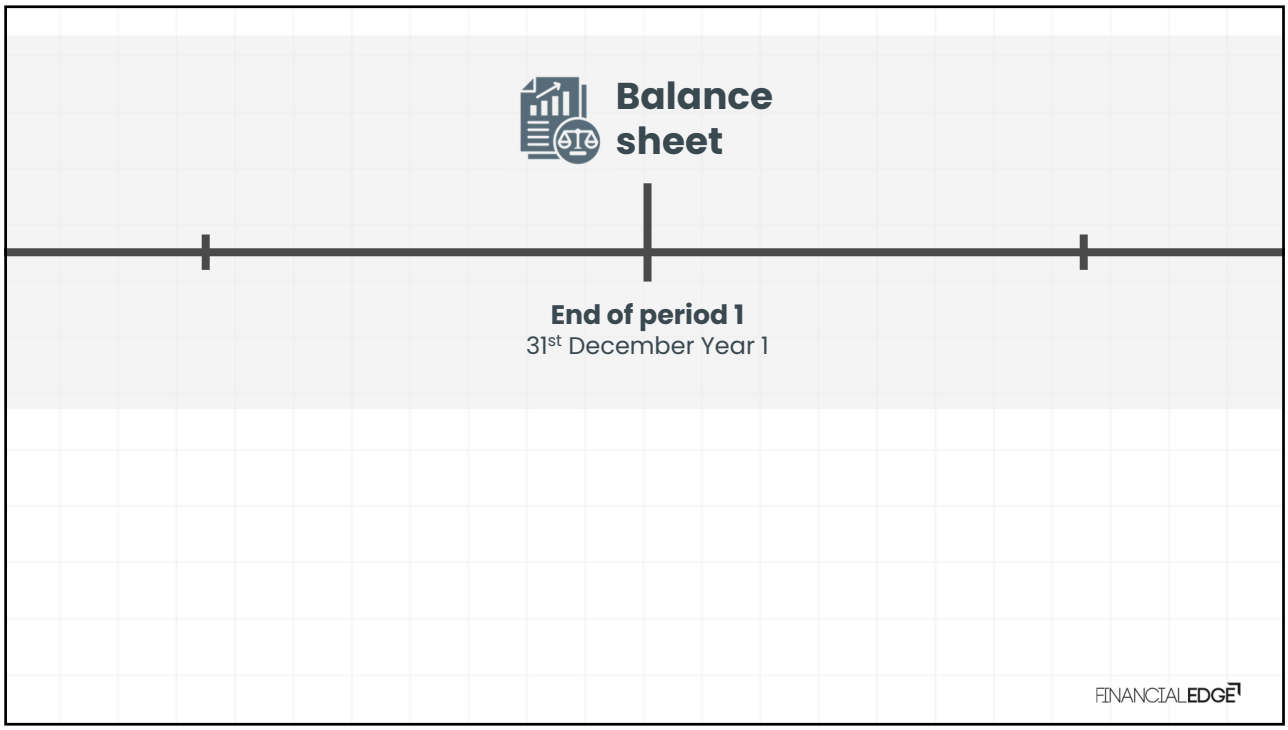
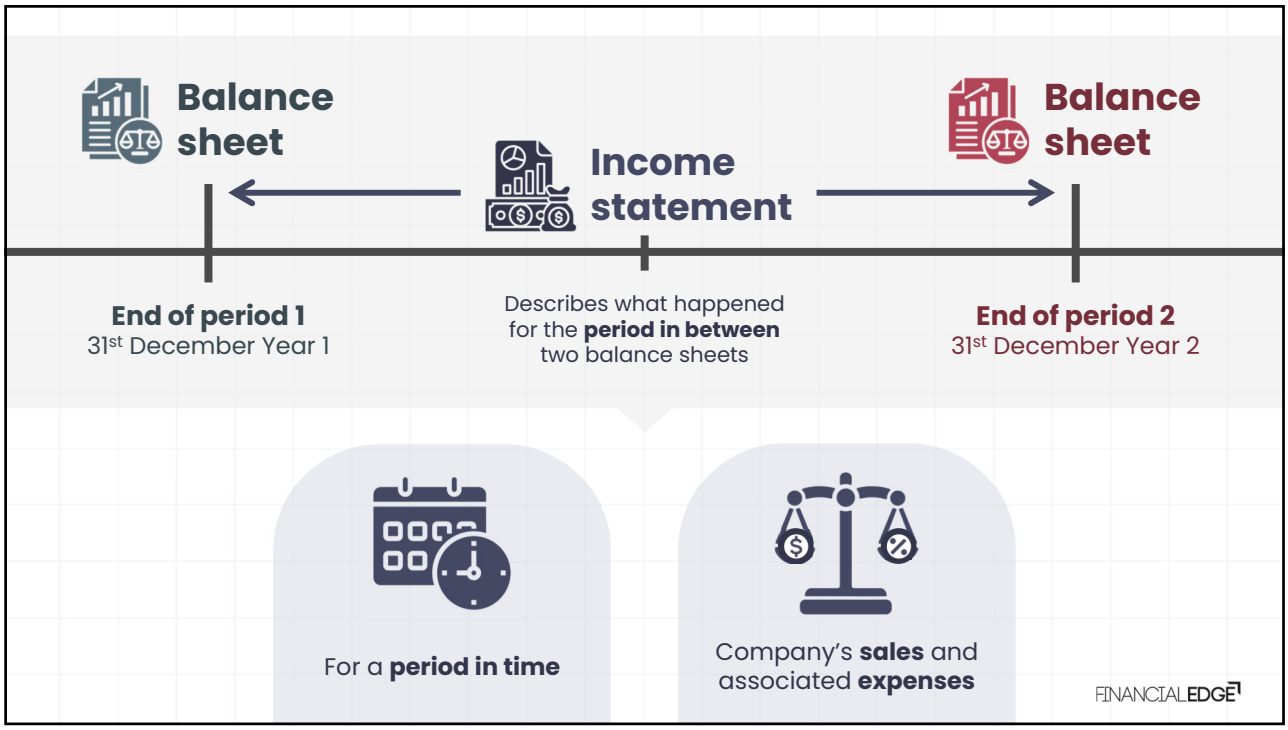


