Reading Financial Statements

You don't need to be an engineer to drive a car! Neither do you need to be an accountant to read financial statements.

Workbook from

GraduateTutor.com

Reading Financial Statements

The GraduateTutor Team

©2013 - 2014 GraduateTutor.com

This book is dedicated to all our students who inspire us everyday to get better at what we do.

Contents

How to use this book:

We want you to be able to understand financial statements. Learning isn't a spectator sport. So while we have picked the 2011 financial statements of Apple, please pull up the financial statements of the companies that you are interested in so that you can apply what we teach to those companies as we go along.

We have provided Apple's income statement, balance sheet and cash flow statement at the end of this text book. Tear or print these out so you can refer to these or make notes on these as we walk you through the numbers. Similarly, have the financial statements of the companies that you are interested in printed out so that you can compare the numbers and study those companies as we walk you through the financial statements of Apple. We have also provided you the 2011 financial statements of Microsoft, Google and Walmart at the end of this book for easy access.

By the time you are done reading this book, we would like you to have practised these techniques on one or two other companies. Keep studying more financial statements to get better and better. Remember this is what Warren E. Buffet does for a hobby!

What you will need: • Apple's 2011 financial statements • Pen/pencil to make notes • Microsoft Excel or a calculator for computations when required • Financial statements of Google, Walmart and Microsoft (these are provided for 2011) • Financial statements of any other companies you are interested in

1. Income Statements

How profitable is the company?

If you were asked how much money you made and how much money you spent in the last year, what would your response be? If I were to pose the equivalent question to a company, I may be given the income statement in reply. I should be able to answer the following questions after I review the income statement of a company:

> What are the revenues of the company during the given period?
>
> Have the revenues increased or decreased over the last two years?
>
> What are the various components of cost?
>
> Did the company sell any assets?
>
> How profitable was the company during this period?
>
> What are the earnings attributable to a share or the Earnings Per Share?

The income statement may be referred to by other names including “statement of income” or “statement of operations” but essentially highlights the revenues the company earned over a period and the expenses incurred to generate that revenue.

You must note three things before you dive into an income statement. First, note the time period that the income statement covers. Income statements show the revenues, expenses and profits over a specific period, usually a year or a quarter. Second, pay attention to the unit of measurement used - this could be thousands or millions. The third is the currency in which the figures are reported- most US firms will provide their reports in US dollars. However, other firms may report their numbers in their respective home currencies.

When we look at Apple’s financial statement, we see that the income statement indicates “three years ended September 24, 2011”. Apple’s financial statement provides income statements for three years 2009, 2010 and 2011, each covering a year of activity.

What are the company’s profits?

I look at the income statement to understand how profitable the company is. The income statement tells me the value of the goods and services the company was able to make serving its customers over a specific period. This amount is reflected as revenues of the business. The income statement also shows the various expenses or costs incurred to generate the revenues during this period. These expenses are recorded under various categories or heads that are often called line items. The expenses are set off against or subtracted from the revenues to indicate the profit or net income of the business.

Revenues – Expenses = Net Income (Profits)

If the net income is positive, we say that the company has made a profit and is profitable. If the net income is negative, it is referred to as a loss and we say that the company has not been profitable during the period.

The income statement helps one understand if the business is able to provide goods and services at a cost lower than the price it is able to charge its customers.

To illustrate this, let's look at Apple's 2011 income statement. We see that Apple was able to generate revenues of $108.2 billion. In other words, Apple provided its customers goods and services worth $108.2 billion. Apple incurred expenses of $82.3 billion to generate this revenue, leaving itself a net income or profit of $25.9 billion.

		2011	%
Revenues	$	108,249	100%
Expenses	$	82,327	76%
Net income	$	25,922	24%

Apple's 2011 Income Statement

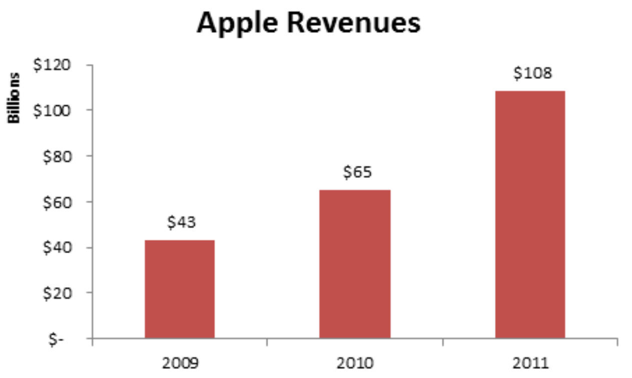
To make this more meaningful, I look at expenses as a percentage of revenues and see that the expenses are 76% of revenues. The net income is 24% of revenues and is commonly referred to as the net profit margin. It indicates that for every dollar of revenue Apple makes, it earns 24 cents as profit.

How does this compare to Google, Dell, Wal-Mart and American Airlines? Which of these companies are profitable?

Components Of The Income Statement

1.1 Revenue

The first line I look at in an income statement is the revenue generated in the specific period. I also check if the revenue has increased or decreased over time.



Apple's revenue over 3 years

For instance, when I look at the income statement of Apple, Inc., I can see that the revenue for the year ended on September 24, 2011 is $108 billion. I also see that the revenue has increased over 2009 and 2010.

How does Apple's revenue compare with the revenues of Google, Walmart and American Airlines?

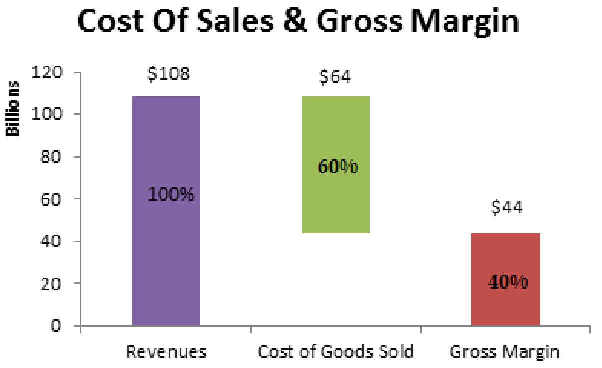
Which of these companies is the largest in terms of revenue?

Which company's revenues are growing the fastest?

Many income statements also provide a breakup of the different types of revenues. For instance, Google provides a breakup of its revenues as revenues from advertising on its own properties, advertising from network properties and other fees. Some companies also report gross and net revenue. Gross revenue is the revenue the company has made during the year. However, a company can expect non-paying customers, cancellations and refunds and these are subtracted from the gross revenue to arrive at the net revenue.

1.2 Cost Of Sales & Gross Margin

The next line I look at is the cost of sales. It is also referred to as the cost of goods sold and indicates the direct costs involved in providing the services or manufacturing the goods that generated the revenues such as the cost of raw material, salaries, rents, wages, etc. In 2011, we see that it cost Apple $64 billion in direct expenses (cost of goods sold) to produce $108 billion in sales.



Apple's Cost of Sales and Gross Margin in 2011

Gross margin is arrived at by subtracting the cost of sales from revenues. This figure indicates how much money is left over after the cost of sales to cover other operating expenses such as marketing, distribution, administration and corporate expenses. Dividing the gross margin by the revenues gives me the gross profit margin in percentage terms. I review what this number has been over a few years to see if it will give me any insight into the business. An increasing or steady gross profit margin is a good sign whereas a declining gross profit margin is cause for concern. The table below shows that Apple has been able to maintain a steady gross profit margin over the last few years.

