TRAINING NOTEBOOK

- MANAGEMENT OF ORGANISATIONS AND BUSINESS DEVELOPMENT -

ACCOUNTING & CORPORATE FINANCE

COLEACP

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Dear trainers, some advice…

WHY A TRAINING NOTEBOOK?

The "Manuals" edited by COLEACP are valuable training materials. To write them, COLEACP approached the best experts in the field with the aim of producing a technical document for a large public on a given theme that brings together and structures most of the current knowledge. These manuals are intended to be as accurate and complete as possible, adapted to the ACP context and focused on cross-cutting issues in horticulture. But the objective was also to make them affordable, understandable and enjoyable to read by people who are not necessarily experts in the field. Nevertheless, it is a **considerable effort to** assimilate all the material collected in a short time.

The training manuals, which are aimed primarily at experts and the most qualified people, are **often voluminous and complex**, and **it was necessary to help the expert trainers to identify the most important elements to retain**, and to collect for them a list of "key messages" to be disseminated to learners during COLEACP training. This Training Notebook is therefore **a valuable and practical tool** that is at your disposal to **help you prepare your training on the** topic covered in this booklet.

WHAT DOES THE TRAINING NOTEBOOK CONTAIN?

Each Training Notebook contains:

1. The list of materials to be delivered to participants during the training

This is a summary table of contents of the Training Manual. This list allows you to have an **overview of** all the **main points that** will have to be covered during the training. The **order of the list does not necessarily have to be respected**, as the organization of the sequences is left to your discretion and may depend on other factors (e.g. availability of an expert trainer; timing of the training sequences; space reserved for exercises;...).

In some cases, **only certain aspects** (or chapters) of the **subject will be covered** (for example: if the participants have a perfect command of certain parts of the subject covered in the training, it is not necessary to present them in detail; a small reminder may be sufficient and effective to cover the rest).

However, when you cover part of the material (a chapter), the main 'points' listed for each chapter allow you to organize your presentations and animations in a logical and relevant way for the learner. **You are also advised to present all the points of a chapter**.

2. Training leaflets

A Training Notebook contains as many 'leaflets' as there are chapters in the training manual (only the "case study" is not included). Each sheet contains, on the one hand, the **Training objectives of** this part of the subject to be delivered (what the learner must be able to deliver...), and on the other hand, according to the structure of the table, the '**key messages**' (what the learner must absolutely have assimilated at the end of the training). It is therefore very important to ensure that **all messages are well distributed during the training sequence**.

3. A summary of the content of the manual

A summary of the manual has been included in this Training Notebook. Structured in the same way as the manual, it contains most of the content in 15-20 pages but remains much less complete (the summary does not include figures or case studies).

This summary is **primarily intended for the trainer**:

- *At the beginning of the mission*, when preparing its intervention sequences and supports, it allows you to quickly become familiar with all the content you will need to address and to visualize the links between the different parts of the material to be delivered.
- *During the training*, you can use this summary **to prepare your daily summaries**, reminding participants of the essential elements seen during a day (15-20 minute summary at the end of the day with answers to questions).
- *At the beginning or end of the training,* if you wish, you can give participants a copy of this summary. If the summary is distributed at the beginning of the training, it is advisable to ask participants to highlight the passages mentioned in your end-of-day summary (benchmarks in the subject).

The summary is also useful for learners at the end of the course: it will allow them to **remember in a** few minutes the **main part of the topic covered** (for example before an assessment of prior learning), whereas reading the entire manual could be tedious.

HOW CAN THIS TRAINING NOTEBOOK HELP YOU PREPARE YOUR TRAINING INTERVENTIONS?

The intention of making this Training Notebook available to you is to **help you prepare your training sequences and structure your program day by day**:

- **Consider that each leaflet represents a whole**: if there are for example 4 leaflets, it means that there must be 4 distinct parts in your training. Sufficient time must therefore be allowed in the programme for each of these 4 parts. Each part of the subject will also have to be subject to a competency assessment.
- **Then consider the training objectives**: this will help you to choose: (a) the most appropriate training method for achieving your objectives (e.g. should you plan exercises, simulations, group activities, etc.); (b) the method for evaluating the learning acquired in this part.
- **Finally, prepare your materials** (e.g. power point, flipcharts or animation sheets, evaluation questions) by ensuring that all key messages are included (have I planned to discuss all these points? have I planned an evaluation on each key point?).

DON'T FORGET TO COMPLETE THIS TRAINING NOTEBOOK

This Training Notebook is made **for you**... It is **a tool that must live!**

At the end of each leaflet, a space was left free to add **your personal notes**: as a trainer you can note some thoughts on how to get messages across, note your questions, participants' reactions, points that raise difficulties... *i.e.* **capitalize on your experience as a trainer!**

You can also **note the types of media you have used**. This will be very useful when you have a new session to facilitate on the same theme. COLEACP provides you with many tools and materials, but do not hesitate to create others or use other existing materials that may be available... the **rule is to master each of the materials used in training** and to ensure that they help to convey key messages more effectively than in their absence.

Materials to be delivered

CHAPTER 1 – ACCOUNTING AND CORPORATE FINANCE: FUNDAMENTALS

- Defining accounting and corporate finance
- Basic financial statements
- Importance and difference between cash flow and profit

CHAPTER 2 – FINANCE AND ACCOUNTABILITY PRINCIPLES

- Traditional organisational and financial structures
- Standardisation of financial accounting, core accounting principles
- Presentation of the income statement
- Gaap principles
- Corporate finance principles
- Consolidation principles

CHAPTER 3 – FINANCIAL ANALYSIS

- Financial diagnosis of the company
- Overall viability of a business
- Analysing, reviewing and interpreting of working capital and cash flow
- Understanding and interpretation of off-balance sheet commitments
- Understanding and interpretation of fixed cost and variable cost
- Break-even analysis, calculation
- Analysis of profit margin and profitability
- Analysis of working capital structure

CHAPTER 4 – FINANCIAL PROJECTION

- Key Performance Indicators (KPI), definition and types
- Forecasting methods
- Estimate sales and cost of sales
- Financial forecasting

CHAPTER 5 – VALUATION

- Business valuation, definition, uses
- Main valuation approaches and methods
- Weighted average cost of capital (WACC)
- Other valuation methods

Training leaflet

LEAFLET 1: Accounting and corporate finance: fundamentals 13

LEAFLET 2: Finance and accountability principles 19

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LEAFLET 1

Accounting and corporate finance: fundamentals

TRAINING OBJECTIVES

At the end of this training sequence, the participant must be able to:

- Understand the three basic accounting statements: balance sheets, income statement and cash flow statements.
- Appreciate the accounting equation: Assets = Liabilities + Owners' Equity.
- Understand the importance of cash to the business and how the cash flow statement can identify liquidity issues.
- Appreciate the difference in focus betweenthe accounting profession and corporate finance and how they provide different understanding.
- Recognise that the different accounting reports are relied on by financial analysts to assess current performance and make projections about future performance and profitability of a business.

KEY MESSAGES

1. Defining accounting and corporate finance, the accounting equation: definition and components, types of journals

- Accounting and corporate finance deals with financing, capital structure, and money management to help maximise returns and shareholder value.
- In corporate finance, free cash flows are considered a most important measure.
- Free cash flows examine how much money a company has available to distribute to investors, or reinvest, after all expenses have been covered.
- Corporate finance is the discipline that provides analysis for informed decision-making in financial situations.
- In accounting, insight into a firm's financial situation is gained through what is known as the 'accounting equation', **Assets = Liabilities' + Owners' Equity**.
- The accounting equation must be in balance and looks at what a company owns (its assets), what it owes (its liabilities), and the residual that belongs to shareholders (owners' equity).
- Assets can be classified into current assets and noncurrent assets.
- Current assets are typically what a company expects to convert into cash within a year's time.

