

# Investing 202

## Understanding Income Statements



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# What is an income statement?

- An income statement shows a company's revenue and expenses over a period of time. It's also called a Profit and Loss statement or a "P&L".



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# Reporting Periods

- The most common time periods are:
  - 1 Quarter or 90 days
  - 1 Year or 365 days
  - TTM: Trailing Twelve Months
  - YTD: Year to Date

Some companies report 6 months and 9 months as well.



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# Reporting Periods

- Trailing Twelve Months or TTM is used a lot in the workplace when it comes to attendance policies and points. For example, you may only be able to receive 5 attendance points without penalty and those points carry over each month on a rolling 12-month basis until they are wiped away and no longer considered.
- TTM is used on income statements to calculate what a company's earnings were within the period (Jan to Dec -> Feb to Jan -> Mar to Feb etc). Because each company's fiscal year may be different, each company's TTM may also be different.



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# How do companies report their income statements?

- Companies usually show the income statement in the quarterly earnings press release but not always.
- You can find income statements by reviewing:
  - 10-Q (Quarterly Report)
  - 10-K (Annual Report)
  - Financial websites such as Yahoo Finance, The Motley Fool, Benzinga, etc.
  - [SEC.gov](http://SEC.gov)



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# Income Statement

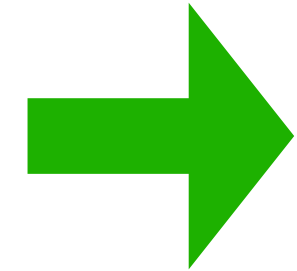
Revenue	
-	Cost of Goods Sold
Gross Profit	
-	Operating Expenses
Operating Income	
-	Interest Expense
Pre-Tax Income	
-	Income Tax
Net Income	

- The income statement flows in a step-down manner. The top number is revenue or sales and the costs are subtracted as you continue going down.



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# Revenue



Revenue	
-	Cost of Goods Sold
Gross Profit	
-	Operating Expenses
Operating Income	
-	Interest Expense
Pre-Tax Income	
-	Income Tax
Net Income	

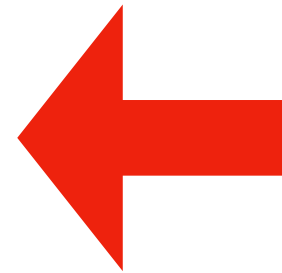
- This is the amount received or to be received from the sales of products/services to customers during the reporting period.
- Sales revenue includes discounts, returns and any other deductions from the sales price or is net.



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# Cost of Goods Sold (COGS)

Revenue	
-	Cost of Goods Sold
Gross Profit	
-	Operating Expenses
Operating Income	
-	Interest Expense
Pre-Tax Income	
-	Income Tax
Net Income	



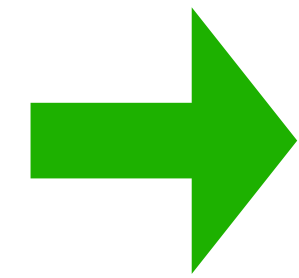
- This figure shows all of the costs and expenses related to producing the product/service.
- If you sell calculators, it would be the variable costs of:
  - Chips
  - Plastic
  - Labor Costs
  - Etc.



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# Gross Profit



Revenue	
-	Cost of Goods Sold
Gross Profit	
-	Operating Expenses
Operating Income	
-	Interest Expense
Pre-Tax Income	
-	Income Tax
Net Income	

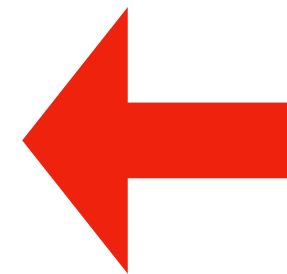
- This is the company's revenue minus the company's COGS. Gross profit is also used synonymously with *gross income*.