Year	2009	2010	2011
	%	%	%
Revenues	100%	100%	100%
Cost of Goods Sold	60%	61%	60%
Gross Margin	40%	39%	40%

Apple's Cost of Goods Sold and Gross Margin in 2009, 2010 and 2011

What do you notice about the gross profit margins of Google, Walmart and American Airlines?

Which of these companies has been able to maintain a steady gross profit margin?

Has the change been for better or worse?

1.3 Operating Expenses

The cost of sales and gross margin are typically followed by other operating expenses. These include research and development, selling expenses, marketing costs, commissions, royalties and fees and any other operating expenses incurred during this period in the normal course of business. Operating expenses are slightly different from the cost of sales expenses because they are usually incurred over the period considered and not directly linked to the production of goods or services.

Apple's financial statements shows that it spent $2.4 billion on research and development and $7.6 billion in selling and general expenses in 2011. The amount of money spent by a company on the different types of operating expenses will depend on the nature of its business. Apple is in the technology area and is required to invest significantly in research and development whereas Wal-Mart which is a retailer may not need to do so.

What other differences do you notice in the operating expenses of Apple and Walmart?

1.4 Operating Income

I subtract the operating expenses from the gross margin to arrive at the operating income. The operating income indicates the profits generated from the core activities of the business. This is a number that I should pay attention to because it represents the value the company generates from its core business. I should also look at what this number has been as a percentage of revenue over the last few years to see if I can notice any trend in profitability from the business.

Apple's operating income in dollars and its operating income as a percentage of revenues over the last three years has been increasing significantly. This indicates a very profitable business and a healthy trend.

Year	2009	2010	2011
Operating income	$ 11,740	$ 18,385	$ 33,790
Operating income as a % of revenues	*27%*	*28%*	*31%*

Apple's Operating Income in 2009, 2010 and 2011

What do you notice about the operating income in dollars and the operating income as a percentage of revenues when it comes to Google, Dell, Wal-Mart and American Airlines?

Other income and expenses

After the operating income and expenses have been reviewed, I will review the other income and expenses of a business. Often, businesses have, intentionally or unintentionally, acquired investments that produce sizeable revenues. Most companies have borrowed money and will pay interest on the money borrowed. The interest costs incurred will be reflected in this section of the balance sheet. Sometimes, other expenses that have been incurred

by the company will reduce the overall profitability of the company.

Apple has a lot of cash in its balance sheet and relatively little debt. Therefore, Apple has other income to report and no interest expenses to report.

What other income and expenses do you notice in the income statements of Google, Dell, Wal-Mart and American Airlines?

Net income and income taxes

Subtracting the other income and expenses from the operating income of the business will give you the profit before taxes. Uncle Sam collects his share of the profits at this point. Taxes collected are used to run the government and provide public infrastructure to the nation. The computation of income taxes is a more complex process and is one that we will not address at this level.

Subtracting the provision for income taxes from the profit before taxes gives you the net income of the business. This is the amount the business has generated during the period for its shareholders.

Year	2009	2010	2011
Operating income	$11,740	$18,385	$33,790
+ Other income & expense	$ 326	$ 155	$ 415
- Income before income taxes	$12,066	$18,540	$34,205
- Provision for income taxes	$ 3,831	$ 4,527	$ 8,283
= Net income	$ 8,235	$14,013	$25,922
Growth rate		70%	85%

Apple's Net Income in 2009, 2010 and 2011

Apple's net income has been increasing dramatically with growth rates of 70% and 80%. Can we say the same about Google, Wal-Mart and American Airlines?

1.5 Earnings Per Share and Dividend

We saw in the earlier section that Apple generated $25.9 billion of net income for its shareholders in 2011. This belongs to all the shareholders together. Dividing the net income by the number of shares outstanding gives the portion of net income that belongs to a shareholder who owes only one share of Apple. This is referred to as the **Earnings Per Share (EPS)**.

Often, companies have another line here indicating Diluted EPS which is arrived at by dividing the net income by the outstanding shares and options or share warrants. We will not address this topic at this level.

The earnings per share is only the amount of net income attributable to each share outstanding in the company. The company can decide to retain this income in the company so it can be re-invested back into the business or to pay it out to shareholders. The amount paid to the shareholders is called the dividend. Apple has not paid out a dividend historically but has announced one recently. Wal-Mart, however, pays out dividends every quarter. What do you notice in the income statements of Google and American Airlines?

An important aspect to note regarding the income statement is that the amounts reflected are what the company earned or incurred. It is not the amount of money collected or actually paid. This information is usually derived from the cash flow statements.

Summary

The income statement summarizes the performance of a company for a specified period. The income statement tells you the revenue generated from goods or services provided and the expenses incurred to generate that revenue.

If I could only take away three facts from an income statement, I would look at:

- the revenues generated by the firm (so I know the size of the business)
- the profit margin (so I know the percentage of revenues that was left over for its shareholders after expenses)

• earnings per share (so I know the portion of the earnings I would be entitled to if I owned one share)

2. Balance Sheets

2.1 *What is the financial health of this company*?

What would you tell me if I were to ask you about your present-day net worth or financial position? You would list out all your assets which may include cash, stocks, automobiles, homes, land, etc. You would also list out your liabilities (amounts you owe others) which may include credit card dues, car loans, home mortgages etc. You would subtract your liabilities from your assets and that is your net worth.

My assets			
Cash	$	10,000	
Car	$	25,000	
Home	$	250,000	
Total assets			$ 285,000
My Liabilities			
Credit card	$	600	
Car loan	$	6,000	
Home loan	$	65,000	
Total liabilities			$ 71,600
MY NET WORTH			$ 213,400

Net Worth Balance Sheet

If I were to ask a company that question, I may be given the balance sheet as a response. The balance sheet gives me perspective on the financial health of the company. It lists the assets and liabilities of the company. The balance sheet also tells me the net worth of the company. I should be able to answer the following questions after I review the balance sheet of a company:

•What are the assets of the company as on the balance sheet date?

•What is the total value of the assets?

•Who does the company owe money to?

•What is the total amount of money owed to others?

•How much money did the shareholders invest in the company?

•How much money did the company generate for the shareholders?

•What is the net worth of the company?

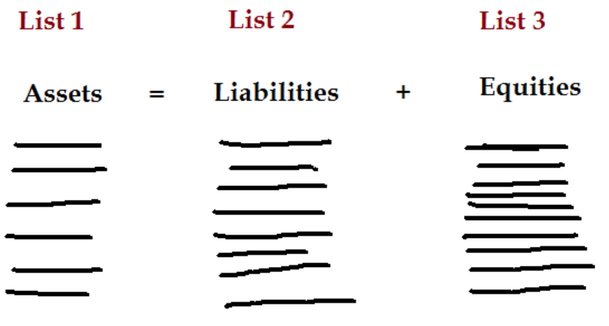
2.2 Overview

The first thing that I notice on a balance sheet is the heading. It should provide me three pieces of information. The first is the date of the balance sheet - the balance sheet provides the financial position of a company as on that date. Balance sheets usually provide figures for two dates – usually the beginning and the end of a time period. The second is the unit of measurement - the reported figures may be in thousands or millions. The third is the currency in which the figures are reported- most US firms will provide their reports in US dollars. However, other firms may report their numbers in their respective home currencies.