Income Statement Introduction

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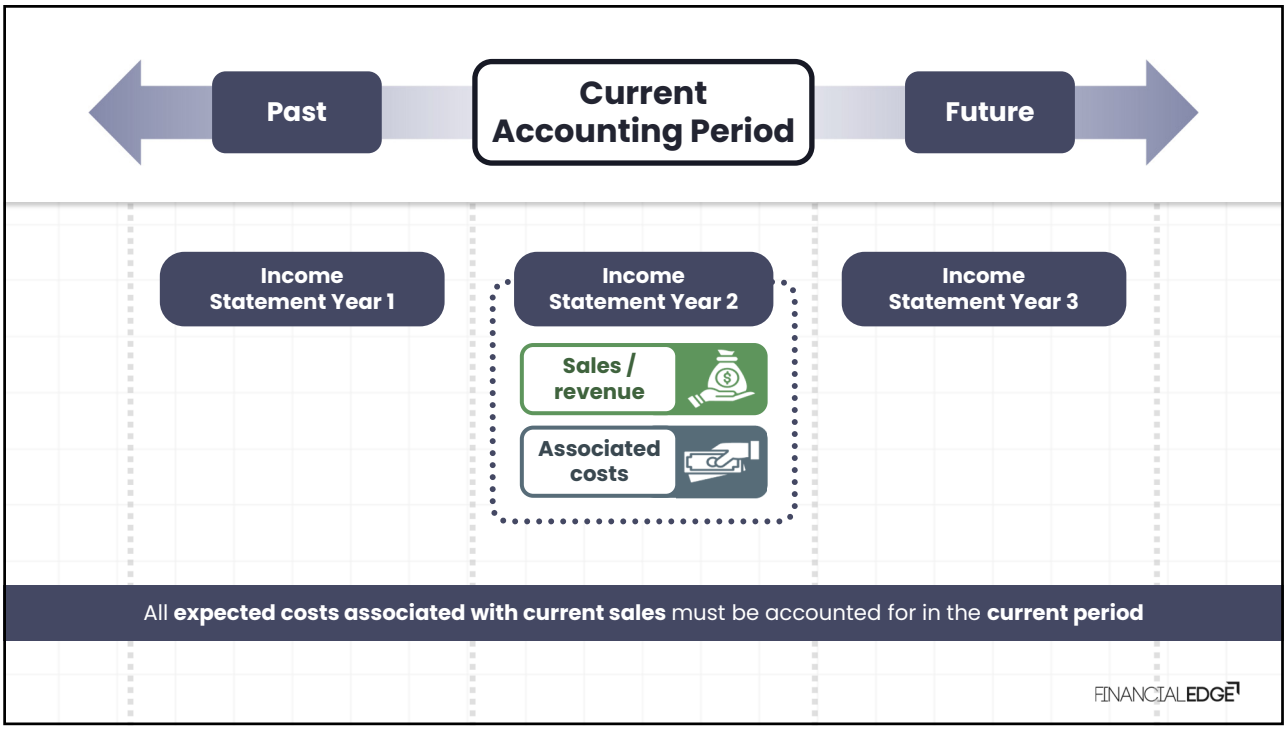




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Matching Principle Introduction

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Matching Principle – Revenue Recognition

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Revenue recognition

Helps companies decide in which year they can record revenue



Rule

A company can **recognize revenue** upon:

Delivery

When the customer is **delivered their product**

OR

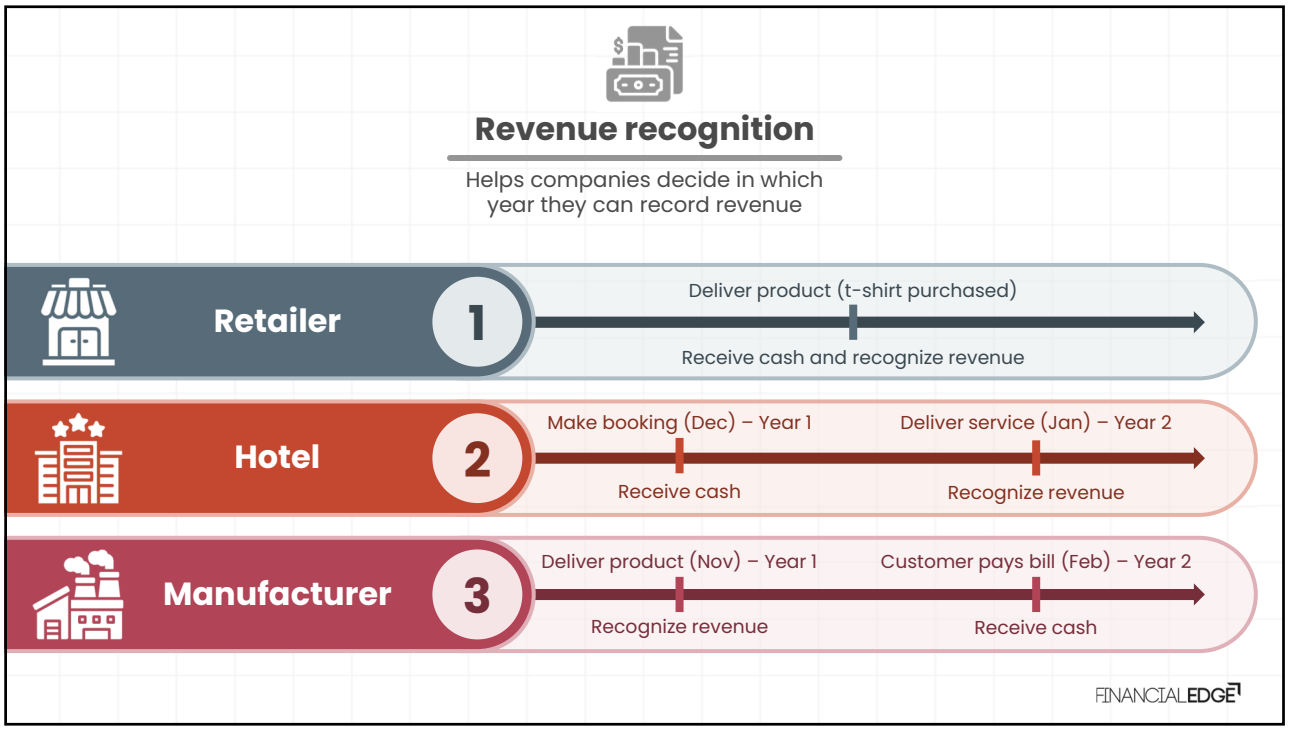
Service performance

When the customer **receives the service** they required

Sales (Income Statement) and **cash flows** (Cash Flow Statement) are often at **different times**

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Income Statement – Presentation and Expenses

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Income statement	
Sales	X
Cost of goods sold (COGS)	(X)
Gross profit	X
Selling, general and admin (SG&A)	(X)
Operating profit	X
Interest/finance expense	(X)
Profit before tax	X
Tax expense	(X)
Net income	X

- Cost of goods sold (COGS) (X) → **Making/buying the product**
- Selling, general and admin (SG&A) (X) → **Supporting the business**
- Interest/finance expense (X) → **Financing the business**
- Tax expense (X) → **Paying the government**

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How did we know those sales went with those expenses?

