

Securities and Financial Statements

Firms need assets to operate and funds to acquire assets

To raise funds, they sell securities (claims)

Debt: e.g., Short- and Long-term Debt, Accounts Payable

Equity: e.g., preferred stock, common stock

Sale and redemption (e.g., bonds) recorded on Balance Sheet

Periodic payments (e.g., interest) recorded on Income Statement

Priority and fixity of claims

1. creditors (fixed)
2. preferred shareholders (fixed, deferrable)
3. common shareholders (residual)

Market value of firm's securities

firm's *expected future* performance

current general security market conditions (other opportunities)

Value = f(size, timing, risk) of future cash flows

Note: financial statements refer to the *past*, but value depends on the future

Main Financial Statements: Overview

Balance Sheet

state of firm at end of accounting period (“stock,” like snapshot)
historical values of assets when acquired and financing when raised

Income Statement

in/outflows of “funds” during accounting period (“flow,” like movie)
does not distinguish cash and non-cash flows (*accrual* basis)
does not indicate when flows actually occur

Cash Flow Statement

in/outflows of cash during accounting period (flow)
includes cash from operations, investment, and financing activities
operating cash flow similar to net income, but with all non-cash items filtered out

Balance Sheet

What firm owns (Assets) and owes (Claims) at some point in time, organized by *liquidity*, recorded at *historical* values

Shows *sources* (Claims) and *uses* (Assets) of funds in past

Assets	Liabilities & Equity
Cash	Accounts Payable
Marketable Securities	Notes Payable
Accounts Receivable	Accrued Wages
Inventories	Accrued Taxes
Land	Long-term Debt
Plant & Equipment	Preferred Stock (if any)
[Intangibles]	Common Stock
<i>Total assets</i>	<i>Total claims</i>

Claims

Liabilities (in red) are debt (“other peoples’ money”), and must be repaid

Equity (in black) is owners’ share, a residual (everything that’s not owed to someone else)

Income Statement

Flow of funds through firm during period, *without distinguishing between cash and non-cash* items or *when* flows actually occur (accrual basis, matching)

Sales
– Cost of Goods Sold (CoGS)
– Operating Expenses
– Depreciation
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= Earnings before Interest and Taxes (EBIT)
– Interest
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= Earnings before Taxes (EBT)
– Taxes
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= Net Income before Preferred Dividends
– Preferred Dividends (if any)
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= Net Income (NI)
– Common Dividends (if any)
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= <i>Addition</i> to Retained Earnings ($\Delta R/E$)

Net Income is “profit” or “the bottom line.”