

capo'07

The Pathologists' Meeting™



CHICAGO

Education by the Experts



What You Can Learn From a Balance Sheet

Harry J. Zemel, MD, FCAP

Agenda

Topic	Time
Opening/ Introductions	8:30-8:40
Richard Hausner, MD, FCAP	8:40-9:35
Break	9:35-10:05
Jim Dechene, JD	10:05-11:00
Harry Zemel, MD, FCAP	11:00-11:45
Questions	11:45-12:00
Summary and Closing	

Disclosure

- There is nothing to disclose.
- There are no products or services involved with this presentation.

Course Objectives

- You will learn how to look at a balance sheet and understand what it means to a business
- You will see how the balance sheet and the net worth statement are the same.



What is on the balance sheet?

- What you have - What you owe=what you own
- $\text{Assets} - \text{Liabilities} = \text{Net Worth}$
- $\text{Assets} = \text{Liabilities} + \text{Equity}$
- What we discuss as a balance sheet can also be applied as your net worth statement personally.

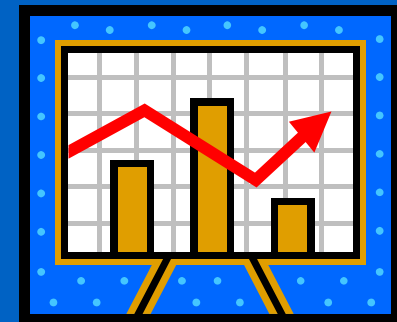
Balance Sheet Elements

Assets = Liabilities + Shareholder Equity

- Assets
 - Current assets
 - Cash
 - Accounts Receivable
 - Inventory
 - Prepaid Expense
 - Long-term assets
 - Depreciation
 - Other assets
- Liabilities and Equity
 - Current liabilities
 - Accounts Payable
 - Accrued Expenses
 - Current Portion of Debt
 - Income taxes payable
 - Long term liabilities
 - Shareholder's Equity
 - Capital Stock
 - Add. Paid-in Capital
 - Retained earnings

Current Assets

- Cash
- Accounts Receivable
- Inventory
- Prepaid Expenses



Cash

- Cash and securities
- Have maturity of one year or less



Where does the cash come from?

- Operating Activities
 - All sources of revenue-expenses
- Investing Activities
 - Reflects changes in long term assets
- Financing Activities
 - Reflects changes in long term debt and stock

Where do we find out where the cash is coming from?

- Cash Flow Statement
 - Tracks the movement of cash
 - Shows where it is coming from and where it is going.
 - The one statement that shows where a business is spending its cash

Cash Flow Statement

- Beginning balance
 - Cash Receipts
 - Cash Disbursements
- Cash from Operations
- Fixed Asset Purchases
- Net borrowings
- Income taxes paid
- Sale of Stock
- Ending Cash Balance



Review this financial document knowing several additional facts:

- Enclosed is a Balance Sheet for a company you serve as a member of the Board of Directors.
- Review this financial document knowing several additional facts:

Balance Sheet

XYZ Laboratories, Inc.
12/31/2006

Assets

Current Assets

Cash	\$12,000
Accounts Receivable	\$90,000
Inventory	\$120,000
Prepaid Expenses	\$10,000

Total Current Assets \$232,000

Long Term Assets	\$250,000
Depreciation	(\$50,000)

Total LT Assets \$200,000

Other Assets \$45,000

Total Assets \$477,000

Liabilities and Equity

Current Liabilities

Accounts Payable	\$95,000
Accrued Expenses	\$45,000
Current Portion of LT Debt	\$25,000
Income Tax Payable	\$5,000

Total Current Liabilities \$170,000

Long Term Liabilities

Long Term Debt \$225,000

Total Liabilities \$395,000

Shareholder Equity

Capital Stock	\$5,000
Additional paid in Capital	\$70,000
Retained Earnings	\$7,000

Total Liab and Equity \$477,000

Additional Data

- 1. The last three years of net profits were \$7,000, \$5,000 and (\$3,000).
- 2. The interest on the long-term debt is \$15,750 per year.
- 3. There are 1000 outstanding shares of the stock.

Questions for you are as follows:

- This company is discussing going to the bank for a loan for new equipment. As a board member you need to approve or disapprove. What is your vote and why?
- Is the amount of debt in line with your comfort level or acceptable standards? What is leverage?
- What is the Book value of this company? Is it the only measure of a company's worth?

Question #1

Should this business borrow more money?

XYZ Laboratory is having a Board meeting and you are a member.

There are discussions as to whether to apply for a bank loan to purchase new equipment. What do you think the bank will tell you?