- Noncurrent assets are long-term investments that a company does not expect to convert into cash in the short term.
- Liabilities can be classified as either current liabilities or noncurrent liabilities.
- Current agriculture is the main user of biodiversity (90% of European maize comes liabilities are typically those due within one year, which may include accounts payable and other accrued expenses.
- Shareholders' equity belongs to the shareholders, whether they are private or public owners.
- Paid-in capital is money the shareholders in the corporation invest in the business.
- Treasury stock is a company's own stock, which it buys back from other investors.
- Retained earnings is the company's total net income or loss from the first day it is in business to the date on the balance sheet.
- The first step in the accounting cycle is the Journal, which is the way that all business transactions are recorded or entered in accounting systems.
- Man users of financial information fall into two categories: internal (owners, management) and external (creditors, employees, investors, government, consumers, stock exchange).

2. Basic financial statements: definition, main types and uses

- Financial statements are reports designed to provide insight into the financial health and status of an organisation.
- Three main types of financial statements are: income statement or profit and loss statement, balance sheet, or statement of financial position and cash flow.
- An income statement is a summary of a company's profit or loss during any one given time period, such as a month, a calendar quarter, or one year.
- The income statement records all revenues for a business during the period under review, as well as the operating expenses for the business.
- The income statement is used to track revenues and expenses in order to determine the operating performance of the business over a reporting period.
- Income statement are used by potential lenders to determine credit limits and whether or not to award a loan.
- The balance sheet is a snapshot of the financial condition of a business at a specific moment in time, usually at the close of an accounting or reporting period.
- The balance sheet helps a small business owner quickly get a handle on the financial strength and capabilities of the business.
- Balance sheets can identify and analyse trends, particularly in the area of receivables and payables.
- Balance sheets are arranged in balance according to the accounting equation: Assets = Liabilities + Shareholders' Equity.

- Cash flow statements provide great insight into the financial condition of the business and a detailed picture of what happened to a business's cash during a specified period, known as the reporting period or accounting period.
- Cash flow shows cash inflows and outflows and an organization's ability to operate in the short and long term, based on how much cash is flowing into and out of the business.
- The cash flow statement helps to evaluate the current cash position, helps in applying for loans from banks and other financial institutions and impacts internal financial decisions.

3. How to prepare financial statements and their components

Income statements

- Components of an income statements: sales or revenue, gross profit, cost of goods sold (CGS), operating expenses, total expenses, net income.
- Sales represent the amount of revenue generated by the business.
- CGS represents the direct costs associated with growing the plants or flowers as well as producing any product for sale – an aggregate of all cost of goods.
- Gross profit is calculated by subtracting the cost of goods sold from net sales.
- Operating expenses are the daily expenses incurred in the operation of the business which are divided into two categories: selling and marketing expenses and general/ administrative expenses.
- Total expenses are a tabulation of all expenses incurred in running your business, exclusive of taxes or interest expense on interest income, if any.
- Profit is the balance that remains when a business' operating expenses are subtracted from its revenues which can be depicted as a positive or negative number.

Balance sheet

- Components of a balance sheet: assets, liabilities, and owners' or stockholders' equity.
- The balance sheet is divided into two sections: one section outlines a company's assets and the other outlines the company's liabilities and owners' equity.
- The reporting date and period of a balance sheet must be determined, the period can be quarterly or yearly; the reporting date can be the final date of the quarter or the year.
- Assets are subdivided into current and long-term or non-current assets to reflect the ease of liquidating each asset.
- A balance sheet will list assets in two ways: As individual line items and then as total assets.
- Line items under long-term assets include land, buildings, machinery, and vehicles that are used in connection with the business.

- Current and noncurrent assets should both be subtotaled, and then totaled together.
- Liabilities are subdivided into current and long-term liabilities.
- Line items under current liabilities include accounts payable, notes payable, accrued expenses, current portion of long-term debt, deferred revenue.
- Line items under long term liabilities include long term debt, deferred revenue, and long term lease obligations.
- Owners' or stockholders' equity is made up of the initial investment in the business as well as any retained earnings that are reinvested in the business.
- Owners' equity includes common stock or shares, preferred stocks and retained earnings.
- Total liabilities, including owners' equity, must equal the assets.
- Balance is obtained by totaling up all the assets of the business, subtracting all the liabilities except for owners' equity. The remaining amount is the owners' equity.

Cash flow

- The cash flow statement is broken into three sections: operating activities, investing activities and financing activities.
- The cash flow statement begins with the operating activities which are generated once the company delivers its regular goods or services and includes both revenue and expenses.
- Two common methods used to calculate and prepare the operating activities section of cash flow statements are the direct and indirect method.
- The direct method, take all cash collections from customers and subtract all the cash disbursements from the operating activities – payments to suppliers, cash paid for wages.
- The indirect method depends on the accrual accounting method in which the accountant records revenues and expenses at times other than when cash is paid or received.
- Investing activities include cash flow from purchasing or selling fixed assets such as physical property and non-physical property.
- Financing activities detail cash flow financing from issuing debt and equity securities coming from owners and lenders and also includes dividend payments and principal repayments.
- Cash flow is typically depicted as being positive or negative.
- A positive cash flow speaks to a company's ability to remain solvent and grow its operations.
- A negative cash flow indicates the business is spending more cash than it is receiving.

4. Importance and difference between cash flow and profit

- It is important to understand the metrics of both profit and cash flow and their differences to make key decisions on the financial health and performance of a company.
- The key difference is that while profit indicates the amount of money left over from revenue or fees earned after all expenses have been paid, cash flow indicates the net flow of cash received into and out of a business.
- Cash flow is reported in the cash flow statement while information about a company's profit is reported in its income statement.
- A company can be profitable and have a negative cash flow hindering its ability to pay its expenses, expand, and grow.
- A company with positive cash flow and increasing sales may fail to make a profit, as is the case with many startups and businesses scaling up.

PERSONAL NOTES AND MEDIA USED

LEAFLET 2

Finance and accountability principles

TRAINING OBJECTIVES

At the end of this training sequence, the participant must be able to:

- Identify the traditional organisational and financial structures and understand their differences.
- Know the major international financial and accounting conventions underpinning preparation of the financial statements.
- Understand and value of ratio analysis and how it assists in assessing the profitability and short and long-term viability of a company.
- Appreciate the value of including discounted cash flow for greater effectiveness in appraising the valuation of an income-producing project.

KEY MESSAGES

1. Traditional organisational and financial structures, definition, types and differences

- Organisational structure is simply the framework within which tasks are coordinated and allocated and is the very foundation of a company, defining operational procedures.
- There are three key forms of business organisational structures: sole proprietorships, partnerships, and Corporations/Limited Liability Company.
- Each structure has characteristics providing pros and cons related to possible funding options to acquire the assets and operate the business.
- Sole Proprietorships are the simplest form of business ownership for any sole owner.
- Partnerships are comprised of at least two persons, intent on doing business for profit together, and equally share management duties and profits or losses.
- Corporation or Incorporated (Inc.) Company is a company which is incorporated, is limited by shares, which separates the ownership from the company.

2. Standardisation of financial accounting, core accounting principles and conventions

- International Financial Reporting Standards (IFRS) succeeded the International Accounting Standards Board (IASB) as the independent international standard-setting body based in London.
- The IASB recommendations have been principles-based to have relevance to various countries with different jurisdictions.
- In the United States, the Financial Accounting Standards Board (FASB) is the body supporting US Generally Accepted Accounting Principles (GAAP).
- These bodies continue to collaborate to harmonise their policies with an objective of the standardisation of disclosure requirements to facilitate the comparability and improved reliability of financial reports.
- The policies issued by these accounting bodies cover aspects such as recognition, presentation, measurement and disclosure of accounting transactions and events reported in financial statements.
- The core accounting principles of relevance to MSMEs include understandability, comparability and relevance, accrual basis of accounting, comparability and frequency of reporting, consistency and presentation, and monetary unit principle.

3. Presentation of the income statement

- There are two types of the presentation method of the income statement: The Single Step Income Statement and The Multi-Step Income Statement.
- The Single Step Income Statement is a simple approach which takes total revenues and subtract total expenses, to find the bottom line.
- The Multi-Step income statement shows several steps to the bottom line, starting with the gross profit from which operating expenses are deducted to yield income from operations. Added to the net income from other revenues and other expenses provides income before taxes. The final step is to deduct taxes, which produces net income for the period under review.
- The Single Step Income Statement does not calculate the gross profit of the business. For this reason, most businesses use the multi-step income statement format.