Income statement	
Sales	X
Cost of goods sold (COGS)	(X)
Gross profit	X
Selling, general and admin (SG&A)	(X)
Operating profit	X
Interest/finance expense	(X)
Profit before tax	X
Tax expense	(X)
Net income	X

The Matching Principle



Year 2 income statement

- Sales
- Associated expenses
- Tax expense

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Operating Profit and EBIT

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Income statement	
Sales	X
Cost of goods sold (COGS)	(X)
Gross profit	X
Selling, general and admin (SG&A)	(X)
Operating profit	X
Interest/finance expense	(X)
Profit before tax	X
Tax expense	(X)
Net income	X

A good measure of a company's performance

How profitable are the products?

Performance captured in:

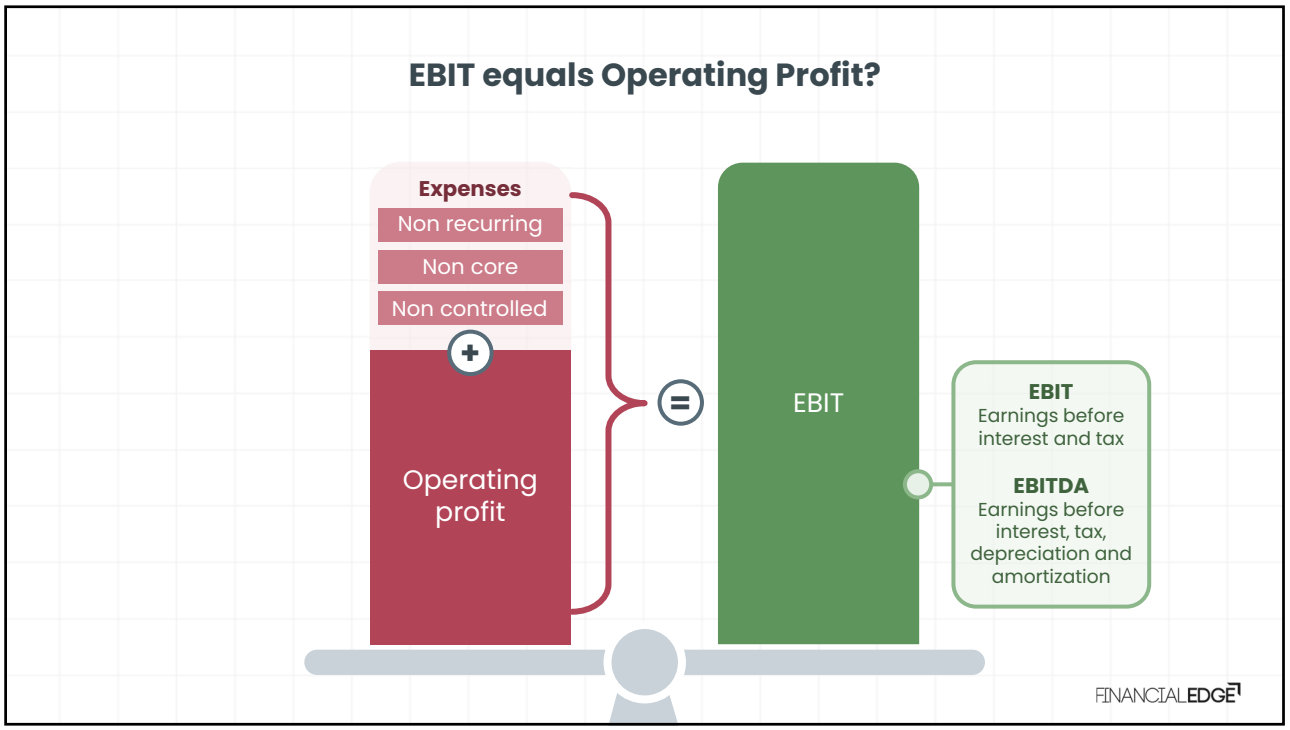
- Sales
- Cost of goods sold (COGS)
- Selling, general and admin (SG&A)