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# Operating Expenses (OPEX)

Revenue	
-	Cost of Goods Sold
Gross Profit	
-	Operating Expenses
Operating Income	
-	Interest Expense
Pre-Tax Income	
-	Income Tax
Net Income	



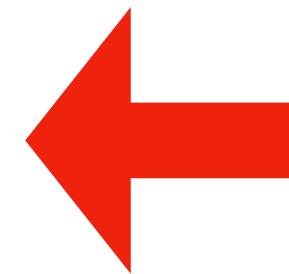
- This is a catchall category that includes all costs to run a company's day-to-day operations.
- Some companies show detailed costs while others lump it all together.



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# Operating Expenses (OPEX)

Revenue	
-	Cost of Goods Sold
Gross Profit	
-	Operating Expenses
Operating Income	
-	Interest Expense
Pre-Tax Income	
-	Income Tax
Net Income	



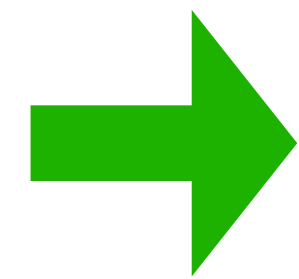
- Common categories include:
  - **Research & Development (R&D)**
  - **Sales**
  - **Marketing**
  - **Selling, General & Administrative (SG&A)**
  - **Overhead** (rent, utilities, travel, salary, bonus, stock-based compensation)

OPEX is usually a company's largest expense on their income statement.



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# Operating Income



Revenue	
-	Cost of Goods Sold
Gross Profit	
-	Operating Expenses
Operating Income	
-	Interest Expense
Pre-Tax Income	
-	Income Tax
Net Income	

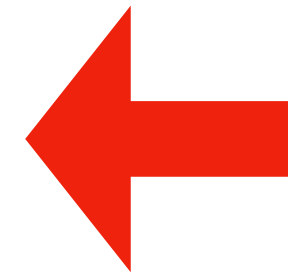
- This is the gross profit minus the OPEX. This shows how much profit a company earned from its ongoing operations.
- This can also be called “EBIT” which stands for **Earnings Before Interest and Taxes**.



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# Interest Expense

Revenue	
-	Cost of Goods Sold
Gross Profit	
-	Operating Expenses
Operating Income	
-	Interest Expense
Pre-Tax Income	
-	Income Tax
Net Income	

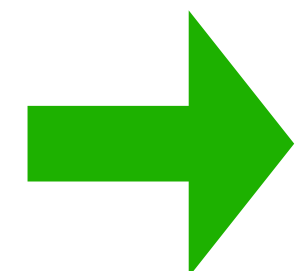


- This is the amount of interest paid during the reporting period. This can also include other types of financing charges like loan origination fees.
- This can also be a positive number if the company generates more interest than it spends.



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# Pre-Tax Income



Revenue	
-	Cost of Goods Sold
Gross Profit	
-	Operating Expenses
Operating Income	
-	Interest Expense
Pre-Tax Income	
-	Income Tax
Net Income	

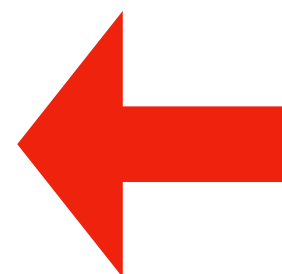
- This is the OPEX minus the interest expense. This can also be called “EBT” which stands for **Earnings Before Taxes**.



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# Income Tax Expense

Revenue	
-	Cost of Goods Sold
Gross Profit	
-	Operating Expenses
Operating Income	
-	Interest Expense
Pre-Tax Income	
-	Income Tax
Net Income	

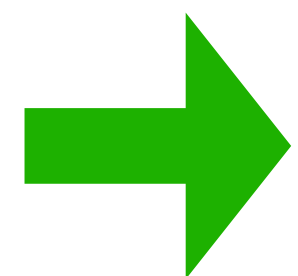


- This is the amount of taxes paid to federal and state governments.



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# Net Income



Revenue	
-	Cost of Goods Sold
Gross Profit	
-	Operating Expenses
Operating Income	
-	Interest Expense
Pre-Tax Income	
-	Income Tax
Net Income	

- This is the bottom line also referred to as “earnings” or “profits”.
- If the number is positive, the business is considered profitable. If the number is negative, the business is considered unprofitable.