Balance Sheet

XYZ Laboratories, Inc.
12/31/2006

Assets

Current Assets

Cash	\$12,000
Accounts Receivable	\$90,000
Inventory	\$120,000
Prepaid Expenses	\$10,000

Total Current Assets \$232,000

Long Term Assets	\$250,000
Depreciation	(\$50,000)

Total LT Assets \$200,000

Other Assets \$45,000

Total Assets \$477,000

Liabilities and Equity

Current Liabilities

Accounts Payable	\$95,000
Accrued Expenses	\$45,000
Current Portion of LT Debt	\$25,000
Income Tax Payable	\$5,000

Total Current Liabilities \$170,000

Long Term Liabilities

Long Term Debt \$225,000

Total Liabilities \$395,000

Shareholder Equity

Capital Stock	\$5,000
Additional paid in Capital	\$70,000
Retained Earnings	\$7,000

Total Liab and Equity \$477,000

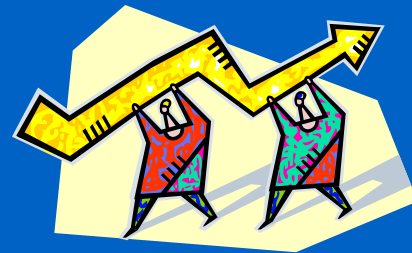
Working Capital

- *The amount of money the business has to “work with” in the short term*
- *The Cash needed to feed the operation*



Liquidity

- Current ratio
 - $\text{Current Assets} / \text{Current Liabilities}$
- Quick Ratio
 - $\text{Cash} + \text{Receivables} / \text{Current Liabilities}$



Does this business have too much debt?

- How much is too much?
- What parameters should you look for?
- Can the business afford the Debt?
- Is the Debt being used to the business's advantage?

Four of the Important Elements on the Balance Sheet

- Cash (Liquidity)
- Working Capital ($\text{CurAssets} - \text{CurLiab}$)
- Debt-Long Term
- Book Value

Balance Sheet Elements

Assets = Liabilities + Shareholder Equity

- Assets
 - Current assets
 - Cash
 - Accounts Receivable
 - Inventory
 - Prepaid Expense
 - Long-term assets
 - Depreciation
 - Other assets
- Liabilities and Equity
 - Current liabilities
 - Accounts Payable
 - Accrued Expenses
 - Current Portion of Debt
 - Income taxes payable
 - Long term liabilities
 - Shareholder's Equity
 - Capital Stock
 - Add. Paid-in Capital
 - Retained earnings

Question #2

How much debt is too much?

- Where to look?
- What are the guidelines?
- What was debt used to finance?
- What is leverage?

Where to look?

- Balance Sheet
 - Long term liabilities
- Income Statement
 - Interest on debt

Leverage Ratios

- Leverage: How much of the business' assets are financed with debt.
- Debt to Equity Ratio: $\frac{\text{Current} + \text{Long Term Debt}}{\text{Shareholder Equity}}$
- Debt Ratio: $\frac{\text{Current} + \text{LTD}}{\text{Total Assets}}$
- Times Interest Earned: $\frac{\text{Earnings before Interest and Taxes}}{\text{Interest Expense}}$

XYZ Laboratory

- Debt to Equity = $\frac{\$25,000 + \$225,000}{\$82,000} = 3.05$
- Debt Ratio = $\frac{\$25,000 + \$225,000}{\$477,000} = 0.5$
- X Interest Earned = $\frac{\$17,750}{\$15,750} = 1.13$

What was financed?

- Probably the most important question.
- Was it new equipment that would add productivity?
- Was it a new car for the CEO?

Question #3

What is the Business Worth

- Book Value
 - Total Equity \$82,000
 - Total Equity/ # of outstanding shares.
 - $\$82,000/1000 = \$82/\text{share}$
- Price-Earnings Multiple
 - What earnings multiple is the business comparable?

Summary

- We have examined three key elements of the balance sheet.
 - Cash
 - Debt
 - Equity
- How each are so very important in understanding your business

Pearls of Pathology

- Know your cash position
- Know how the cash was used
- Be mindful of the debt and its use

Questions?



References

- Financial and Business Statements
 - 2ed. G. Friedlob and F. Plewa, Jr. 2000
- Financial Statements
 - Thomas Ittelson 1998
- Accounting Fundamentals for Non-Accountants
 - Stephen A. Moscove 1984
- www.reportsgalley.com
- www.investopedia.com

Thank you for
participating!

Please complete the course
evaluation before you leave.

Education by the Experts