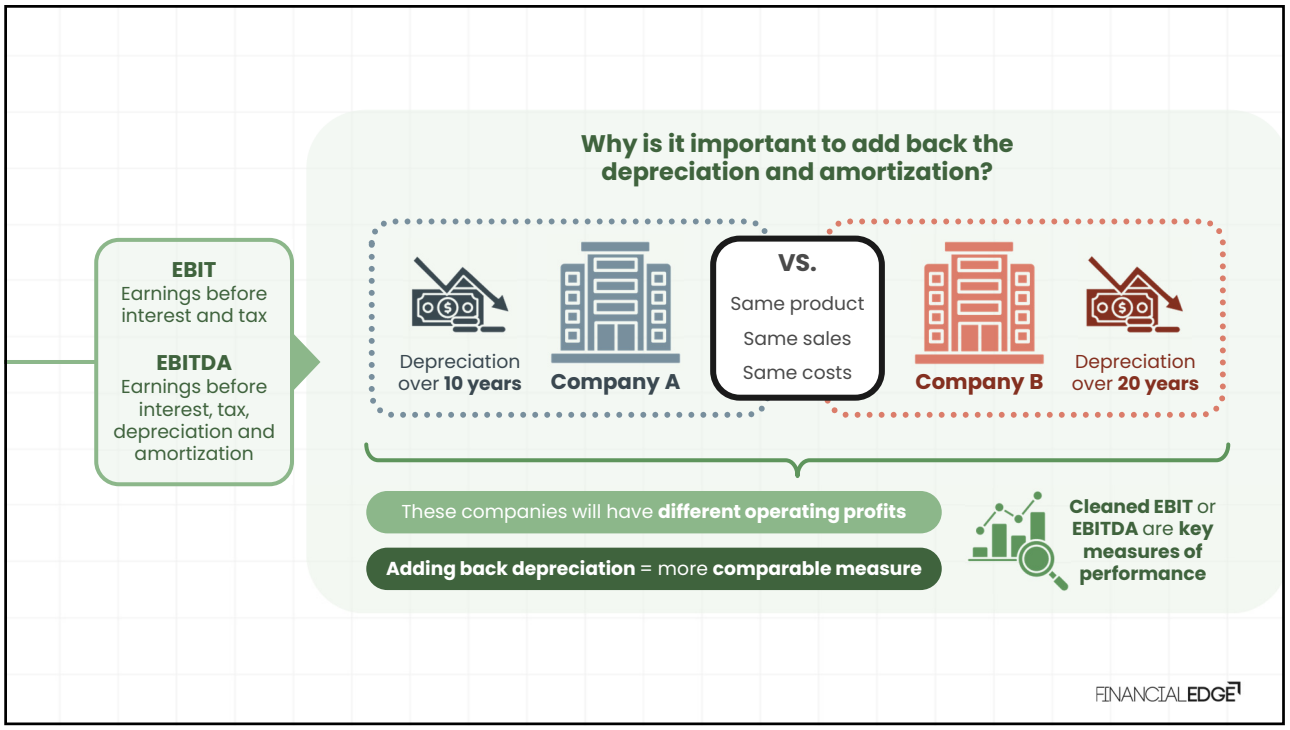
= Operating Profit

Profit before financing and government costs

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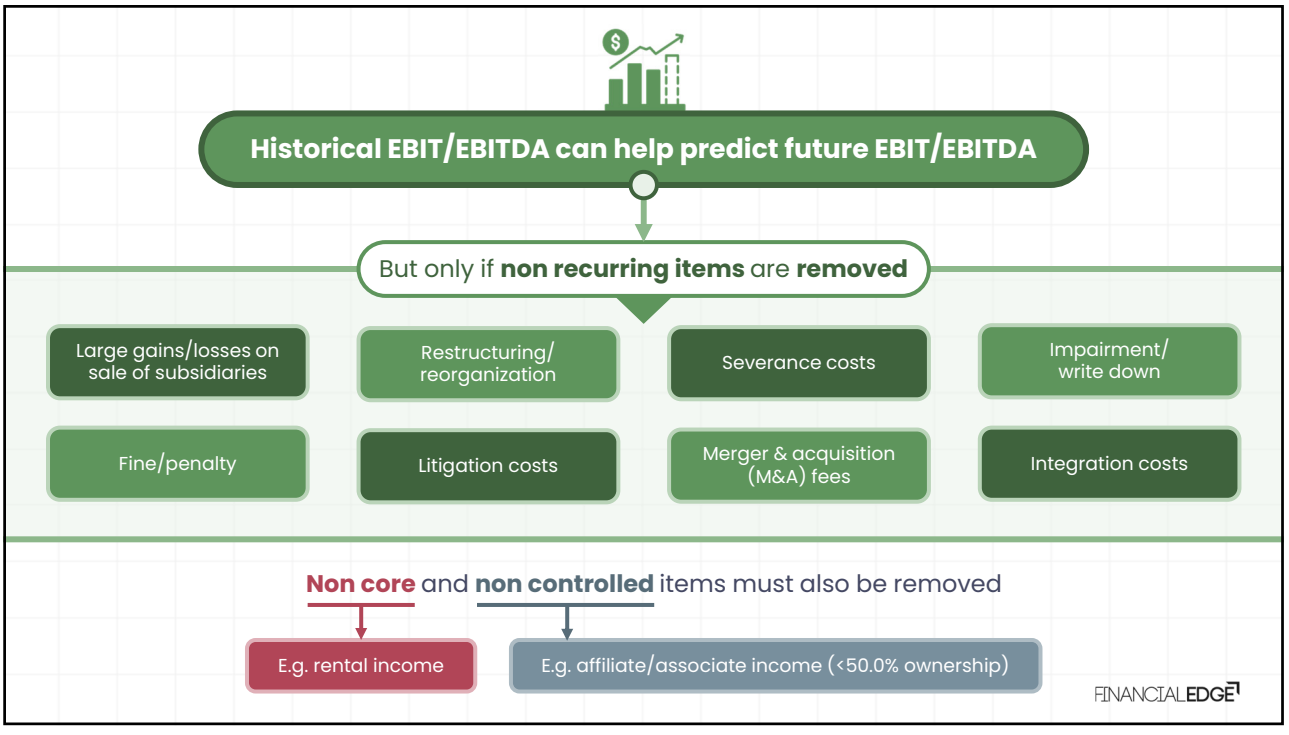




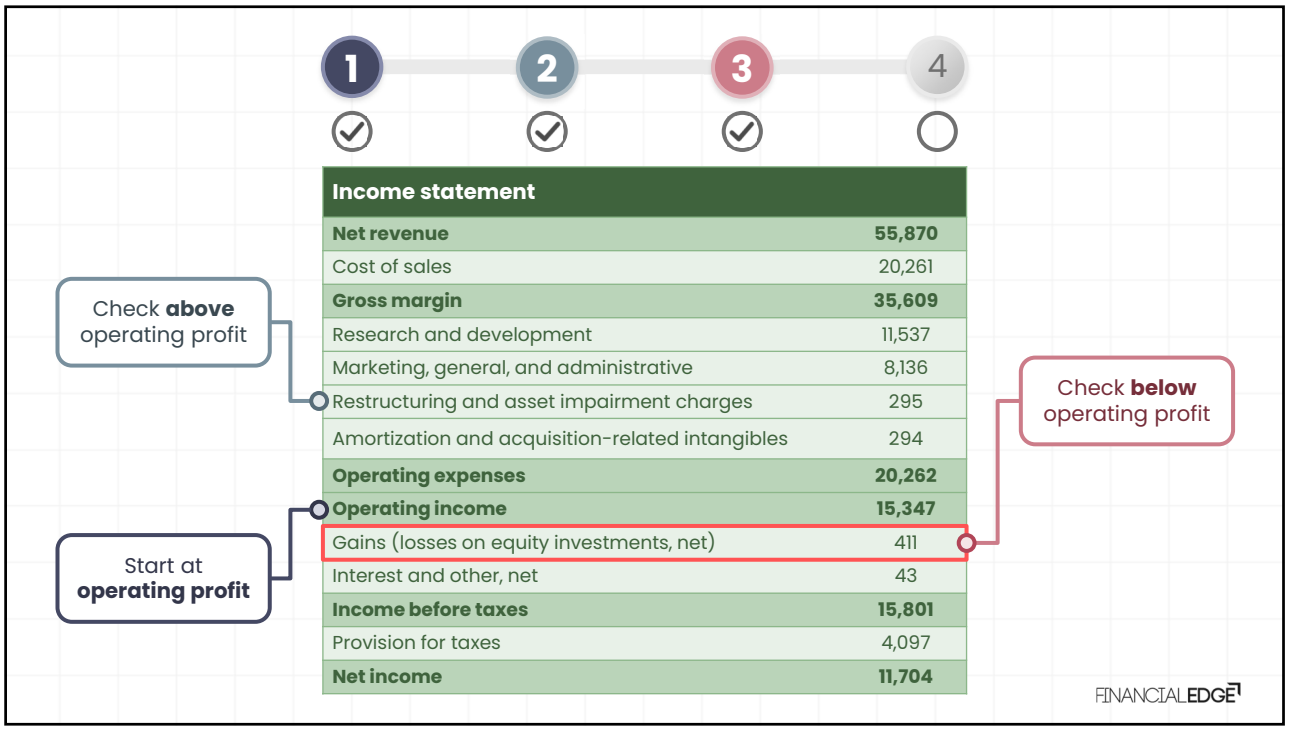
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Cleaning EBIT and Finding Items in Financial Statements