4. GAAP principles

- Single Entry principle states that all financial statement and records are distinct from its owners or other business.
- Monetary unit principle – all transaction should be recorded in a single curreny.
- Specific time period – all the financial statements have a start date and an end date.
- Recognition principle – company should record the revenue and costs as an when they occur and not when cash is received/paid.
- Going concern principle – as per this principle, it is assumed that business has no end date.

- Full disclosure principle – every company must make full disclosure of its information.
- Matching principle – a company should report an expense in the period in which it earns the corresponding revenue.
- Conservative principle - a business should provide for all expenses and losses but shall never anticipate any gain or profit.
- Historical cost principle – the accounting posting should be made at the amount of actual price payment.

5. Corporate finance principles

- Corporate finance principle are investment, financing and dividend principles.
- Investment principle involves the most efficient use of funds and making investments that return the minimum tolerable hurdle rate and provide the best decision for the company's long-term benefit.
- The investment decisions should result in revenue opportunities and savings for the future.
- Financing principle is concerned with achieving the right mix of debt, equity capital.
- Divinded principle as businesses generate excess returns the company needs to determine ways of rewarding owners.
- This entails determining the appropriate allocation between payout rate to the investors and how much to reinvest in the business.

6. Consolidated methods

- Many corporations are comprised of several separate companies and are therefore required to prepare consolidated financial statements.
- Consolidation is required when a corporation owns and controls a majority or 50% interest another corporation's outstanding common stock.
- The accounting principles applied in the preparation of the consolidated financial statements are the same accounting principles applied in preparing separate-company financial statements.
- Each individual company maintains its own accounting records, but consolidated financial statements are needed to present the companies together as a single economic entity for general-purpose financial reporting.
- The consolidation process adds together the financial statements of two or more legally separate companies, creating a single set of financial statements.

PERSONAL NOTES AND MEDIA USED

LEAFLET 3

Financial analysis

TRAINING OBJECTIVES

At the end of this training sequence, the participant must be able to:

- Recognise the importance of the financial statements as a source document to diagnose the financial health of a company.
- Appreciate how past performance, when used together with the current financial situation, can be useful to make projections.
- Understand why accounting data and ratio analyses of Income Statement, Balance Sheet and Cash flow, when compared to past periods and similar businesses to benchmark performance, can indicate profitability and short and long-term viability.
- Use benchmarking to other similar companies and industry trends to assess the overall viability of a firm.
- Measure a firm's liquidity, overall viability, or insolvency.
- Recognise that validation is necessary to improve the likelihood of a successful entrepreneurial pursuit and to make sure that the business idea is financially viable.
- Know what is required and how to approach the data gathering and preparation of a business plan to evaluate whether the business is sustainable and can support itself financially into the future.
- Identify Key Performance Indicators (KPIs) that guide entrepreneurs or business managers in the monitoring of profitability, liquidity, sustainability, and strategic action.

KEY MESSAGES

1. Financial diagnosis of the company, importance, objectives, ratio analysis

- The financial diagnosis of companies is important to all stakeholders whether internal or external to the company and each stakeholder comes with a different perspective.
- The aim is to detect possible situations of financial uncertainty, to identify the origin and cause for any concern or disequilibrium, which will have to be solved or addressed.
- The objective is to track a company's financial capacity to generate profit and its capacity to honour long and short-term obligations when they fall due.

- Ratio analysis makes it possible for more meaningful analysis of financial statements.
- The more commonly used financial ratios fall into the following five categories: liquidity, treasury or activity, solvency or debt, profitability, and market ratios.
- Treasury or activity ratios measure treasury management and how a firm manages its assets in their conversion of purchases and raw material into sales and cash and how it manages the accounts payable.
- Market ratios are used to evaluate the publicly traded companies and identify attractive, undervalued stocks and those that may be overvalued to be avoided or sold.
- Profitability ratio relate to a firm's earnings to sales, assets or equity.
- Liquidity is the measure of a firm's ability to meet short-term obligations as they come due.
- Solvency or leverage ratios measure going concerns by the extent of the firm's assets coverage of commitments for future payments to creditors, bondholders, and banks – debt to equity ratios, equity ratio and debt ratio and debt service coverage ratio.

2. Overall viability of a business

- Overall viability is the sizing up of a business' ability to start, grow and survive.
- Viability is linked to profitability and sustainability over the long term.
- Use of liquidity, solvency, profit, and operational data, as applies, are useful to assess the overall viability of a business after comparing to prior performance and benchmarking to other similar companies and industry trends.
- The process involves the same steps taken to create a comprehensive strategic and business plan.
- Probably the most important factor that makes a business viable, in addition to the marketing strategy, is a continuing focus on the financial status of the business.
- A sustainable and profitable business will be creating a tremendous asset and building a business for the long term.

3. Analysing, reviewing and interpreting financial reports

- Each user of financial statements has a focus area of interest for the analysis, whether an existing or potential investor, creditor, supplier, or employee.
- Financial statement analysis informs of the financial position, operating results, and cash flow.
- From balance sheet data, you can evaluate whether the business is able to meet financial obligations and the level of indebtedness.
- Balance sheet analysis of a company, combined with data from other related financial statements, provide a comprehensive basis for strategy formulation and action.

- The balance sheet review begins with being satisfied with the accuracy of the report, including whether it is a qualified report, if audited, which would indicate that the going concern concept is in question.
- Confirm that the report is in balance: Assets=Liabilities + Equity.
- Then review the numbers as compared with the comparative period to see if there has been any significant change and analyse the reasons for the movement.
- The main conventions relating to the balance sheet include business entity, historic cost, prudence, going concern and double entry accounting.
- Like a balance sheet, an income statement is a means for measuring a company's financial performance.
- The income statement shows a company's profit and loss over a period of time: revenue, expenses and profit.
- The profit or loss is determined by taking all revenues and subtracting all expenses from both operating and non-operating activities.
- Information from the income statement can give information on operational efficiency.
- Anallyse trend in the available historical data to create drivers and assumptions to forecast future values.

4. Understanding and interpretation of working capital and cash flow

- Working capital is a snapshot of the current assets less current liabilities of the company.
- It is also the capital necessary for the company to operate.
- It requires a certain amount of cash on hand to cover unexpected costs, make regular payments and buy raw materials used in production.
- Working capital reflects various company activities, such as current liabilities and current portion of long-term liabilities, revenue collection, payments to suppliers and inventory management.
- The length of the working capital cycle is the time it takes to convert the total net working capital (current assets less current liabilities) into cash.
- Businesses typically try to manage working capital cycle by selling inventory quickly, collecting revenue from customers quickly, and paying bills slowly to optimize cash flow.
- The cash flow statement discloses how a company raised money and how it spent those funds during a given period.
- Cash flow analysis is intended to identify the amount of funds a company's daily operations generate, thereby showing whether this amount is sufficient to cover financial obligations.
- The cash flow analysis is also a good way of seeing the relationship that exists between major outflows of cash going toward financial obligations and major inflows of cash coming from.

- As an outgrowth of conducting a cash flow analysis, a business should be able to detect whether its combined inflows and outflows yield a positive cash flow or a negative deficit.
- If a company is consistently bringing in more cash than it spends, that company is considered to be of good value.

5. Understanding and interpretation of off-balance sheet commitments

- Off-balance sheet (OBS) is a term for accounts that do not appear on a company's balance sheet although they contain assets and liabilities for which the company is accountable.
- OBS are used to share risks and benefits with other companies, as in the case of joint venture (JV) projects.
- Companies must disclose off-balance sheet financing (OBSF) in disclosures in qualitative and quantitative reporting in footnotes of financial statements.
- There are several ways to structure off-balance sheet items: operating lease and accounts receivable.
- OBS operating lease is one in which the lessor retains the leased asset on its balance sheet.
- The company leasing the asset only accounts for the monthly rental payments and other fees associated with the rental rather than listing the asset and corresponding liability on its own balance sheet.
- At the end of the lease term, the lessee generally can purchase the asset at a drastically reduced price.
- Accounts receivables represent a considerable liability for many companies.
- This asset category is reserved for funds not yet been received from customers, so the possibility of default is high.