Apple's balance sheet in its 2011 annual report described the financial state of the company at two points in time, specifically on September 24, 2011 and September 25, 2010. We can also see that all the figures are presented in millions except the number of shares which is reported in thousands. Since Apple is a US-based company, it reports its figures in US dollars. What do you notice first when you look at the balance sheets of Google, Wal-Mart and American Airlines?

2.3 Three Components of a Balance Sheet

The balance sheet can be looked at as three lists.



The first list is a list of **assets** of the company. An asset is defined as any current or future economic resource of the company. This could be money owed to the company, land or buildings owned, rights to mining or other resources, patents or trademarks or anything else of value.

The second list is a list of **liabilities** or amounts the company owes others. A company could owe money to its suppliers or employees. A company could also owe interest and principal payments to banks or other institutions.

The third list is usually titled **shareholders' equity**. This list usually contains the amounts investors or owners have contributed to the company. It also lists the profits (or losses) that the company has made. The profits or losses retained by the company is usually labeled "retained earnings".

Assets = Liabilities + Shareholders' equities

The basic accounting equation states that the sum of the values in the assets list must equal the sum of the values in the liabilities list and the shareholders' equity list. This equation follows all the rules of algebra and can be rearranged into any convenient form. For example, this equation is rearranged to get the net worth of the company as follows:

In the case of Apple, we see that

Assets = Liabilities + Shareholders Equities

A = L + E

A ($116,371) = L(39,756) + E (76,615)

Alternatively,

Assets - Liabilities = Shareholders Equities

A - L = E

A ($116,371) - L(39,756) = E (76,615)

Let's look at the three lists in a balance sheet in more detail.

2.4 Assets

An asset is defined to be any current or future economic resource of the company. This could be money owed to the company, land or buildings, rights to mining or other resources, patents or trademarks or anything else of value. Assets are classified into two types in a balance sheet - current assets and long term assets. Assets that can be converted into cash quickly (usually within a year or less) as classified as current assets on the balance sheet. Assets that cannot be converted into cash quickly and are intended to be used by the company over a longer period are classified as long term assets or other assets. Examples of current assets include cash, accounts receivables, inventory, bonds and stocks which can easily be converted into cash. Examples of long term assets include land, buildings, machinery, etc. which are used by the business over a long term.

	24-Sep-11	25-Sep-10
Current assets:		
Cash and cash equivalents	$ 9,815	$ 11,261
Short-term marketable securities	16,137	14,359
Accounts receivable	5,369	5,510
Inventories	776	1,051
Deferred tax assets	2,014	1,636
Vendor non-trade receivables	6,348	4,414
Other current assets	4,529	3,447
Total current assets	44,988	41,678
Long term assets:		
Long-term marketable securities	55,618	25,391
Property, plant and equipment, net	7,777	4,768
Goodwill	896	741
Acquired intangible assets, net	3,536	342
Other assets	3,556	2,263
Total Long term assets	71,383	33,505
Total assets	$116,371	$ 75,183

Apple's list of current and long-term assets

Apple's current assets list has six items that total up to almost $45 billion. Its long term assets come to $71 billion, thus adding up to $116 billion of total assets.

What are the assets of Google, Wal-Mart and American Airlines?

Which of these companies has the most assets?

You have to be careful interpreting the asset side of the balance sheet because of serious limitations in financial accounting. Financial accounting regulations require companies to follow specific rules when it comes to the valuation of assets. These rules could cause anomalies that we must be aware of.

Some assets like land are recorded at historical values as values do not depreciate. This means that if Apple bought land for its factories 20 years ago, the value of land will be reflected in its balance sheets at the price it paid for the land 20 years ago. The value of the land has probably appreciated considerably since then. This appreciation will not be reflected in Apple's balance sheet because accounting rules require you to record land at historical cost except under certain conditions.

Some assets are recorded at 'net cost'. Net cost is historical cost reduced in value 'according to its use'. This process of adjusting historical costs according to use is called depreciation. For example, if a machine was purchased for $100,000 and was intended to be used for 10 years, its value would be decreased (depreciated) by $10,000 each year that the machine is in use. The real value of the machine in the market may be more or less than the net value. Other assets have specific guidelines too. For example, inventories must be valued at the lower of cost or market prices.

> We must keep in mind that the value of assets listed in a balance sheet may not be the true value of the assets in the market today. Therefore, we must recognize that the value of the figures in the balance sheet will not reflect the true value of a company as a whole.

To value the company as a whole, I prefer to use the concept of "enterprise value". Very simply, the enterprise value is the market capitalization of a company plus the debt minus the excess cash or assets of the company. Valuation of a company is not something that we will address at this stage.

2.5 Liabilities

The liabilities section of the balance sheet lists out what the company owes other people. A company could owe money to its suppliers or employees. A company could also owe interest and principal payments to banks or other institutions.

The liabilities section is broken down into current liabilities and long term liabilities. Current liabilities are liabilities that the company is obligated to pay in the short term (usually considered to be 12 months). Long term liabilities are other liabilities that the company is not obligated to pay in the short term.

	24-Sep-11	25-Sep-10
Current liabilities:		
Accounts payable	$ 14,632	$ 12,015
Accrued expenses	9,247	5,723
Deferred revenue	4,091	2,984
Total current liabilities	27,970	20,722
Long term liabilities:		
Deferred revenue - non-current	1,686	1,139
Other non-current liabilities	10,100	5,531
Total long term liabilities	11,786	6,670
Total liabilities	39,756	27,392

Apple's list of current and long-term liabilities

Apple's current liabilities list has three items listed for a total of $28 billion. Its long term liabilities total $12 billion, thus adding up to $40 billion of total liabilities.

What are the liabilities you see in the balance sheets of Google, Wal-Mart and American Airlines?

2.6 Shareholders' Equity

The shareholders' equity section of the balance sheet shows the amount of money attributable to the shareholders. The first part of this section usually shows the common stock or the amount of money paid by the shareholders to receive shares of the company. This section will also highlight the number of shares that the company is authorized to issue and the number of shares the company has issued so far.

	24-Sep-11	25-Sep-10
Shareholders' equity:		
Common stock,	13,331	10,668
1,800,000 shares authorized; 929,277 and 915,970 shares issued and outstanding,		
Retained earnings	62,841	37,169
Accumulated other comprehensive income/(loss)	443	(46)
Total shareholders' equity	76,615	47,791

Apple's Shareholders' Equity

We can see that although Apple has been authorized to issue 1.8 billion shares it has only issued 930 million shares as on September 24, 2011. We can also see that the shareholders have paid $13.3 billion to the company in return for these shares.

Retained earnings is the next component of this section. Retained earnings reflect the amount of net income retained by the company instead of being paid to shareholders as dividends. Companies retain profits instead of paying it back to shareholders to reinvest it into the business. We see that Apple has about $63 billion of profits that have not been paid out to shareholders and this is classified as retained earnings.

What is the amount of money paid by the shareholders of Google, Walmart and American Airlines?

What are the retained earnings you note for Google, Wal-Mart and American Airlines?

Often, this section will also contain a line called **accumulated other comprehensive income**. This usually consists of amounts that have not flowed in through the income statement. We will not review the accumulated other comprehensive income figure at this level.

2.7 Summary

The balance sheet reflects the financial health of the company as on the date of the balance sheet. The balance sheet can be looked at as three lists. The first list is a list of assets of the company. Assets are defined to be any current or future economic resources of the company. The second list is a list of liabilities or amounts the company owes others. A company could owe money to its suppliers or employees or financial institutions. The third list called shareholders' equity reflects amounts that investors or owners have contributed to the company in exchange for shares as well as the retained earning which is the profit retained by the company to fund further investment. If I could only take away three facts after reviewing the balance sheet, I would answer the following questions:

- What is the value of assets owned by the company?
- What is the value of liabilities owed by the company?
- What is the net worth of the company?