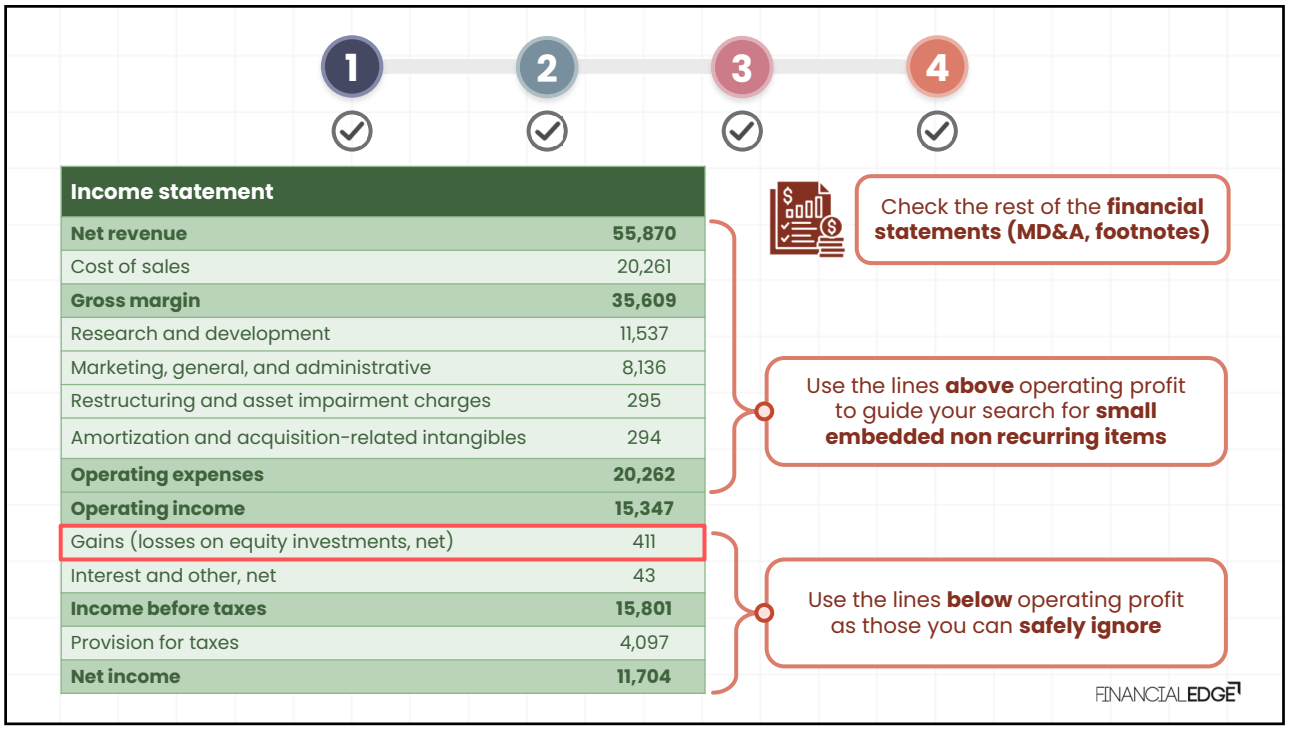
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Income statement	
Net revenue	**55,870**
Cost of sales	20,261
Gross margin	**35,609**
Research and development	11,537
Marketing, general, and administrative	8,136
Restructuring and asset impairment charges	295
Amortization and acquisition-related intangibles	294
Operating expenses	**20,262**
Operating income	**15,347**
Gains (losses on equity investments, net)	411
Interest and other, net	43
Income before taxes	**15,801**
Provision for taxes	4,097
Net income	**11,704**



Income statement	
Net revenue	**55,870**
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Cleaning EBITDA – Double Counting Depn

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In going from **EBIT to EBITDA**, we need to **add back depreciation** and **amortization (D&A)**

Cash flow statement | Always includes D&A

Cash flows from operating activities:	
Net earnings	$ 4,554
Adjustments to reconcile net earnings to net cash provided by operating activities:	
Depreciation and amortization	4,016

Calculating EBIT
Add back non recurring items, such as impairments

Going from EBIT to EBITDA
Add back depreciation and amortization (D&A)

However, D&A often includes **hidden impairments** which we **don't want to add back again**

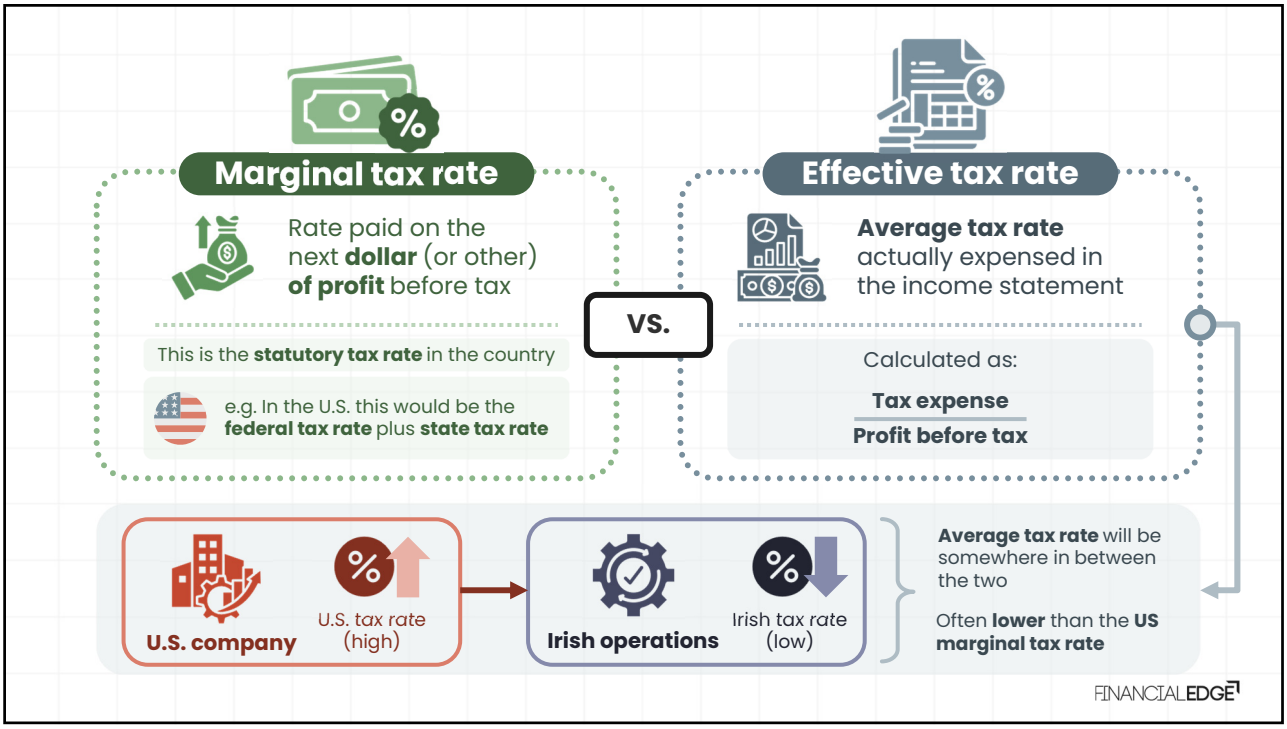
Footnote detail	
Depreciation	2,968
Amortization	913
Impairment	135
Total	**4,016**