6. Understanding and interpretation of fixed cost and variable cost

- Business expenses (*i.e.* costs) are generally categorized either as fixed or variable and need to be understood and managed by business owners and or management.
- Fixed costs do not change even when the company's sales volumes or production levels increase.
- Especially for start-ups, these expenses must be met from cash flow or cash equivalents.
- Fixed expenses are usually long-term commitments such as rental of property and equipment lease to manufacture products or deliver services.
- Variable costs are not independent of the company's activities and must be considered when setting prices.

7. Break-even analysis, calculation

- Once the fixed and variable costs for the product are determined, then with that information it is possible to calculate the company's breakeven point.
- Small business owners also use the calculation to determine how many product units they must sell at a given price point to break even.
- Break-even analysis is only reliable if costs are fixed within a specified production level.
- Calculating the breakeven point is just one component of cost-volume-profit analysis, but it is often an essential first step in establishing a sales price-point that ensures a profit.
- No matter how a company expresses its break-even point, it is still the point of zero income or loss.
- The break-even point formula is calculated by dividing the total fixed costs of production by the price per unit less the variable costs to produce the product.

8. Analysis of main KPIs

- The quick ratio or acid test ratio is a liquidity ratio that measures the ability of a company to pay its current liabilities when they come due with only quick assets.
- The higher the quick ratios, the more favorable for the company because it shows there are more quick assets than current liabilities.
- EBITDA, which stands for Earnings Before Interest, Taxes, Depreciation, and Amortization, is a financial calculation that measures a company's profitability before deductions that are often considered irrelevant in the decision-making process.
- EBITDA is the net income of a company with certain expenses like amortization, depreciation, taxes, and interest added back into the total.
- Like all profitability measurements, higher numbers are preferred over lower numbers because higher numbers indicate the company is more profitable.
- The EBITDA margin takes the basic profitability formula and turns it into a financial ratio that can be used to compare all different sized companies across and industry.
- The EBITDA margin formula divides the basic earnings before interest, taxes, depreciation, and amortization equation by the total revenues of the company – thus, calculating the earnings left over after all operating expenses (excluding interest, taxes, dep, and amort) are paid as a percentage of total revenue.
- EBITDA/Liabilities ratio is a specialized ratio that compares the financial stability of a company and its liquidity position.
- Interest coverage ratio is a financial ratio that measures a company's ability to make interest payments when due.
- This liquidity ratio has nothing to do with being able to make principle payments on the debt itself, only the firm's ability to afford the interest on the debt.

- Investors are concerned about seeing investments in the company appreciate based on profits and operational efficiencies and that the company can pay its bills on time without having to sacrifice its operations and profits.
- Creditors use the interest coverage ratio to identify whether a company can support additional debt. If a company cannot afford to pay the interest on its debt, it would be a poor credit risk.

9. Analysis of main KPIs

- Profit margins are useful for determining and then comparing the profits as a percentage of revenue earned, after subtracting expenses.
- This can then be compared to the profit margin analysis of peers.
- There are three main profit margin percentages, including: gross profit margin, operating profit margin and net profit margin.
- These three different percentages provided insight into the business's profitability, and comparability to competitors.
- Gross profit margin shows the amount of profit the business makes on its cost of goods sold (CGS).
- The gross margin reflects how efficiently the business uses labor and supplies in the production process.
- Gross Profit Margin = (Sales – CGS) / Sales.
- Operating profit margin compares earnings before interest and taxes (EBIT) to sales.
- Operating Profit Margin = EBIT / Sales.
- Net profit margin compares net income and sales.
- A higher net profit margin means a more efficient conversion of sales into actual profit.
- Net Profit Margin = Net Profit/Sales.
- Conducting a profit margin analysis can help to grow the business and demonstrate to investors that the business is a worthwhile investment.
- Profit margin analysis can be used in conjunction with other profit ratios such as the Return on Equity (ROE) or Return on Assets (ROA).
- ROE is a basic test of how effectively a company's management uses investors' funds.
- It shows whether management is growing the company's value.
- ROE is calculated as: ROE= Annual Net Income/Average Shareholders' Equity.
- ROA reveal how much profit a company earns for every dollar of its assets.
- Assets include things like cash in the bank, accounts receivable, property, equipment, inventory, and furniture. It is calculated as: ROA = Annual Net Income/Total Assets.
- The financial leverage or debt separates ROE and ROA.
- Together ROA and ROE provide a clear picture of management's effectiveness at managing leverage risk and generating returns from shareholders' investments.

10. Analysis of working capital structure

- The more working capital, the less financial difficulties a company should have.
- WC = Current assets – Current liabilities.
- It measures a company's operational efficiency and short-term financial health.
- The working capital cycle demonstrates the process of using working capital to pay suppliers and other short-term obligations.
- The finished goods are then sold to customers, primarily on credit.
- Accounts receivable and debtors must be managed, and outstanding amounts need to be collected and banked.
- Useful management tools for following up on accounts receivable is the Flash Report and the Accounts Receivable Ageing Report.
- Ratios such as efficiency ratio, working capital ratio, asset turnover ratio help to improve the company's operations management.

PERSONAL NOTES AND MEDIA USED

LEAFLET 4

Financial projection

TRAINING OBJECTIVES

At the end of this training sequence, the participant must be able to:

- Understand financial forecast and the different methods of forecasting.
- Distinguish between the total market (TAM) and the potential target market (SAM).
- Understand that financial information, from the company and from the competition or the industry, and economic indicators are important considerations in the preparation of business plans and financial projections.
- Understand To know the management methods and risks related to organic fertilizers.
- Understand the use of financial information to create growth targets, budgets, and revenue projections.

KEY MESSAGES

1. Key Performance Indicators (KPI), definition and types

- There are financial KPIs, operational KPIs, sales KPIs, each measure will be unique to the business and should be a S.M.A.R.T. objective that reflects one of the more important elements of the business.
- There are different types of KPIs. Two types are Financial and Growth KPIs.
- Financial KPIs measures the bottom line of the business: financial success. This could be revenue, net income, cash flow, the health of a business's balance sheet, or something more specific.
- Growth KPIs include overall revenue growth, new customers., or a range of other metrics.
- Customer KPIs are based on regular surveys, or the number of repeat purchases, levels of customer engagement with your products or apps, interactions on social media, among others.
- Leading indicators are measurable facts that that which has happened and is relied on to forecast a particular outcome or are used to predict or influence future performance.
- Lagging indicators measure what has already happened or used to determine the result of past performance.

2. Forecasting of organic matter and amendments

- The objective of business forecasting is not only to determine the trend, but also to make analysis based on definite statistical data, which will enable the firm to take advantage of future conditions.
- In financial forecasting, future estimates are made through preparation of projected financial statements – projected income statement, projected balance sheet, projected cash flow and funds flow statements, using ratios and other analytic tools.
- Other forecasting methods include days sales, percentage of sales and regression analysis methods and projected cash flow, income statement and balance sheet.
- Day sales method is used to forecast sales by calculating the number of days sales and establishing its connection to balance sheet items to arrive at the forecasted balance sheet. This technique is useful for forecasting funds inflow to the company.
- Percentage of sales method is used method in estimating financial requirements of the firm based on forecast of sales.
- Simple regression analysis methods provide estimates of values of the dependent variable from values of independent variable. For financial forecasting purpose, sales are taken as an independent variable and then values of each item of asset (dependent on sales) are forecasted.
- Multiple regression analysis is a further application and extension of the simple regression method with sales assumed as a function of several variables. This computation requires use of computer programs.
- The projected financial statements are based on forecast of sales and anticipated expenses for the period under estimation.
- Benefits of financial forecasting include but are not limited to providing basic and necessary information for setting company objectives and for preparation of financial plans; acting as a performance benchmark for firm's financial discipline; providing information for decision-making about the business and projecting fund requirement and its utilisation.