3. Cash Flow Statements

3.1 *Follow the money*

If you were asked whether your cash balance increased or decreased over the last year and why, what would your response be? If I were to pose the equivalent question to a company, I may be given the cash flow statement as an answer. I look at the cash flow statement to understand how the company generated cash or used its cash during the period in question. I should be able to answer the following questions after I review the cash flow statement of a company:

> Did the company increase or decrease its cash and cash equivalents (deposits, bonds etc.) during the period?
>
> How much money did the company generate from its operations?
>
> How much money did the company invest in its business?
>
> Did the company sell any assets?
>
> How much money did the company pay its shareholders and lenders?

> Did the company raise money from its shareholders and lenders?

"**Cash Equivalents**" is a term applied to temporary investments that are highly liquid or marketable. These are investments that can be converted into known amounts of cash quickly. The cash flow statement considers both cash and cash equivalents alike and explains the changes in the total of both cash and cash equivalents.

3.2 Overview

While the balance sheet of the company can tell me what the cash and cash equivalents balance at the beginning of the period and the end of the period were, it cannot tell me how the company generated or consumed the cash. Similarly, the income statement can tell me the value of goods the company earned - it cannot tell me the net cash collected as most companies sell on credit and take time to pay vendors. It is the cash flow statement that tells me how the company generated or used its cash and cash equivalents.

The cash flow statement highlights the cash the company spent or generated from its operating activities (day-to-day running), investing activities (buying and selling assets) and financing activities (raising more money from its investors or lendors or returning money to them). The sum of changes in these three categories will reflect the overall increase or decrease in cash and cash equivalents during the period. This increase or decrease when added to the cash and cash equivalents at the beginning of the period will give you the cash and cash equivalents at the end of the period.

Cash generated by or used in ***operating*** *activities*	$ 37,529	
Cash generated by or used in ***investing*** *activities*	$(40,419)	
Cash generated by or used in ***financing*** *activities*	$ 1,444	
Total (Decrease)/increase in cash (& cash equivalents)		$ (1,446)
Cash and cash equivalents, beginning of the year		$ 11,261
Total (Decrease)/increase in cash (& cash equivalents)		$ (1,446)
Cash and cash equivalents, end of the year		$ 9,815

Select figures from Apple Inc.'s 2011 Cash Flow Statement

If we look at Apple's cash flow statement and pull out this information, we will see that Apple generated $38 billion dollars of cash from its operations. It invested about $40 billion of cash into its business. Apple also raised $1.4 billion from providers of capital. The net impact of this was a negative $1.4 billion indicating that it has $1.4 billion less cash and cash equivalents at the end of the year than it had at the beginning of the year.

What do you notice in the cash flow statements of Google, Wal-Mart and American Airlines?

3.3 Operating activities

The term "operating activities" refers to the core activities of the company or business. It consists of the activities involved in selling goods and/or providing services that generate revenues and expenses for the company. The operating activities of a business will depend on the nature of the business.

> The operating activities of a watch company will be the manufacturing, marketing and selling of watches. The purchase and sale of land will be considered an operating activity for a real estate company.

The operating section of a cash flow statement may be presented in two ways: the indirect method and the direct method.

Most companies use the indirect method to report the cash flow statement because the accounting processes and systems commonly used make this convenient. The indirect method starts with the net income figure derived from the income statement and adds or subtracts the difference between cash collected and amounts presented in the income statement to arrive at the actual cash position from operations.

It also removes the non-operating activities that were included in the income statement. The direct method presents the cash collected by the business from operations and subtracts the cash paid for operating activities. We will not study the mechanics of computing the cash flow from operating activities through either the direct or indirect method at this level. At this level, it is sufficient to understand the total amount of cash generated by or used in operating activities.

	2011
Operating activities:	
Net income	**25,922**
Adjustments to reconcile net income to cash generated by operating activities:	
Depreciation, amortization and accretion	1,814
Share-based compensation expense	1,168
Deferred income tax expense	2,868
Changes in operating assets and liabilities:	
Accounts receivable, net	143
Inventories	275
Vendor non-trade receivables	(1,934)
Other current and non-current assets	(1,391)
Accounts payable	2,515
Deferred revenue	1,654
Other current and non-current liabilities	4,495
Cash generated by operating activities	**37,529**

Operating activity section of Apple Inc.'s 2011 cash flow statement

We can see that although Apple has reported a net income of only $25 billion, it has generated $38 billion from its operating activities. How much cash has Google, Wal-Mart and American Airlines generated or used in operating activities according to their respective cash flow statements?

3.4 Investing activities

A company will need to spend money on assets like equipment, buildings, land, etc. to grow or maintain its business. A company will also sell these assets when these are outdated or when it needs to fund the purchase of new assets. These activities are categorized as investing activities. The investing activities section of the cash flow statement will include both the cash generated by selling assets and the cash spent in buying assets. Cash outflows are indicated by negative numbers and cash inflows are indicated by positive numbers in the investing section of the cash flow statement. The investing activities of a business will depend on the nature of the business. For instance, the purchase of land will be considered an investing activity for a watch company while it will be considered an operating activity for a real estate company.

From the investing section of its cash flow statement, we can see that Apple has both sold and bought assets. The net impact of Apple's investing activities is the use of $40 billion of cash and marketable securities. In other words, Apple has invested $40 billion.

How much money has Google, Wal-Mart and American Airlines used for or generated from investing activities?

		2011
Investing activities:		
Purchases of marketable securities	$	(102,317)
Proceeds from maturities of marketable securities	$	20,437
Proceeds from sales of marketable securities	$	49,416
Payments made in connection with business acquisitions, net of cash acquired	$	(244)
Payments for acquisition of property, plant and equipment	$	(4,260)
Payments for acquisition of intangible assets	$	(3,192)
Other	$	(259)
Cash used in investing activities	$	(40,419)

Investing activity section of Apple Inc.'s 2011 cash flow statement

3.5 Financing activities

Any activity that involves receiving or returning money from or to its providers of capital (investors or lenders) is categorized as a financing activity. This includes issuing shares, borrowing money, paying dividends, paying interest on money borrowed, etc. Cash outflows are indicated by negative numbers and cash inflows are indicated by positive numbers in the financing section of the cash flow statement.

		2011
Financing activities:		
Proceeds from issuance of common stock	$	831
Excess tax benefits from equity awards	$	1,133
Taxes paid related to net share settlement of equity awards	$	(520)
Cash generated by financing activities	**$**	**1,444**

Financing activity section of Apple Inc.'s 2011 Cash Flow Statement

We see that Apple issued stock in 2011. It also gained tax benefits and paid taxes related to the issue of stock in 2011. The net impact of these financing activities was a $1.4 billion cash flow into the company.

3.6 Insight gained from the cash flow statements

The cash flow statement reveals the liquidity position of the company. It shows if the company will be able to fund its operations without resorting to outside funds. This is important in preparing for and surviving lean periods or economic downturns.

The cash flow statement also reveals the life stage of a company. Is the company growing, mature or declining?

A growing company may have a negative cash flow from operating and investing activities and a positive cash flow from financing activities as it continues to need money from shareholders to grow. A mature firm will have a positive cash flow from operating activities and possibly a negative balance in its investing activities. A declining firm may have a positive cash flow from operating and investing activities and a negative cash flow from financing activities as it uses money from its business to pay back its investors.