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Taxes – Marginal and Effective Tax Rates

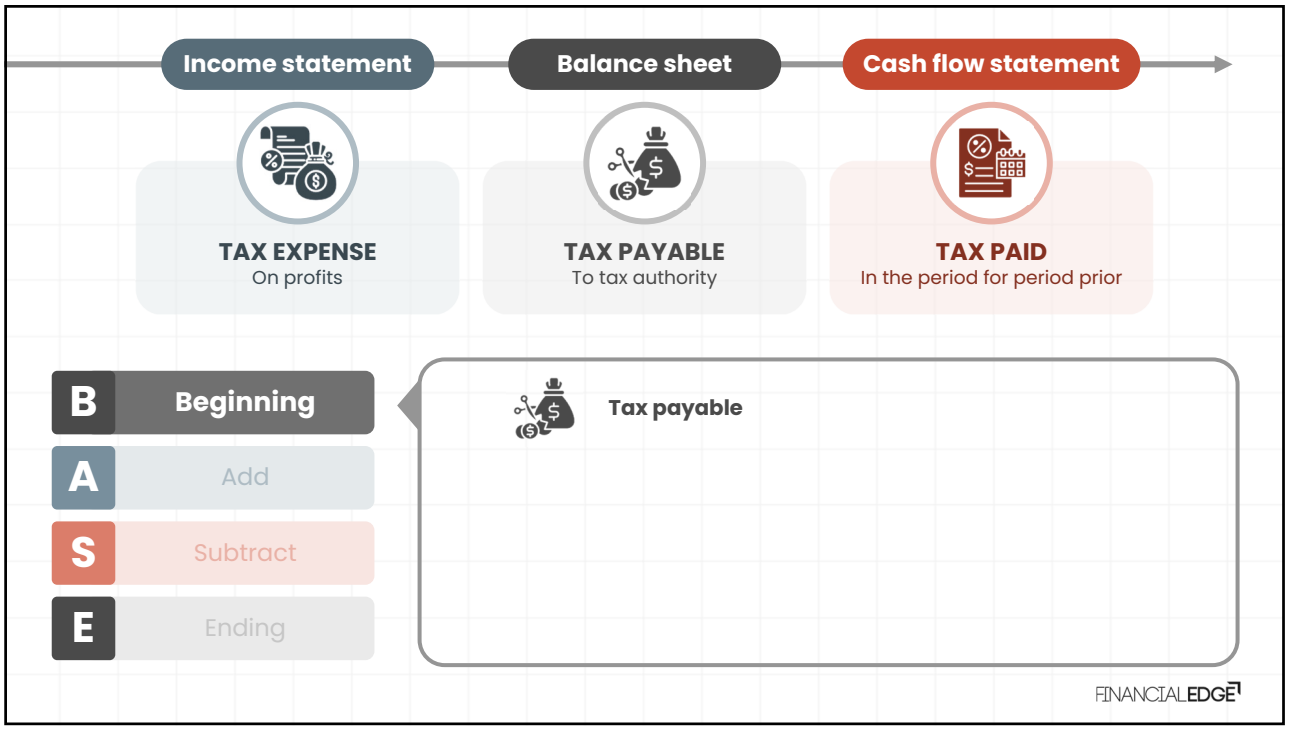
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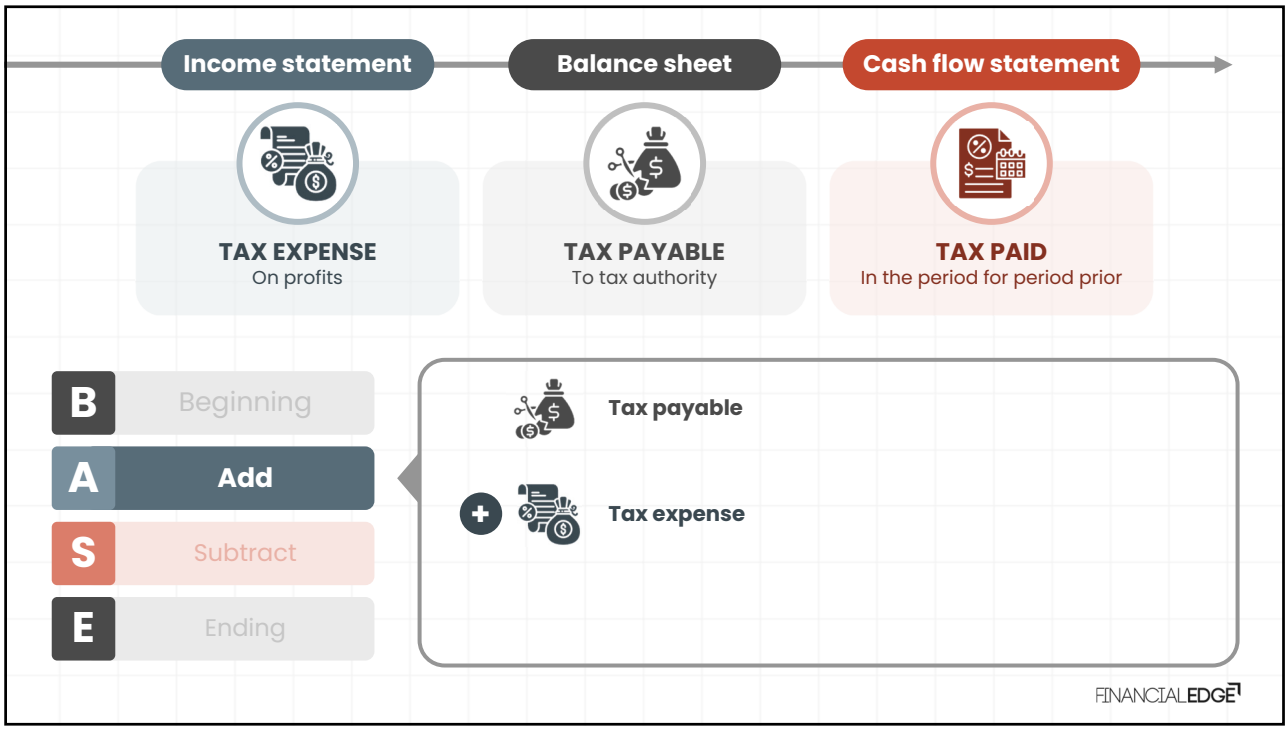
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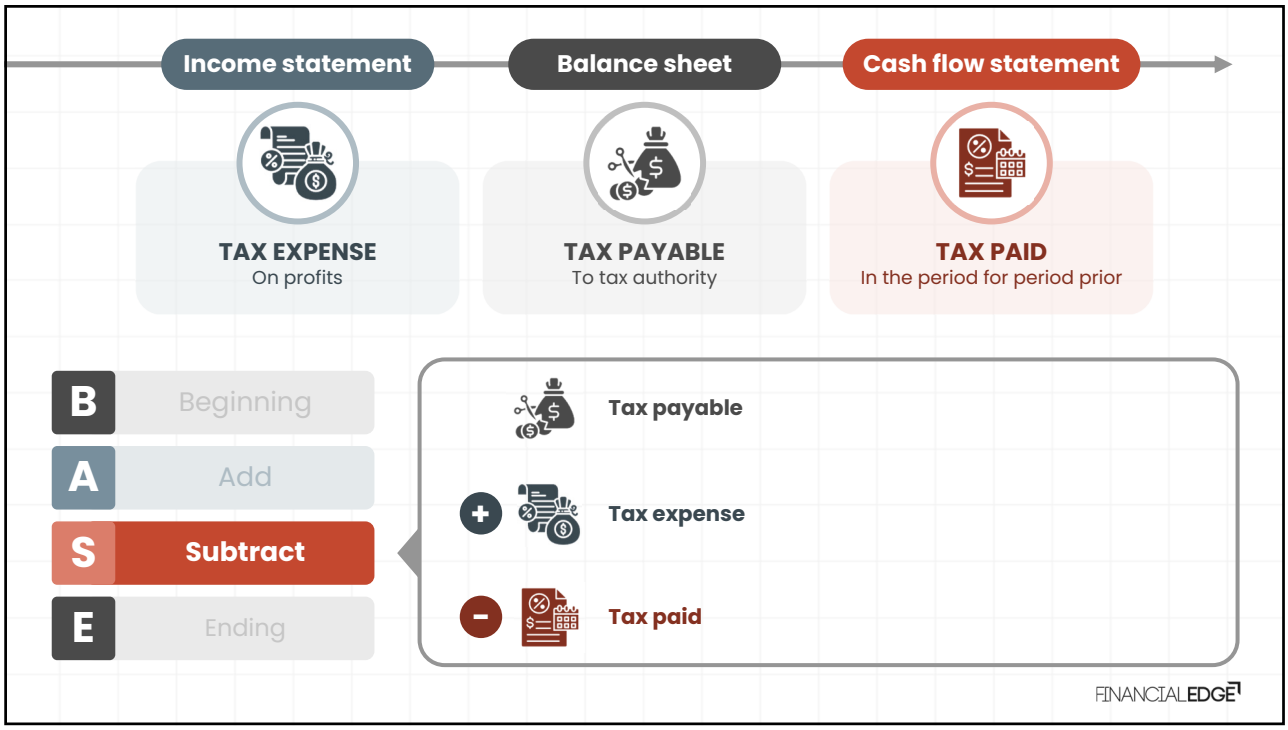
Taxes in the Financial Statements