3. Estimate sales and cost of sales

- Calculating the estimated sales begins with identifying the total available market (TAM) which is the total size (people, revenues, units) of the market with the problem the product is intended to resolve. SAM (Served Available Market) is that part of the TAM who can use the solution to the problem.
- Business potential can be determined by using market analysis and competitor information to estimate the potential market share and growth expectations and use to project capital and operational expenses.
- The most important factor to consider for market potential, is the market size of your product.
- Competitive assessment of the opportunity for success with the new product requires knowledge and understanding of the customer, and the key competitors and their value propositions.

- To determine market potential, it is important to understand the competitive landscape.
- Determining market potential includes understanding the likelihood that the product will be accepted and the hurdles to be overcome.

4. Financial forecasting

- Financial forecasting is a dynamic process that should be revisited at least quarterly, or whenever a major event takes place.
- The recommended approach for financial forecasting is to use key financial ratios, that investors and lenders use to evaluate the financial statements. Two such ratios are: quick ratio and gross profit margin.
- Quick ratio also known as the acid-test ratio, measures the ability of a business to use its most liquid assets to cover its current liabilities. A low quick ratio is a red flag that a cash crunch could be a major stumbling block for a business.
- Gross profit margin ratio measures the efficiency of a business in using its raw materials, labor, and manufacturing-related assets to generate the bottom line.
- The gross profit margin is a useful test for the best-case scenario.
- A gross margin that makes a dramatic jump from the regular scenario to the best-case scenario could be an indication that the estimates are not conservative enough – the costs may be too low.
- There are several other financial ratios, but it is appropriate to use ones that make the most sense to the operation and are of most interest to the investors and lenders. These ratios can be used to assess company performance on an ongoing basis.
- There are several strategic tools to help focus on market related decision and to further guide the decisions – Michael Porter's Five Forces Model and PESTLE analysis, which help determine threats and opportunities from outside forces, such as political or economic change.

PERSONAL NOTES AND MEDIA USED

LEAFLET 5

Valuation

TRAINING OBJECTIVES

At the end of this training sequence, the participant must be able to:

- Understand the concept of business valuation.
- Understand the difference between enterprise value and equity value.
- Learn how to calculate various equity and enterprise value multiples.
- Identify the different valuation methods.
- Understand a business weighted average cost of capital (WACC).
- Be able to calculate WACC.

KEY MESSAGES

1. Business valuation, definition, uses, types of values

- Business valuation is the process by which the economic worth of a company is determined. It is required when selling a business, looking to merge or acquire another company, certain tax purposes, looking for business financing or investors.
- Business valuation values assets that the company owns and management structure, projected earnings, share price and revenue are factors.
- In corporate finance, the most common types of value are equity and enterprise value.
- Enterprise value is the sum of a company's market capitalization and its debts, minus the cash and cash equivalents it holds.
- Enterprise value accounts for a company's current stocks, debt and cash.
- Equity value uses the same calculation as enterprise value, but it adds in stock options, convertible securities, and other potential assets and liabilities.
- Equity considers factors that may not currently impact a company but can at any time. It reveals a company's potential future value and its growth potential.
- Enterprise value provides investors with a fast and easy way to estimate a company's value, while equity value helps company owners and shareholders shape future decisions.

2. Main valuation approaches and methods

- Three main approaches used in valuation are intrinsic, comparative and cost approach.
- Each of these principal valuation approaches includes different detailed methods of application.
- Intrinsic approach is derived from the discounted cash flow based on present value of future cash flows or benefits, based on projections and assumptions.
- Comparative approach uses the comparable company analysis (or "comps" for short) which is the use of values and ratios of similar companies to derive the value of another business. Comps is a relative form of valuation.
- Cost approach is based on the book value or replacement value.
- Intrinsic approaches include different business valuation methods of application such as Asset-Based Valuation Method, ROI-Based Valuation Method and the Discounted Cash Flow (DCF).
- The asset-based business valuation method uses the balance sheet, to determine the company's worth, based on the business's total net asset value, minus the value of its total liabilities.
- ROI-Based Valuation Method evaluates the value of your company based on the company's profit and the return on investment (ROI) an investor could potentially receive for buying into the business.
- The discounted cash flow valuation method, also known as the income approach, values a business based on its projected cash flow, adjusted (or discounted) to the present value.
- The DCF method can be particularly useful if profits are not expected to remain consistent in the future.
- Comparative approaches include different business valuation methods of application such Book value method, trading comparables method and precedent transactions (Comparative method).
- The book value method calculates the value of the business at a given moment in time by looking at the balance sheet. This approach may be particularly useful if the business has low profits, but valuable assets.
- Comparable company analysis (also called 'trading multiples' or 'peer group analysis' or 'equity comps' or 'public market multiples') is a relative valuation method in which the current value of a business is compared to other similar businesses by looking at trading multiples like Price/Earnings (P/E), (EV/EBITDA), or other ratios.
- Multiples of EBITDA are the most common valuation method.
- Precedent transactions analysis is another form of relative valuation that compare the company in question to other businesses that have recently been sold or acquired in the same industry.

3. Weighted average cost of capital (WACC): an investment tool, definition and uses

- Investors use WACC as a tool to decide whether to invest or not.
- The WACC represents the minimum rate of return at which a company produces value for its investors.
- Securities analysts employ WACC when valuing and selecting investments.
- WACC is used as the discount rate to calculate the net present value of a business.
- It can be used as a hurdle rate against which to assess the return on investment or ROI.
- The purpose of WACC is to determine the cost of each part of the company's capital structure (**Capital Structure = Debt + Equity**).
- A healthy capital structure that reflects a low level of debt and a high amount of equity is a positive sign of investment quality.
- Capital structure is a permanent type of funding that supports a company's growth and related assets.
- To calculate WACC, investors need to determine the company's cost of equity and cost of debt which together are the components required to arrive at the WACC.
- If an investment opportunity has a lower Internal Rate of Return (IRR) than its WACC, it should buy back its own shares or pay out a dividend instead of investing in the project.

4. Other valuation methods

- In corporate finance, a leveraged buyout (LBO) is a transaction where a company is acquired using debt as the main source of consideration.
- Break-up analysis or sum of parts valuation is an approach to valuing a firm by separately assessing the value of each business segment or subsidiary and adding them up to get the total value of the firm. It can be used in conjunction with various valuation techniques.

PERSONAL NOTES AND MEDIA USED

Summary of the manual

Accounting & corporate finance

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1. DEFINITION OF ACCOUNTING AND CORPORATE FINANCE

Accounting and corporate finance deals with financing, capital structure, and money management to help maximise returns and shareholder value. In accounting, insight into a firm's financial situation is gained through what is known as the 'accounting equation', which is: Assets = Liabilities + Owners' Equity. This accounting equation must be in balance and looks at what a company owns (its assets), what it owes (its liabilities), and the residual that belongs to shareholders (owners' equity). The accrual basis is used to record accounting entries in the accounting system. The first step in the accounting cycle is the Journal, which is the way that all business transactions are recorded or entered in accounting systems.

Unlike accounting's reliance on transactional data, finance looks at how effectively an organisation generates and uses cash. Corporate finance is the discipline that provides analysis for informed decision-making in financial situations, such as the decision to raise capital, consider whether to merge or buy another company or whether to issue debt.

The process of recording and classifying financial transactions is to maintain records of a business's financial activities to create a useable summary of financial transactions. This provides a snapshot of the business's financial stability. Financial records should be centralized for easy retrieval as needed to respond to queries regarding audit and tax obligations and to manage debtors and creditors.

2. BASIC TYPES OF FINANCIAL STATEMENTS

The process of recording and classifying financial transactions is to maintain records of a business's financial activities to create a useable summary of financial transactions. Financial statements are reports designed to provide insight into the financial health and status of an organisation. Investors can better understand whether to invest in a company; business owners or entrepreneurs, are able to assess business performance and adjust key initiatives or strategies; and managers can more effectively manage budgets, oversee their team, and develop closer relationships with leadership – leading ultimately to playing a larger role in the business. The main types of financial statement are:

- income statement;
- balance sheet;
- cash flow.

