🚀 Stock Investor Accelerator Cheatsheet: Reading Financial Statements

1. 📘 Reading Financial Statements:

Income Statement: Reflects revenue, expenses, and net income; crucial for understanding profitability.

- 💰 Sales: Total revenue from product or service.
- 🏭 COGS: Direct production costs.
- 📈 Gross Profit: Sales - COGS
- 🖊️ Operating Profit: Gross Profit - Operating Expenses.
- 🌐 Net Income: Profits after all expenses, interest, and taxes.

Balance Sheet: Provides a snapshot of assets, liabilities, and equity, offers insight into financial health.

- 🏢 Assets: Everything the business owns (property, equipment).
- 💰 Liabilities: Everything the business owes (loans, debts).
- 💼 Equity: Capital from selling shares and retained earnings. Total equity = Assets - Liabilities.

Cash Flow Statement: Tracks cash movements, split into operating, investing, and financing activities. Use to identify cash generation.

- 💼 Operating Activities: Cash generated by the company's core business operations.
- 💸 Investing Activities: Cash used for investments in assets.
- 💰 Financing Activities: Cash exchanged between the company and its owners or creditors.

2. 📊 Projecting Earnings:

Forecast future sales and expenses based on operations and expansion plans.

- 📉 Sales Estimates: Volume x Price Per Unit = Sales.
- 💰 Costs: COGS + Operating Expenses = Total Costs.
- 📈 Gross Profit: Total Sales - COGS.
- 🖊️ Operating Profit: Gross Profit - Operating Expenses.
- Factor in required investments:
    - Working Capital: Cash needed for daily functions.

    - Depreciation Expense: Non-cash expense; asset value reduction.
    - Capital Expenditures: Investments into assets for improvement or maintenance.

3. 💡 Estimating Profit Returns:

- 📈 Operating Margins: Ratio of earnings to sales.
- 💼 Incremental Margins: Additional earnings generated from business growth.
- 📉 Earnings per share growth: Growth in profit per outstanding share of stock.
- 🤑 Capital returns:
    - ROE (Return on Equity): High ROE = effective profit generation. Look for consistently high or improving ROE.
    - ROIC (Return on Invested Capital): Increasing ROIC means increasing value for investors.
    - Leverage Ratio: Measures debt relative to earnings (EBITDA), indicating risk level (years to pay back debt).

4. 🏷️ Valuation:

- 💵 Discounted Cash Flow: Value of investment based on expected future cash flows, discounted by time value of money.
    - Use weighted average cost of capital (WACC) to discount.
- 📊 P/E Ratio: Market value per share / earnings per share.

5. 🌟 Investment Takeaways:

- 📈 Sustainable earnings: Steady earnings growth increases equity value.
- 🚀 Efficient Capital Use: Look for firms that efficiently use capital to grow.
- 💵 Quality Earnings: Earnings with positive cash flow from core operations.
- 💰 Debt Management: Lower levels of debt to earnings reduces financial risk.
- 🌐 Positive Return Metrics: Increasing ROE and ROIC indicate higher value.

6. 📚 Definitions:

- EBITDA: Cash earnings before interest, taxes, depreciation, amortization.
- Net Income: Total profit after expenses.
- Depreciation: Value loss of assets over time.
- CapEx: Funds used for acquiring/upgrading assets.
- Free Cash Flow: Cash generated by operations after CapEx.
- Working Capital: Capital used in daily operations.

- Leverage Ratio: Company's debt to its EBITDA ratio.
- DCF: Technique of valuing based on future cash flows, adjusted for time value.
- WACC: Expected return to all investors.
- Terminal Value: Estimated long-term value beyond the projection period.
- Exit Multiple: Expected price at sale.
- Retained Earnings: Cumulative net income retained on the balance sheet.
- Shareholder Equity: Capital from shareholders and retained earnings.
- Book Value: Net accounting value to shareholders (total assets - total liabilities).
- ROE: Profitability measure of net income to shareholders' equity.
- ROIC: Profitability measure of operating profit to total capital.
- P/E Ratio: Market value per share to earnings per share.
- EPS: Profit allocated to each outstanding share of common stock.

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