the profit or losses. The line is called retained earnings. Profits from the P&L increased equity	\$ 50
8 Liability and owners's equity		\$ 100

- Owners' equity includes:
 - Capital (money invested into the business by the owners)
 - Retained earnings (all your revenue minus all your expenses since launch)

- Equity can also drop when an owner draws money out of the company to pay themselves, or when a corporation issues dividends to shareholders.



Balance sheets: Investors

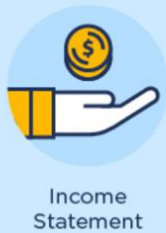
1. Assets: How much the company owns:
 1. Cash, investments, real estate, equipment and intangibles: Intellectual Property (IP), patents, copyrights and trademarks.
 2. A larger amount can be used to grow the business and pay dividends.
2. Liabilities & Debts obligations: Lower is typically better.
 1. Excessive debt may negatively impact the company future cash flow.
 2. See your debt repayment plan
3. Shareholder equity: Includes the \$ the company has raised from investors.
4. Debt to equity Ratio: Total liability/total shareholder equity.
 1. Below 1 = company has less debt than equity (less risky investment)
5. Current Ratio: Current assets/Current liabilities will tell you the ability to meet its short-term financial obligations.
 1. 1.5 or greater, able to pay its short-term bills



What is an Income statement (P & L)?

Accounts	Description	2020	2021	Variance \$	Variance %
1 Sales (revenue)	Dollar value of all products or services a company provided to its customers during a given period time. Top line growth or sales growth	\$ 60,000	\$ 61,200	\$ 1,200	102.00%
2 Cost of Goods Sold	All costs directly involved in producing a product or delivering a service	\$ 10,000	\$ 10,200	\$ 200	102.00%
3 Gross Profit	Sales – Cost of Goods sold	\$ 50,000	\$ 51,000	\$ 1,000	102.00%
4 Operating expense	Costs that are not directly related to making the product or delivering a service	\$ 45,000	\$ 45,000	\$ -	100.00%
5 Net income	Is the bottom line of income statement: What is left after all costs and expenses are subtracted from revenue.	\$ 5,000	\$ 6,000	\$ 1,000	120.00%
6 Margin (%)	Degree to which a business makes money (Net income by revenues). Indicates how many cents have been generated for each dollar of sales	8%	10%		
7 Variance or Difference:	Between budget and actual; actual this month vs actual last month (quarter or year), dollars or %				

Income = Revenues – Expenses (Indirect Expenses, Direct Expenses)



Income statement (P & L): Investors

1. Potential for growth: Revenue: # of customers, revenue per customer, revenue growth rates.
 1. Will the business grow in value?
 2. Will they have recurring revenue?
 3. Are the assumptions in the projections reasonable? And how are they going to realize the projections.

2. Gross Margins: The higher the Gross Margin, the quicker the company will be able to reach its breakeven point and the faster it can generate free cash flow.
 1. Investors will look for potential of high returns.
 2. Are the margins high enough to justify the investment?

3. Customer acquisition costs (CAC): \$ spent to acquire a single customer.
 1. Incremental revenue per marketing dollar spent.

4. Breakeven point: The point at which a company can generate net profits



Cash Flow
Statement

What is a Cash flow statement?

	Accounts	Cash Flow statement: Description	31-Dec-18
1	Cash flow from Operations	All cash flow related to actual operations of the business	
2	Cash receipts from customers		\$ 87
3	Cash paid from inventory		\$ (7)
4	Cash paid for wages		\$ (53)
5	Net cash flow from Operations		\$ 27
6	Cash flow from Investing	Refers to investments made by the company : Capital Investments, purchase of assets	
7	Cash receipts from sale of property and equipment		\$ 13
8	Cash paid for purchase of equipment		\$ (17)
9	Net cash flow from Investing		\$ (4)
10	Cash flow from Financing	Refers to borrowing and paying back loans, transactions between a company and its shareholders	
11	Cash paid for loan repayment		\$ (5)
12	Net cash flow from investing		\$ (5)
13	Net increase of cash		\$ 18

- Operations: Cash you have generated from making and selling your product or service. (+) Managing your business well. (-) Pricing issues or aging A/R
- Investing: Displays how much money has been used in (or generated from) making investments during a specific time period. (-) means the company is investing in its future growth.
- Financing: Shows level of dependency on outside financing. Cash you have received from debt or how much debt you have paid down. (+) took out debt: pay for expenses or invest in business. (-) mean paying down debt.



Cash Flow
Statement

Cash flow statement: Investors

1. Cash flow refers to the rates at which a business takes in revenue and pays out cash.
2. Cash flow statements include information about how much they pay in interest.
 1. This is useful to predict the future cash flow, which will affect how fast the company can grow.
3. Do they have enough working capital to grow at the projected rate?
4. Free cash flow generation: \$ of cash a company can generate after accounting for both its operating expenses and its capital expenditure
5. The free cash the company can either reinvest into the business or pay out as dividends

7 Key points to remember



1. Are margins high enough to justify investment?
2. Are the assumptions reasonable?
3. Debt repayment plan
4. Intangibles: Intellectual Property (IP), Patents, Copyrights & trademarks
5. Do they have enough working capital to grow at the projected rate?
6. Is Operational cash flow positive?
7. Startup equity investors are buying a % of the company from the founders in perpetuity

Thank you! Q&A

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