An income statement is a summary of a company's profit or loss during any one given time period, such as a month, a calendar quarter, or one year. The income statement records all revenues for a business during the period under review, as well as the operating expenses for the business.

Components of an income statement include sales, cost of goods (CGS), gross profit, operating expenses.

The income statement is used to track revenues and expenses so that you can determine the operating performance of the business over a reporting period. Small business owners use these statements to find out which areas of their business are over or under budget. It can be used to pinpoint specific items that are causing unexpected expenditures or supply expenses. Income statements can also track dramatic increases in product returns or cost of goods sold as a percentage of sales and can be used to determine income tax liability.

The balance sheet or statement of financial position, contains the most important financial information about your business as it communicates an organization's worth, or 'book value'. A balance sheet is a snapshot of the financial condition of a business at a specific moment in time, usually at the close of an accounting period. The balance sheet comprises assets, liabilities, and owners' or stockholders' equity. Assets and liabilities are divided into short- and long-term obligations, including cash accounts such as checking, money market, or government securities.

A balance sheet helps a small business owner quickly get a handle on the financial strength and capabilities of the business. Analysts see how a company is performing, as at the balance sheet date and can predict how it is poised to perform in the immediate future. This makes balance sheets an essential tool for individual and institutional investors, as well as key stakeholders within an organization and any outside regulators. Balance sheets can identify and analyse trends, particularly in the area of receivables and payables.

Cash flow statements are one of the most critical financial documents that an organization prepares, providing great insight into the financial condition of the business. Knowing how to read and understand a cash flow statement can enable you to extract important data about the financial health of a company. The cash flow statement is typically broken into three sections: Operating activities; Investing activities; and Financing activities. Positive cash flow indicates that a company has more money flowing into the business than out of it over a specified period. Negative cash flow means your cash outflow is higher than your cash inflow during a period, but it does not necessarily mean profit is lost.

It is important to note that cash flow is different from profit, which is why a cash flow statement is often interpreted together with other financial documents, such as a balance sheet and income statement.

The main groups that use financial information presented in financial statements are internal users and external user. Internal Users are owners and management. External users are creditors, employees, investors, government, consumers and the stock exchange. Users base their expectations of returns on their assessment on:

- the amount, timing, and uncertainty of future net cash inflows to the entity;
- management's stewardship of the entity's resources;
- qualitative characteristics of financial information.

3. FINANCE AND ACCOUNTABILITY PRINCIPLES

Organisational structure is simply the framework within which tasks are coordinated and allocated. An organizational structure is the very foundation of a company, defining operational procedures. There are three key forms of business organisational structures:

- sole proprietorships;
- partnerships;
- corporations/limited liability company.

Sole proprietorships are the simplest form of business ownership for any sole owner. It is easy to set up and requires no formal procedures, unless a special license is required. Many new businesses start out as sole proprietorships but as the business grows and becomes more complex then this form of structure limits access to funding for expansion as the unlimited company continues to rely on the credit worthiness of the owner who is named as the responsible party for any credit facilities and with unlimited liability.

Partnerships are comprised of at least two persons, intent on doing business for profit together, and equally share management duties and profits or losses. Sometimes called a general partnership, the partners manage and control the business and share the burden of ownership. All revenues from the business flow directly through to the partners. Partners are personally liable for all debts and any liabilities that result from the operation of the business, meaning liabilities are not capped and can be paid through the seizure of an owner's assets.

Corporation or incorporated (Inc.) company, a company which is incorporated is limited by shares, which separates the ownership from the company. The shareholders have no personal liability for debts incurred by the business and the structure is designed to separate the business assets of the company from the personal assets of the owners. In case of a default, owners as shareholders have their investment in the company, which is the extent of their exposure to the company. Shareholders are insulated from personal responsibility for the debts and liabilities of the company.

Each structure has characteristics providing pros and cons related to possible funding options to acquire the assets and operate the business. Ultimately the type of business organisation selected comes down to the owners' level of concern over management control, liability exposure, tax issues, and business transfer issues.

Corporate finance is primarily focused on maximizing shareholder value while minimizing risk.

The decisions involve identifying the sources of capital, determining the most efficient use of the company's funds and the best way to reward owners and investors. It is essential for any business to determine "sources of funds, expansion of business, planning the future course of actions, managing finance, and assuring healthy profitability and economic viability". This may be broken out into core principles: Investment, Financing and Dividend principle.

International Financial Reporting Standards (IFRS) succeeded the International Accounting Standards Board (IASB) as the independent international standard-setting body based in London. As other countries have followed the lead of the EU, globally, companies have adopted international accounting standards (IAS) issued by the IASB. The IASB recommendations have been principles-based to have relevance to various countries

with different jurisdictions. In the United States, the Financial Accounting Standards Board (FASB) is the body supporting US GAAP. The policies issued by these accounting bodies cover aspects such as recognition, presentation, measurement and disclosure of accounting transactions and events reported in financial statements. Among the objectives is the standardisation of disclosure requirements to facilitate the comparability of financial statements and improved reliability of financial reports.

Financial statements include a statement of financial position (balance sheet); a statement of comprehensive income – this may be presented as a single statement or with a separate statement of profit and loss and a statement of other comprehensive income; a statement of changes in equity; a statement of cash flows; notes, including a summary of the significant accounting policies and comparative information is required for the prior reporting period. IFRS approved financial statements use the accrual basis in preparation and are derived from collecting, analysing and communicating financial information. Most MSMEs do not have in-house resources to ensure that their financial statements are prepared in compliance with IFRS.

Financial statements are of a great significance for owners and management to know the solvency, profitability and capital structure of the firm. The management of the business wants to know how well their decisions are doing which will be reflected in the position of the firm. The accounts are the basis, on which the management can study the merits and demerits of the business activity. The financial statements also assist to determine the future course of action for the business and whether the assumptions made about the business and industry are realistic.

The core accounting principles of relevance to MSMEs include comparability and relevance, understandability, accrual basis of accounting, comparability and frequency of reporting, consistency of presentation and monetary unit principle.

The objective of the GAAP principles is to improve transparency. However, there is no guarantee that the financial statements of the companies following these principles are free from errors and omissions (both intentional and unintentional).

Many corporations are comprised of several separate companies and are therefore required to prepare consolidated financial statements. Consolidation is required when a corporation owns and controls a majority or 50% interest another corporation's outstanding common stock. The accounting principles applied in the preparation of the consolidated financial statements are the same accounting principles applied in preparing separate-company financial statements. Each individual company maintains its own accounting records, but consolidated financial statements are needed to present the companies together as a single economic entity for general-purpose financial reporting.

4. FINANCIAL ANALYSIS

The financial diagnosis of companies is important to all stakeholders whether internal or external to the company and each stakeholder comes with a different perspective. Internal financial diagnosis will be done by managers, shareholders, and employees. Persons external to the company will also be interested in the financial well-being of the organisation. These include financial analysts, potential shareholders, banking or financial organisations or the regulators. The objective is to track a company's financial capacity to generate profit and its capacity to honour long and short-term obligations when they fall due. Oftentimes, the need to make comparisons with other similar businesses and the industry, aids in contextualizing the financial findings in relative terms. Ratio analysis makes this possible for more meaningful analysis of financial statements. The more commonly used financial ratios fall into five categories: liquidity, treasury or activity, solvency or debt, profitability, and market ratios. Each of these categories speaks to the area of focus for the review.

Treasury or activity ratios measure treasury management and how a firm manages its assets in their conversion of purchases and raw material into sales and cash and how it manages the accounts payable. Inventory turnover measures how quickly a firm sells its products. Inventory turnover = cost of goods sold/inventory.

Market value ratios are used to evaluate the publicly traded companies and identify attractive, undervalued stocks and those that may be overvalued to be avoided or sold. The more popular ratios include earnings per share, book value per share, and the price-earnings ratio. Others include dividend yield ratio, market value per share, and the market price/book ratio. Each has its application, but together will paint a picture of the financial health of the company using the market information.