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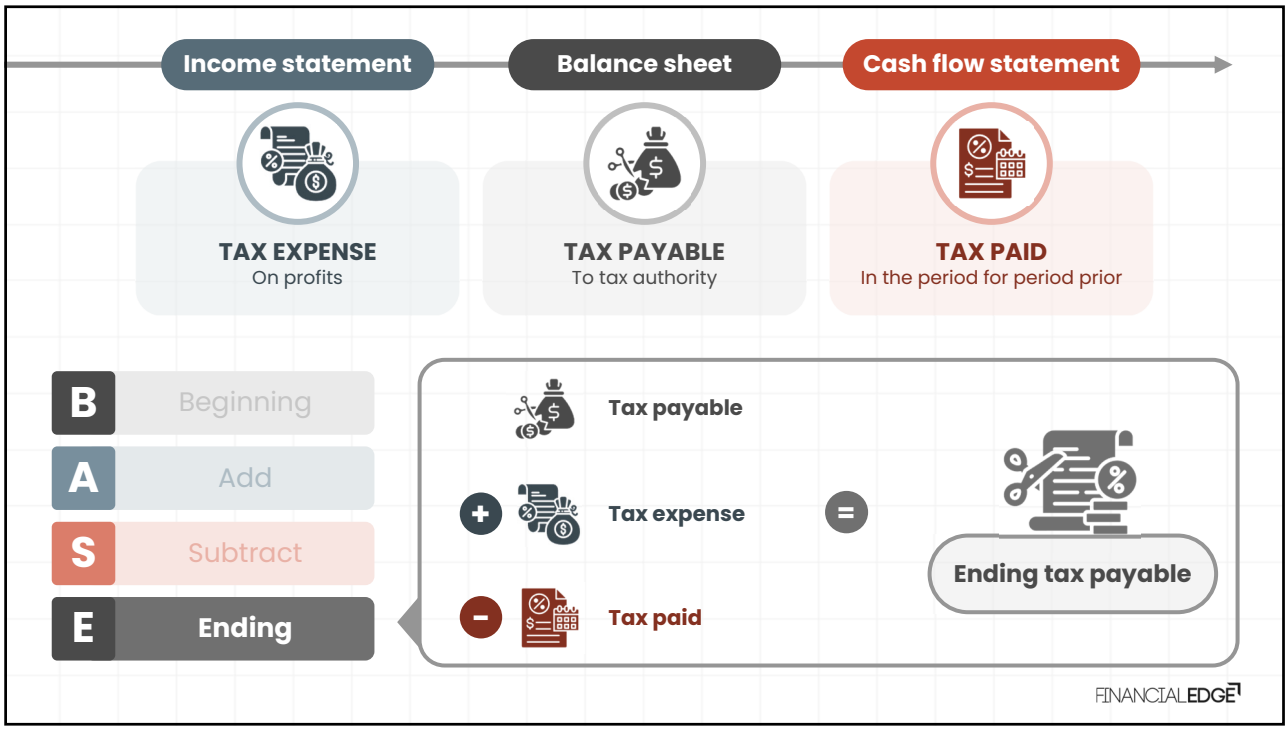