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# Earnings Per Share

- After the net income has been determined, you need to divide it up by the shares outstanding to calculate the earnings per share or EPS.
- For example, if a company makes \$10 million in net income and it has 1 million share outstanding available to purchase, each share is entitled to \$10.
  - $\$10,000,000 / 1,000,000 = \$10$  in EPS



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# Comparing Income Statements

<i>(In millions, except per share data)</i>	THREE MONTHS ENDED		% Change
	5/31/2021	5/31/2020	
Revenues	\$ 12,344	\$ 6,313	96%
Cost of sales	6,689	3,960	69%
Gross profit	5,655	2,353	140%
<i>Gross margin</i>	45.8 %	37.3 %	
Demand creation expense	997	823	21%
Operating overhead expense	2,745	2,368	16%
Total selling and administrative expense	3,742	3,191	17%
<i>% of revenues</i>	30.3 %	50.5 %	
Interest expense (income), net	63	50	—
Other (income) expense, net	(4)	(84)	—
Income (loss) before income taxes	1,854	(804)	331%
Income tax expense (benefit)	345	(14)	2,564%
<i>Effective tax rate</i>	18.6 %	1.7 %	
<b>NET INCOME (LOSS)</b>	<b>\$ 1,509</b>	<b>\$ (790)</b>	<b>291%</b>
Earnings (loss) per common share:			
Basic	\$ 0.96	\$ (0.51)	288%
Diluted	\$ 0.93	\$ (0.51)	282%
Weighted average common shares outstanding:			
Basic	1,579.0	1,555.7	
Diluted	1,614.9	1,555.7	
Dividends declared per common share	\$ 0.275	\$ 0.245	

- Income statements are most useful when they are compared to a similar period. The comparison allows you to tell if a business is growing or shrinking. Look at the example of this income statement with the change highlighted to show context.



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# Comparing Income Statements

Income Statement	
Revenue	% of Revenue
- Cost of Goods Sold	
Gross Profit	Gross Profit / Revenue = Gross Profit Margin
- Operating Expenses	
Operating Income	Operating Income / Revenue = Operating Margin
- Interest Expense	
Pre-Tax Income	
- Income Tax	
Net Income	Net Income / Revenue = Net Margin

- It can also be very helpful to look at each of these figures on a percentage of revenue basis.
- Doing so allows you to compare companies of different sizes and see which direction margins are heading.



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Market Capitalization (Share price x total shares outstanding)	Income Statement:	Valuation Metric:
Market Cap Divided by -->	Revenue / Sales =	Price-to-Sales (P/S) ratio
	- Cost of Goods Sold	
Market Cap Divided by -->	Gross Profit =	Price-to-Gross Profit ratio
	- Operating Expenses	
Market Cap Divided by -->	Operating Income =	Price-to-EBIT ratio
	- Interest Expense	
	Pre-Tax Income	
	- Income Tax	
Market Cap Divided by -->	Net Income =	Price-to-Earnings (P/E) ratio

- The income statement can also be useful in determining point-in-time valuations. These figures are usually calculated using 1-year data.



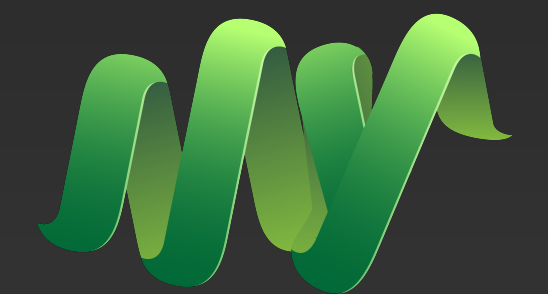
# Next Steps

- 1) Search for a company's most recent earnings report and review the income statement.
- 2) Compare the income statement with an income statement for the same reporting period one year ago.
- 3) Assess if the company is growing or shrinking based on the financials and broader market trends.



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