Profitability ratio relate to a firm's earnings to sales, assets or equity. Profitability ratios are among the most watched financial ratios.

Liquidity is the measure of a firm's ability to meet short-term obligations as they come due. This is a leading indicator of cash flow problems and insolvency. The basic measures of liquidity are the current ratio and the quick or acid test ratio. The current ratio is current assets divided by current liabilities (current ratio = current assets / current liabilities.

Solvency or leverage ratios measure going concerns by the extent of the firm's assets coverage of commitments for future payments to creditors, bondholders, and banks – debt to equity ratios, equity ratio and debt ratio and debt service coverage ratio. These measure the extent to which a firm uses credit rather than stockholder's equity to finance operations. The higher the leverage the higher the risk of default on debt repayment. The riskier the company then the higher the return investors will require on the company's securities. These ratios use book values for the debt, equity and assets and not market values.

Overall viability is the sizing up of a business' ability to start, grow and survive. Whether the business is established, or an entrepreneur has the intention to establish a business, it is prudent to take stock of the strategic objectives and review factors such as the target markets, competition, sourcing and overall financial potential. Viability is linked to profitability and sustainability over the long term. Use of liquidity, solvency, profit, and operational data, as applies, are useful to assess the overall viability of a business after comparing to prior performance and benchmarking to other similar companies and industry trends. The process involves the same steps taken to create a comprehensive strategic and business plan. The Balance Small Business site describes viability as "a two-part process. First, it means creating a marketing strategy by knowing who you are, who

you are selling to, and who else is selling to them. Second, it means having your business financial house in order". This requires research and analyses, and desk, secondary research, and empirical research, to determine and answer strategic questions related to: market selection and segmentation, distribution channel selection, product development, new product launch/test market, the pricing policy, competitor analysis, promotional plan and logistics.

A company or project's break-even point is a valuable benchmark that helps to develop long-term business plans. Knowing your break-even points for key areas like sales, investment repayments, production and operations helps you determine pricing of products, debt servicing and other operational aspects of your business. If you know your break-even points, it is easy to see the effect of different business strategies.

The nature and range of information to be derived from a set of financial statements will depend on the nature of the business, the level of detail available in the financials to complete an analysis and the characteristics of the industry of which the business is a part. Financial statement analysis informs of the financial position, operating results, and cash flow. This allows the user to determine the capital structure, "solvency analysis, profitability analysis and operational capability analysis that we need to do constitute the general framework for financial statement analysis". Financial statements for publicly traded companies are required to be prepared in accordance with International Accounting Standards and if the companies do business in the United States then their financials must comply with generally accepted accounting principles (GAAP).

Balance sheets also called statement of financial position, present the financial position of a company at a point in time. The required format separates assets from liabilities and stockholders' equity. From balance sheet data, you can evaluate whether the business is able to meet financial obligations and the level of indebtedness. The prior year or period comparative is also provided. By comparing the current reporting period, with preceding ones, the user can determine trends – positive or potential financial problems on the horizon, which are the basis for decision-making. Balance sheet analysis of a company, combined with data from other related financial statements, provide a comprehensive basis for strategy formulation and action.

The income statement also called statement of profit or loss, mainly tells us what the revenue was for the period and the expenses incurred. The profit or loss of the company is what is left over after all expenses. Profit or loss for the period = total revenue for the period less total expenses incurred in generating the revenue. Like the balance sheet, an income statement is a means for measuring a company's financial performance. Financial analysis of an income statement can reveal that the costs of goods sold are falling, or that sales have been improving, while return on equity is rising. Income statements are also carefully reviewed when a business wants to cut spending or determine strategies for growth.

Cash flow statement provides a detailed picture of what happened to a business's cash during a specified period. It demonstrates an company's ability to operate in the short and long term, based on how much cash is flowing into and out of the business. The cash flow statement allows you to see how much cash different types of activities generate. Ideally, a company's cash from operating income should routinely exceed its net income, because a positive cash flow speaks to a company's ability to remain solvent and grow its operations. Using this information, an investor might decide that a company with uneven cash flow is too risky to invest in; or they might decide that a company with positive cash flow is primed for growth. Cash flow can be positive or negative. Positive cash flow indicates

that a company has more money flowing into the business than out of it over a specified period. This excess of cash allows the company to reinvest in itself and its shareholders, settle debt payments, and find new ways to grow the business. Negative cash flow means cash outflow is higher than the cash inflow during a period, but it doesn't necessarily mean profit is lost. Instead, negative cash flow may be caused by expenditure, expansion and income mismatch.

Business expenses are generally categorized either as fixed or variable and need to be understood and managed by business owners and or management. Fixed costs do not change even when the company's sales volumes or production levels increase. These generally include expenses such as: Rent, insurance, marketing and advertising and interest on loan. Especially for start-ups, these expenses must be met from cash flow or cash equivalents. Fixed expenses are usually long-term commitments such as rental of property and equipment lease to manufacture products or deliver services. Should cash flow underperform, then these fixed expenses must be provided for out of emergency funds. Variable costs vary directly with changes in activity levels or the volume of products or services the company makes. These costs would not exist if the business did not produce product. These generally include expenses such as direct labor for service companies, raw material and cost of good purchased for resale.

Once the fixed and variable costs for the product are determined, then with that information it is possible to calculate the company's breakeven point. Small business owners also use the calculation to determine how many product units they must sell at a given price point to break even. Break-even analysis is only reliable if costs are fixed within a specified production level.

Ratio used in the analysis of main KPIs: **liquidity ratios: current ratio (CA/CL), quick ratio acid test ratio; solvency ratios: earnings before interest, taxes, depreciation, and amortization (EBITDA)**.

- **The current ratio** is an important measure of liquidity because short-term liabilities are due within the next year. This means that a company has a limited amount of time to raise the funds to pay for these liabilities. Current assets like cash, cash equivalents, and marketable securities can easily be converted into cash in the short term. This means that companies with larger amounts of current assets will more easily be able to pay off current liabilities when they become due without having to sell off long-term, revenue generating assets. The current ratio helps investors and creditors understand the liquidity of a company and how easily that company will be able to pay off its current liabilities.
- **The quick ratio or acid test ratio** measures the ability of a company to pay its current liabilities when they come due with only quick assets. Quick assets are current assets that can be converted to cash within 90 days or in the short-term. Cash, cash equivalents, short-term investments or marketable securities, and current accounts receivable are considered quick assets. The acid test of finance shows how well a company can quickly convert its assets into cash to pay off its current liabilities. The higher the quick ratios, the more favorable for the company because it shows there are more quick assets than current liabilities. A company with a quick ratio of 1 indicates that quick assets equal current assets. This also shows that the company could pay off its current liabilities without selling any long-term assets. This is a good sign for investors, but an even better sign to creditors knowing they will be paid back on time.

- **EBITDA, which stands for earnings before interest, taxes, depreciation, and amortization,** is a financial calculation that measures a company's profitability before deductions that are often considered irrelevant in the decision-making process. In other words, it is the net income of a company with certain expenses like amortization, depreciation, taxes, and interest added back into the total. The accounting effects of non-operating expenses like interest and non-cash expenses like depreciation are added back to net income to analyze and compare the true operating cash flows of the businesses. Like all profitability measurements, higher numbers are preferred over lower numbers because higher numbers indicate the company is more profitable.
- **Interest coverage ratio** is a financial ratio that measures a company's ability to make interest payments when due. This liquidity ratio has nothing to do with being able to make principle payments on the debt itself, only the firm's ability to afford the interest on the debt. Investors are concerned about seeing investments in the company appreciate based on profits and operational efficiencies and that the company can pay its bills on time without having to sacrifice its operations and profits. Creditors use the interest coverage ratio to identify whether a company can support additional debt. If a company cannot afford to pay the interest on its debt, it would be a poor credit risk.
- **Profit margins** are useful for determining and then comparing the profits as a percentage of revenue earned, after subtracting expenses. This can then be compared to the profit margin analysis of peers. There are three main profit margin percentages, including: gross profit margin, operating profit margin and net profit margin. These three different percentages provided insight into the business's profitability, and comparability to competitors.
- **Working capital** provides important information about the financial condition of a company for both investors and managements. Also known as net working capital, this indicates the total amount of liquid assets a company has available to run its business. In general, the more working capital, the less financial difficulties a company should have. WC = current assets – current liabilities. Working capital measures a company's operational efficiency and short-term financial health.