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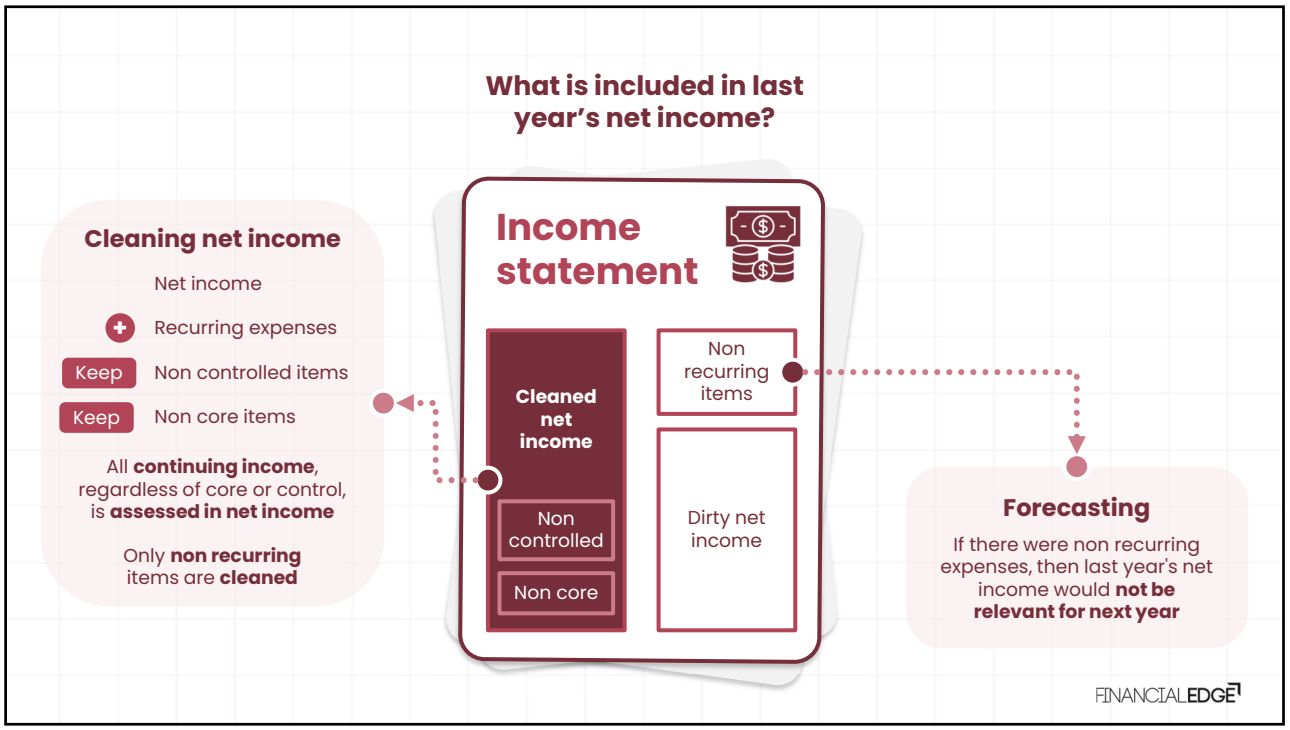
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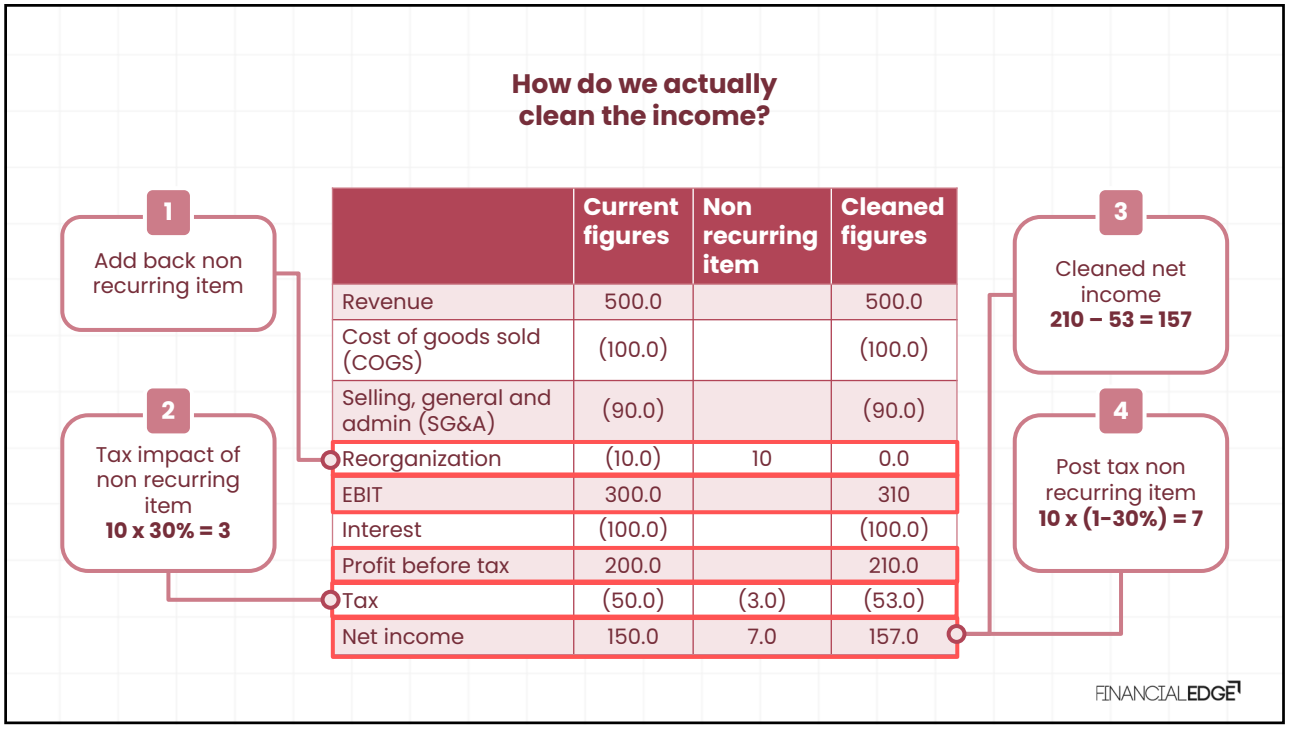


Cleaning Net Income

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	Current figures	Non recurring item	Cleaned figures
Revenue	500.0		500.0
Cost of goods sold (COGS)	(100.0)		(100.0)
Selling, general and admin (SG&A)	(90.0)		(90.0)
Reorganization	(10.0)	10	0.0
EBIT	300.0		310
Interest	(100.0)		(100.0)
Profit before tax	200.0		210.0
Tax	(50.0)	(3.0)	(53.0)
Net income	150.0	7.0	157.0

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Cleaning the Effective Tax Rate (ETR)

Non recurring items **distort** the ETR

To forecast ETR it must be **cleaned**

	Current figures	Non recurring item	Cleaned figures
Profit before tax	200.0	10	210.0
Tax	(50.0)	(3.0)	(53.0)
Net income	150.0	7.0	157.0
ETR	25.0%		25.2%

1 ETR **50.0 / 200.0 = 25.0%**

2 Cleaned ETR **53.0 / 210.0 = 25.2%**

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