Year	2009	2010	2011
Cash generated by or used in ***operating*** *activities*	$ 10,159	$ 18,595	$ 37,529
Cash generated by or used in ***investing*** *activities*	$(17,434)	$(13,854)	$(40,419)
Cash generated by or used in ***financing*** *activities*	$ 663	$ 1,257	$ 1,444
Total (Decrease)/increase in cash (& cash equivalents)	$ (6,612)	$ 5,998	$ (1,446)

Select figures from Apple Inc. 2011 Cash Flow Statement

Looking at Apple's cash flow statement, we can see that Apple is a mature company generating significant cash flow from operating activities and making significant investments to grow its business. What would you conclude about Google, Wal-Mart and American Airlines?

3.7 Summary

The cash flow statements show how the company generated or used its cash during the period in question. The cash flow statement categorizes its cash activities into three categories which are operating activities, investing activities and financing activities. The sum of changes in these three categories will reflect the overall increase or decrease of cash and cash equivalents during the period. This increase or decrease when added to the cash and cash equivalents at the beginning of the period will give the cash and cash equivalents at the end of the period.

The cash flow statements reveal the liquidity position of the company. It also indicates the life stage of a company as growing, mature or declining. Understanding cash flow statements is very important because the ability to generate cash flow determines the true value of a business.

4. Percentage Statements

If I were to ask how one company is different from another company or its competitors, I may be given a variety of answers focusing on its products, customer segments, culture, scope, business model, etc. However, by looking at the company's percentage statements, I can understand how this company is different from another company or its competitors from a financial perspective. Reviewing a company's percentage statements will help me answer the following questions:

• How is this company different from other companies or its competitors?

• Has the company's financial performance been improving or declining?

• What is likely causing the improvement or decline?

• What are the main components of expenses for this company?

• How does the strategy of this company impact its financial performance?

• Is the company's strategy working?

• What is the financial health of this company?

The percentage income statement and percentage balance sheet are prepared from the income statement and the balance sheet respectively. As the name suggests, the components of the percentage statement are not mentioned in dollar terms but in terms of a percentage of another variable.

> The main advantage of a percentage statement is that it can be used to compare companies of different sizes and gain an understanding of business models and strategies.

4.1 Percentage Income Statement

The percentage income statement is prepared by expressing each component of the income statement as a percentage of the net sales or revenues of the company. For example, Apple's 2011 net sales was $108.25 million and its cost of sales was $64.43 million. So the cost of sales as a percentage of net sales will be $64.43/$108.25 or 60%. Its gross margin in 2011 was $43.82 million or 40% ($43.82/$108.25).

	Dollars	Percentage Statements		
	2011	2011	2010	2009
Net sales	$ 108,249	100%	100%	100%
Cost of sales	64,431	60%	61%	60%
Gross margin	43,818	40%	39%	40%
Operating expenses:		0%	0%	0%
Research and development	2,429	2%	3%	3%
Selling & administrative expenses	7,599	7%	8%	10%
Total operating expenses	10,028	9%	11%	13%
Operating income	33,790	31%	28%	27%
Other income & expense	415	0%	0%	1%
Income before income taxes	34,205	32%	28%	28%
Provision for income taxes	8,283	8%	7%	9%
Net income	**25,922**	**24%**	**21%**	**19%**

Percentage income statement in numbers

Components Of Expenses

A glance at this percentage statement for the year 2011 will help us understand what the key cost components for the company were and how profitable its operations were.

A look at Apple's percentage income statement will reveal some interesting facts. The cost of its goods sold is only approximately 60%. This indicates that for every dollar earned, it spent only 60 cents in making its products leaving it a healthy 40 cents to cover other costs and profits. We can also see that it spends about 2-3% of each dollar earned on research and development as well as about 7-10% of its revenues on sales and other general expenses.

What do you notice after looking at the percentage statements of Google, Wal-Mart and American Airlines?

Have these companies spent more of their revenues on research and development or on sales and other general expenses?

What does this say about where they focus their time, energy and money?

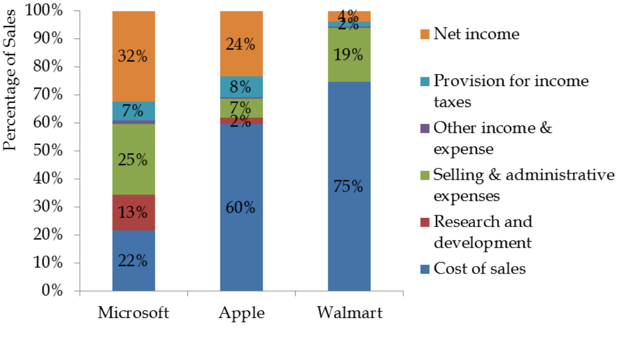
Trends over time

The percentage statement also helps the reader observe trends over time. We can see if the company's profit margins have improved or if its costs have increased over time. In the case of Apple, we can see that Apple's operating margin has been increasing over the last few years. What is causing the increase in operating margins? This could be because of the decreasing proportion of spend on selling and general administration expenses as a result of its increasing sales.

What trends do you notice after looking at the percentage statements of Google, Wal-Mart and American Airlines?

Understand The Nature Of Business

Percentage statements help us understand the nature of different types of businesses. Some businesses are high-margin businesses whereas some are low-margin, high-turnover businesses. Some companies intentionally invest in research & development while some companies do not. Percentage statements help us understand the differences between companies and business patterns. Let's look at the percentage statements of Apple, Microsoft and Wal-Mart.



Percentage Income Statement Chart

We can see striking differences in the way Apple operates when compared to Microsoft, a company that is similar in many ways or to Wal-Mart, a company in an entirely different business. The cost of goods sold highlights the most obvious difference. Wal-Mart is a retailer and therefore its cost of goods sold is expected to be a significant part of its costs. Apple sells hardware and software and so has a lower cost of goods percentage when compared to Wal-Mart. Microsoft mostly sells software and so has lower cost of goods sold than Apple. We can see that Wal-Mart invests nothing in research and development and Microsoft invests a significant amount in research and development.

A company's strategy can also be observed in its percentage statements. For example Wal-Mart's strategy is to be a low price, high volume business and this will be reflected in its sales revenues and profit margins. These percentages will be different for a company like Neiman Marcus whose strategy is to be a high margin,low volume business. If a company has changed its strategy over time, we will see that reflected in the financial statements too. If two companies are in the same business and adopt similar strategies, their percentage income statements will indicate which of the companies ran its operations more efficiently.

Percentage Balance Sheet

Like the percentage income statement, the percentage balance sheet is helpful in understanding the nature of the company and business. It is prepared by expressing each component as a percentage of the total assets or total liabilities of the company.

A comparison of the figures for the past few years will give us an insight into how the company's strategy has played out or changed over the years.