5. FINANCIAL PROJECTION

Key Performance Indicator (KPI), is a measurable value that demonstrates how effectively a company is achieving key business objectives. KPIs can be used to manage different aspects of the business. There are financial KPIs, operational KPIs, sales KPIs. Each measure will be unique to the business and should be a S.M.A.R.T. (Specific, Measurable, Achievable, Realistic and Time bound) objective that reflects one of the more important elements of the business. If properly captured, KPIs should reflect the most important parts of the business and the data captured should be assessed in relation to the overall objectives.

Financial forecasting is a prerequisite for strategic planning. In financial forecasting, future estimates are made through preparation of projected financial statements – projected income statement, projected balance sheet, projected cash flow and funds flow statements, using ratios and other analytic tools. Financial forecasting helps to decide on matters such as capital investment, annual production level, working capital requirement, estimation of funds requirement for business and estimated growth in sales.

6. VALUATION

Business valuation is the process by which the economic worth of a company is determined. There are different approaches, but each method involves a full and objective assessment of the business. Business valuation value assets that the company owns and management structure, projected earnings, share price, revenue are factors. A business valuation is required when: selling a business; looking to merge or acquire another company; looking for business financing or investors; establishing partner ownership percentages and adding shareholders. Three approaches to business valuation are intrinsic, comparative and cost method.

Valuation methods for small businesses include: market value business valuation, asset based business valuation, ROI-based valuation method, capitalization of earnings valuation method, multiple of earnings valuation and the book value method.

The market value business valuation formula is the most subjective approach to measuring a business's worth. The value of is determined by comparing it to similar businesses that have been sold. A sole proprietorship can sell only its assets. The trade name, inventory and equipment may be passed on to a new owner, the previous owner may still be liable for certain obligations. The small business valuation method is relatively imprecise, and the business's worth will ultimately be based on negotiation.

An asset-based business valuation method uses the balance sheet, to determine the company's worth, based on the business's total net asset value, minus the value of its total liabilities.

A ROI-based business valuation method evaluates the value of your company based on the company's profit and the return on investment (ROI) an investor could potentially receive for buying into the business.

The capitalization of earnings valuation method calculates a business's future profitability based on its cash flow, annual ROI, and expected value and bases a business's current value on its ability to be profitable in the future.

The multiple of earnings valuation is a small business valuation method, also known as the time revenue method, that calculates a business's maximum worth by assigning a multiplier to its current revenue which varies according to industry, economic climate, and other factors.

The book value method calculates the value of the business at a given moment in time by looking at the balance sheet. This approach may be particularly useful if the business has low profits, but valuable assets.

The Discounted Cash Flow (DCF) analysis, comparable company analysis, and precedent transactions are the most common methods of valuation used in investment banking, equity research, private equity, corporate development, mergers and acquisitions (M&A), leveraged buyouts (LBO), and most areas of finance for corporations and large businesses.

Comparable company analysis (also called 'trading multiples' or 'peer group analysis' or 'equity comps' or 'public market multiples') is a relative valuation method in which the current value of a business is compared to other similar businesses by looking at trading multiples like Price/Earnings (P/E), Enterprise Value/Earnings Before Interest, Taxes, Depreciation, and Amortization (EV/EBITDA), or other ratios. Multiples of EBITDA are the most common valuation method. The 'comps' valuation method provides an observable value for the business, based on what companies are currently worth. Comps are the most widely used approach, as they are easy to calculate and always current.

Discounted Cash Flow (DCF) analysis is an intrinsic value approach where an analyst forecasts the business' unlevered free cash flow into the future and discounts it back to today at the firm's Weighted Average Cost of Capital (WACC). The DCF analysis is performed by building a financial model in Excel which is the most detailed of the three valuation approaches. It requires several assumptions, will often result in the highest value, and provide the most accurate valuation.

Precedent transactions analysis is another form of relative valuation where you compare the company in question to other businesses that have recently been sold or acquired in the same industry. These transaction values include the take-over premium included in the price for which they were acquired. These values represent the en bloc value of a business. They are useful for M&A transactions but can easily become stale-dated and no longer reflective of the current market as time passes. They are less commonly used than Comps or market trading multiples.

Investors use weighted average cost of capital (WACC) as a tool to decide whether to invest. The WACC represents the minimum rate of return at which a company produces value for its investors. Securities analysts employ WACC when valuing and selecting investments. For instance, WACC is used as the discount rate in discounted cash flow analysis. The rate is applied to the future cash flows for deriving a business's Net present value (NPV). The NPV is an investment measure that investors use to determine whether an investment will achieve a target yield that justifies making the investment. WACC can be used as a hurdle rate against which to assess the return on investment or ROI.

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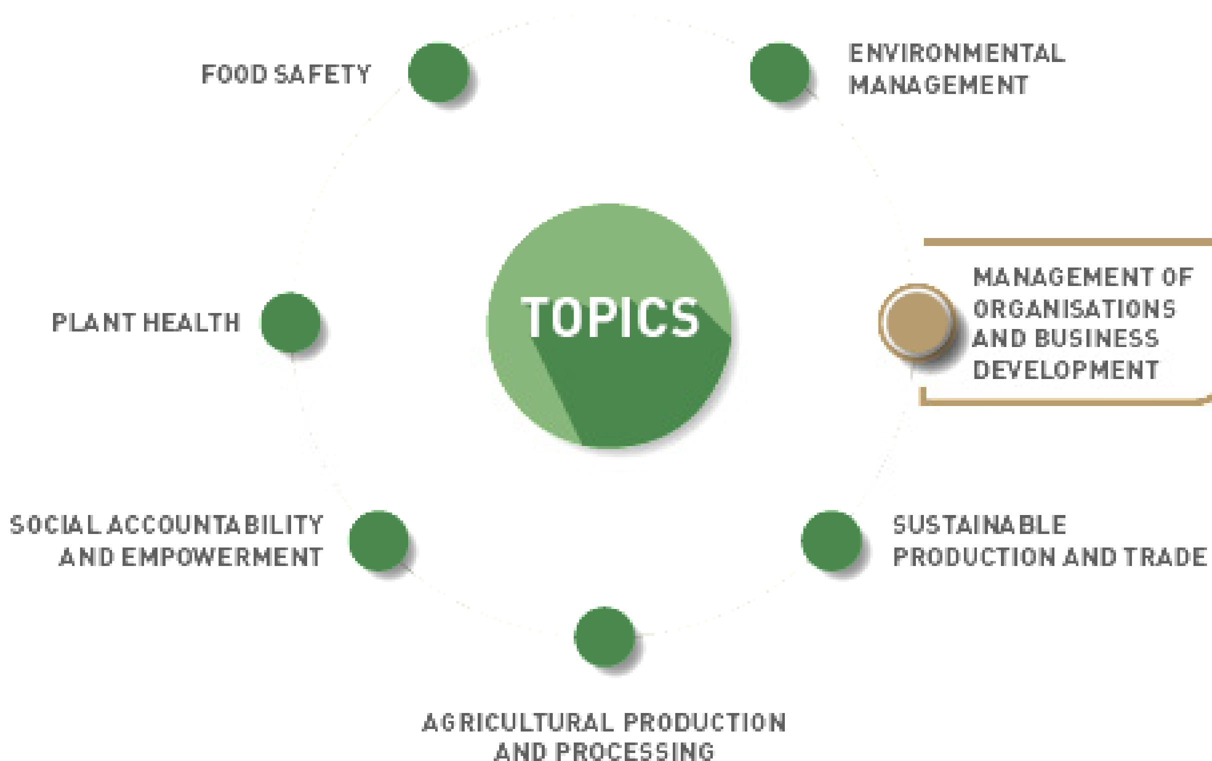

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