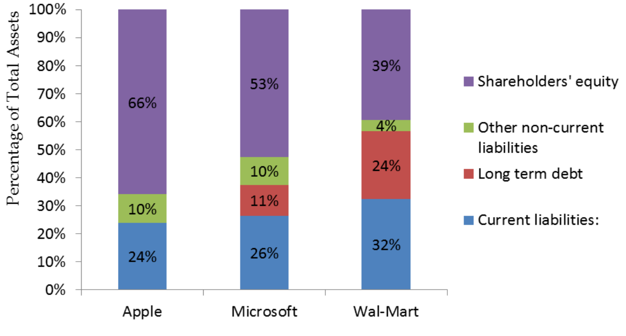
ASSETS:	AAPL	MSFT	Wal-Mart
Current assets:			
Cash and cash equivalents	22%	49%	4%
Accounts receivable	5%	14%	3%
Inventories	1%	1%	20%
Other current assets	11%	5%	2%
Total current assets	**39%**	**69%**	**29%**
Long-term marketable securities	48%	10%	0%
Property, plant and equipment, net	7%	8%	60%
Goodwill	1%	12%	9%
Acquired intangible assets, net	3%	1%	0%
Other assets	3%	1%	2%
Total assets	**100%**	**100%**	**100%**
LIABILITIES AND SHAREHOLDERS' EQUITY:			
Current liabilities:			
Accounts payable	13%	4%	19%
Other current liabilities	11%	23%	14%
Total current liabilities	24%	26%	32%
Long term debt	0%	11%	24%
Other non-current liabilities	10%	10%	4%
Total liabilities	**34%**	**47%**	**61%**
Shareholders' equity:	11%	58%	4%
Retained earnings	54%	-6%	36%
Total shareholders' equity	**66%**	**53%**	**39%**
Total liabilities and shareholders' equity	**100%**	**100%**	**100%**

% of

Percentage Balance Sheet in %

You will see striking differences in the businesses of Apple, Microsoft and Wal-Mart when you look at the percentage balance sheets of these companies.

You will notice that Wal-Mart has 60% of its assets in property, plants and equipment whereas Apple and Microsoft have far lower assets in this category. This reflects the differences in their business models. Wal-Mart requires land and building space throughout the country to run its retail outlets whereas Apple and Microsoft do not require the kind of footprint that Wal-Mart requires. Similarly, Apple and Microsoft have less than 1% of their assets in inventories whereas Wal-Mart has 20% in inventories reflecting the investments in merchandise that Wal-Mart needs to run its business.



Percentage Balance Sheet Chart Liabilities

If you observe the percentage balance sheets of Apple, Microsoft and Wal-Mart, you will see that Apple has no debt, Microsoft operates on little debt and Wal-Mart has a reasonable amount of debt. You will also see that these three companies have earned healthy profits over the last few years, causing their shareholders' equity to be a large portion of their liabilities with Apple having the largest proportion of liabilities in shareholders' equity.

Summary

Reviewing a company's percentage statements will help me answer the following questions:

- How is this company different from another company or its competitors?
- Has the company's financial performance been improving or declining?
- What is likely causing the improvement or decline?
- How does the strategy of this company impact its financial performance?
- Is the company's strategy working?

Appendix A

2011 Apple Income Statement

CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions, except number of shares which are reflected in thousands and per share amounts)

Three years ended September 24, 2011	2011	2010	2009
Net sales	$108,249	$ 65,225	$ 42,905
Cost of sales	64,431	39,541	25,683
Gross margin	43,818	25,684	17,222
Operating expenses:			
Research and development	2,429	1,782	1,333
Selling, general and administrative	7,599	5,517	4,149
Total operating expenses	10,028	7,299	5,482
Operating income	33,790	18,385	11,740
Other income and expense	415	155	326
Income before provision for income taxes	34,205	18,540	12,066
Provision for income taxes	8,283	4,527	3,831
Net income	$ 25,922	$ 14,013	$ 8,235
Earnings per common share:			
Basic	$ 28.05	$ 15.41	$ 9.22
Diluted	$ 27.68	$ 15.15	$ 9.08
Shares used in computing earnings per share:			
Basic	924,258	909,461	893,016
Diluted	936,645	924,712	907,005

Appendix B

2011 Apple Balance Sheet

CONSOLIDATED BALANCE SHEETS
(In millions, except number of shares which are reflected in thousands)

	September 24, 2011	September 25, 2010
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 9,815	$ 11,261
Short-term marketable securities	16,137	14,359
Accounts receivable, less allowances of $53 and $55, respectively	5,369	5,510
Inventories	776	1,051
Deferred tax assets	2,014	1,636
Vendor non-trade receivables	6,348	4,414
Other current assets	4,529	3,447
Total current assets	44,988	41,678
Long-term marketable securities	55,618	25,391
Property, plant and equipment, net	7,777	4,768
Goodwill	896	741
Acquired intangible assets, net	3,536	342
Other assets	3,556	2,263
Total assets	$ 116,371	$ 75,183
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	$ 14,632	$ 12,015
Accrued expenses	9,247	5,723
Deferred revenue	4,091	2,984
Total current liabilities	27,970	20,722
Deferred revenue – non-current	1,686	1,139
Other non-current liabilities	10,100	5,531
Total liabilities	39,756	27,392
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value; 1,800,000 shares authorized; 929,277 and 915,970 shares issued and outstanding, respectively	13,331	10,668
Retained earnings	62,841	37,169
Accumulated other comprehensive income/(loss)	443	(46)
Total shareholders' equity	76,615	47,791
Total liabilities and shareholders' equity	$ 116,371	$ 75,183

Appendix C

2011 Apple Cash Flow Statement

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(In millions, except number of shares which are reflected in thousands)

	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income/ (Loss)	Total Shareholders' Equity
	Shares	Amount			
Balances as of September 27, 2008	888,326	$ 7,177	$ 15,129	$ (9)	$22,297
Components of comprehensive income:					
Net income	0	0	8,235	0	8,235
Change in foreign currency translation	0	0	0	(14)	(14)
Change in unrealized gains/losses on marketable securities, net of tax	0	0	0	118	118
Change in unrecognized gains/losses on derivative instruments, net of tax	0	0	0	(18)	(18)
Total comprehensive income					8,321
Share-based compensation	0	707	0	0	707
Common stock issued under stock plans, net of shares withheld for employee taxes	11,480	404	(11)	0	393
Tax benefit from equity awards, including transfer pricing adjustments	0	(78)	0	0	(78)
Balances as of September 26, 2009	899,806	8,210	23,353	77	31,640
Components of comprehensive income:					
Net income	0	0	14,013	0	14,013
Change in foreign currency translation	0	0	0	7	7
Change in unrealized gains/losses on marketable securities, net of tax	0	0	0	123	123
Change in unrecognized gains/losses on derivative instruments, net of tax	0	0	0	(253)	(253)
Total comprehensive income					13,890
Share-based compensation	0	876	0	0	876
Common stock issued under stock plans, net of shares withheld for employee taxes	16,164	703	(197)	0	506
Tax benefit from equity awards, including transfer pricing adjustments	0	879	0	0	879
Balances as of September 25, 2010	915,970	10,668	37,169	(46)	47,791
Components of comprehensive income:					
Net income	0	0	25,922	0	25,922
Change in foreign currency translation	0	0	0	(12)	(12)
Change in unrealized gains/losses on marketable securities, net of tax	0	0	0	(41)	(41)
Change in unrecognized gains/losses on derivative instruments, net of tax	0	0	0	542	542
Total comprehensive income					26,411
Share-based compensation	0	1,168	0	0	1,168
Common stock issued under stock plans, net of shares withheld for employee taxes	13,307	561	(250)	0	311
Tax benefit from equity awards, including transfer pricing adjustments	0	934	0	0	934
Balances as of September 24, 2011	929,277	$13,331	$ 62,841	$ 443	$76,615

Appendix D

2011 Google Income Statement

CONSOLIDATED STATEMENTS OF INCOME
(In millions, except per share amounts)

	Year Ended December 31,		
	2009	2010	2011
Revenues	$23,651	$29,321	$37,905
Costs and expenses:			
Cost of revenues (including stock-based compensation expense of $47, $67, $249)	8,844	10,417	13,188
Research and development (including stock-based compensation expense of $725, $861, $1,061)	2,843	3,762	5,162
Sales and marketing (including stock-based compensation expense of $231, $261, $361)	1,984	2,799	4,589
General and administrative (including stock-based compensation expense of $161, $187, $303)	1,668	1,962	2,724
Charge related to the resolution of Department of Justice investigation	0	0	500
Total costs and expenses	15,339	18,940	26,163
Income from operations	8,312	10,381	11,742
Interest and other income, net	69	415	584
Income before income taxes	8,381	10,796	12,326
Provision for income taxes	1,861	2,291	2,589
Net income	$ 6,520	$ 8,505	$ 9,737
Net income per share of Class A and Class B common stock:			
Basic	$ 20.62	$ 26.69	$ 30.17
Diluted	$ 20.41	$ 26.31	$ 29.76

Appendix E

2011 Google Balance Sheet

CONSOLIDATED BALANCE SHEETS
(In millions, except share and par value amounts which are reflected in thousands, and par value per share amounts)

	As of December 31, 2010	As of December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$ 13,630	$ 9,983
Marketable securities	21,345	34,643
Total cash, cash equivalents, and marketable securities (including securities loaned of $4,031 and $2,778)	34,975	44,626
Accounts receivable, net of allowance of $101 and $133	4,252	5,427
Receivable under reverse repurchase agreements	750	745
Deferred income taxes, net	259	215
Prepaid revenue share, expenses and other assets	1,326	1,745
Total current assets	41,562	52,758
Prepaid revenue share, expenses and other assets, non-current	442	499
Deferred income taxes, net, non-current	265	0
Non-marketable equity securities	523	790
Property and equipment, net	7,759	9,603
Intangible assets, net	1,044	1,578
Goodwill	6,256	7,346
Total assets	$ 57,851	$ 72,574
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 483	$ 588
Short-term debt	3,465	1,218
Accrued compensation and benefits	1,410	1,818
Accrued expenses and other current liabilities	961	1,370
Accrued revenue share	885	1,168
Securities lending payable	2,361	2,007
Deferred revenue	394	547
Income taxes payable, net	37	197
Total current liabilities	9,996	8,913
Long-term debt	0	2,986
Deferred revenue, non-current	35	44
Income taxes payable, non-current	1,200	1,693
Deferred income taxes, net, non-current	0	287
Other long-term liabilities	379	506
Commitments and contingencies		
Stockholders' equity:		
Convertible preferred stock, $0.001 par value per share, 100,000 shares authorized; no shares issued and outstanding	0	0
Class A and Class B common stock and additional paid-in capital, $0.001 par value per share: 9,000,000 shares authorized; 321,301 (Class A 250,413, Class B 70,888) and par value of $321 (Class A $250, Class B $71) and 324,895 (Class A 257,553, Class B 67,342) and par value of $325 (Class A $258, Class B $67) shares issued and outstanding	18,235	20,264
Accumulated other comprehensive income	138	276
Retained earnings	27,868	37,605
Total stockholders' equity	46,241	58,145
Total liabilities and stockholders' equity	$ 57,851	$ 72,574

Appendix F

2011 Google Cash Flow Statement

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)

	Year Ended December 31,		
	2009	2010	2011
Operating activities			
Net income	$ 6,520	$ 8,505	$ 9,737
Adjustments:			
Depreciation and amortization of property and equipment	1,240	1,067	1,396
Amortization of intangible and other assets	284	329	455
Stock-based compensation expense	1,164	1,376	1,974
Excess tax benefits from stock-based award activities	(90)	(94)	(86)
Deferred income taxes	(268)	9	343
Impairment of equity investments	0	0	110
Other	(20)	(12)	6
Changes in assets and liabilities, net of effects of acquisitions:			
Accounts receivable	(504)	(1,129)	(1,156)
Income taxes, net	217	102	731
Prepaid revenue share, expenses and other assets	262	(414)	(262)
Accounts payable	34	272	101
Accrued expenses and other liabilities	243	745	795
Accrued revenue share	158	214	259
Deferred revenue	76	111	162
Net cash provided by operating activities	9,316	11,081	14,565
Investing activities			
Purchases of property and equipment	(810)	(4,018)	(3,438)
Purchases of marketable securities	(29,139)	(43,985)	(61,672)
Maturities and sales of marketable securities	22,103	37,099	48,746
Investments in non-marketable equity securities	(65)	(320)	(428)
Cash collateral received (returned) from securities lending	0	2,361	(354)
Investments in reverse repurchase agreements	0	(750)	5
Acquisitions, net of cash acquired, and purchases of intangible and other assets	(108)	(1,067)	(1,900)
Net cash used in investing activities	(8,019)	(10,680)	(19,041)
Financing activities			
Net proceeds (payments) from stock-based award activities	143	294	(5)
Excess tax benefits from stock-based award activities	90	94	86
Repurchase of common stock in connection with acquisitions	0	(801)	0
Proceeds from issuance of debt, net of costs	0	5,246	10,905
Repayment of debt	0	(1,783)	(10,179)
Net cash provided by financing activities	233	3,050	807
Effect of exchange rate changes on cash and cash equivalents	11	(19)	22
Net increase (decrease) in cash and cash equivalents	1,541	3,432	(3,647)
Cash and cash equivalents at beginning of year	8,657	10,198	13,630
Cash and cash equivalents at end of year	$ 10,198	$ 13,630	$ 9,983

Appendix G

2011 Microsoft Income Statement

(In millions, except per share amounts)

Year Ended June 30,	2011	2010	2009
Revenue	**$ 69,943**	$ 62,484	$ 58,437
Operating expenses:			
Cost of revenue	**15,577**	12,395	12,155
Research and development	**9,043**	8,714	9,010
Sales and marketing	**13,940**	13,214	12,879
General and administrative	**4,222**	4,063	4,030
Total operating expenses	**42,782**	38,386	38,074
Operating income	**27,161**	24,098	20,363
Other income (expense)	**910**	915	(542)
Income before income taxes	**28,071**	25,013	19,821
Provision for income taxes	**4,921**	6,253	5,252
Net income	**$ 23,150**	$ 18,760	$ 14,569
Earnings per share:			
Basic	**$ 2.73**	$ 2.13	$ 1.63
Diluted	**$ 2.69**	$ 2.10	$ 1.62
Weighted average shares outstanding:			
Basic	**8,490**	8,813	8,945
Diluted	**8,593**	8,927	8,996
Cash dividends declared per common share	**$ 0.64**	$ 0.52	$ 0.52

Appendix H

2011 Microsoft Balance Sheet

(In millions)		
June 30,	2011	2010
Assets		
Current assets:		
Cash and cash equivalents	$ 9,610	$ 5,505
Short-term investments (including securities loaned of $1,181 and $62)	43,162	31,283
Total cash, cash equivalents, and short-term investments	52,772	36,788
Accounts receivable, net of allowance for doubtful accounts of $333 and $375	14,987	13,014
Inventories	1,372	740
Deferred income taxes	2,467	2,184
Other	3,320	2,950
Total current assets	74,918	55,676
Property and equipment, net of accumulated depreciation of $9,829 and $8,629	8,162	7,630
Equity and other investments	10,865	7,754
Goodwill	12,581	12,394
Intangible assets, net	744	1,158
Other long-term assets	1,434	1,501
Total assets	$ 108,704	$ 86,113
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 4,197	$ 4,025
Short-term debt	0	1,000
Accrued compensation	3,575	3,283
Income taxes	580	1,074
Short-term unearned revenue	15,722	13,652
Securities lending payable	1,208	182
Other	3,492	2,931
Total current liabilities	28,774	26,147
Long-term debt	11,921	4,939
Long-term unearned revenue	1,398	1,178
Deferred income taxes	1,456	229
Other long-term liabilities	8,072	7,445
Total liabilities	51,621	39,938
Commitments and contingencies		
Stockholders' equity:		
Common stock and paid-in capital – shares authorized 24,000; outstanding 8,376 and 8,668	63,415	62,856
Retained deficit, including accumulated other comprehensive income of $1,863 and $1,055	(6,332)	(16,681)
Total stockholders' equity	57,083	46,175
Total liabilities and stockholders' equity	$ 108,704	$ 86,113

Appendix I

2011 Microsoft Cash Flow Statement

(In millions)			
Year Ended June 30,	2011	2010	2009
Operations			
Net income	$ 23,150	$ 18,760	$ 14,569
Adjustments to reconcile net income to net cash from operations:			
Depreciation, amortization, and other	2,766	2,673	2,562
Stock-based compensation expense	2,166	1,891	1,708
Net recognized losses (gains) on investments and derivatives	(362)	(208)	683
Excess tax benefits from stock-based compensation	(17)	(45)	(52)
Deferred income taxes	2	(220)	762
Deferral of unearned revenue	31,227	29,374	24,409
Recognition of unearned revenue	(28,935)	(28,813)	(25,426)
Changes in operating assets and liabilities:			
Accounts receivable	(1,451)	(2,238)	2,215
Inventories	(561)	(44)	255
Other current assets	(1,259)	464	(677)
Other long-term assets	62	(223)	(273)
Accounts payable	58	844	(671)
Other current liabilities	(1,146)	451	(2,700)
Other long-term liabilities	1,294	1,407	1,673
Net cash from operations	26,994	24,073	19,037
Financing			
Short-term debt borrowings (repayments), maturities of 90 days or less, net	(186)	(991)	1,178
Proceeds from issuance of debt, maturities longer than 90 days	6,960	4,167	4,796
Repayments of debt, maturities longer than 90 days	(814)	(2,986)	(228)
Common stock issued	2,422	2,311	579
Common stock repurchased	(11,555)	(11,269)	(9,353)
Common stock cash dividends paid	(5,180)	(4,578)	(4,468)
Excess tax benefits from stock-based compensation	17	45	52
Other	(40)	10	(19)
Net cash used in financing	(8,376)	(13,291)	(7,463)
Investing			
Additions to property and equipment	(2,355)	(1,977)	(3,119)
Acquisition of companies, net of cash acquired	(71)	(245)	(868)
Purchases of investments	(35,993)	(30,168)	(36,850)
Maturities of investments	6,897	7,453	6,191
Sales of investments	15,880	15,125	19,806
Securities lending payable	1,026	(1,502)	(930)
Net cash used in investing	(14,616)	(11,314)	(15,770)
Effect of exchange rates on cash and cash equivalents	103	(39)	(67)
Net change in cash and cash equivalents	4,105	(571)	(4,263)
Cash and cash equivalents, beginning of period	5,505	6,076	10,339
Cash and cash equivalents, end of period	$ 9,610	$ 5,505	$ 6,076

Appendix J

2011 American Airlines Income Statement

Consolidated Statements of Operations
For the Years Ended December 31, 2010, 2009 and 2008

	2010	2009	2008
		(In millions)	
Operating revenues:			
Mainline passenger	$ 7,645	$ 6,752	$ 8,183
Express passenger	2,821	2,503	2,879
Cargo	149	100	144
Other	1,440	1,254	1,038
Total operating revenues	12,055	10,609	12,244
Operating expenses:			
Aircraft fuel and related taxes	2,403	1,863	3,618
Loss on fuel hedging instruments, net	—	7	356
Salaries and related costs	2,244	2,165	2,231
Express expenses	2,840	2,628	3,139
Aircraft rent	670	695	724
Aircraft maintenance	661	700	783
Other rent and landing fees	549	560	562
Selling expenses	421	382	439
Special items, net	5	55	76
Depreciation and amortization	258	251	224
Goodwill impairment	—	—	622
Other	1,223	1,181	1,243
Total operating expenses	11,274	10,487	14,017
Operating income (loss)	781	122	(1,773)
Nonoperating income (expense):			
Interest income	13	24	83
Interest expense, net	(233)	(241)	(218)
Other, net	39	(83)	(240)
Total nonoperating expense, net	(181)	(300)	(375)
Income (loss) before income taxes	600	(178)	(2,148)
Income tax provision (benefit)	1	(38)	—
Net income (loss)	$ 599	$ (140)	$ (2,148)

Appendix K

2011 American Airlines Balance Sheet

Consolidated Balance Sheets
December 31, 2010 and 2009

	2010	2009
	(In millions, except share and per share amounts)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 1,856	$ 1,209
Accounts receivable, net	309	282
Materials and supplies, net	184	188
Prepaid expenses and other	480	507
Total current assets	2,829	2,186
Property and equipment		
Flight equipment	3,985	3,710
Ground property and equipment	812	856
Less accumulated depreciation and amortization	(1,238)	(1,098)
	3,559	3,468
Equipment purchase deposits	123	112
Total property and equipment	3,682	3,580
Other assets		
Other intangibles, net of accumulated amortization of $130 million and $106 million, respectively	443	467
Restricted cash	364	480
Investments in marketable securities	57	203
Other assets	190	207
Total other assets	1,054	1,357
Total assets	$ 7,565	$ 7,123
LIABILITIES & STOCKHOLDER'S EQUITY		
Current liabilities		
Current maturities of debt and capital leases	$ 381	$ 418
Accounts payable	343	319
Payables to related parties, net	626	642
Air traffic liability	861	778
Accrued compensation and vacation	236	171
Accrued taxes	149	142
Other accrued expenses	766	815
Total current liabilities	3,362	3,285
Noncurrent liabilities and deferred credits		
Long-term debt and capital leases, net of current maturities	2,596	2,667
Deferred gains and credits, net	293	317
Postretirement benefits other than pensions	140	129
Employee benefit liabilities and other	394	470
Total noncurrent liabilities and deferred credits	3,423	3,583
Commitments and contingencies (Note 8)		
Stockholder's equity		
Common stock, $1 par value, 1,000 shares issued and outstanding	—	—
Additional paid-in capital	2,445	2,445
Accumulated other comprehensive income	20	94
Accumulated deficit	(1,685)	(2,284)
Total stockholder's equity	780	255
Total liabilities and stockholder's equity	$ 7,565	$ 7,123

Appendix L

2011 American Airlines Cash Flow Statement

Consolidated Statements of Cash Flows
For the Years Ended December 31, 2010, 2009 and 2008

	2010	2009 (In millions)	2008
Cash flows from operating activities:			
Net income (loss)	$ 599	$ (140)	$ (2,148)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	258	251	224
Loss on dispositions of property and equipment	7	60	7
Gain on forgiveness of debt	—	—	(8)
Gain on sale of investments	(53)	—	(1)
Goodwill impairment	—	—	622
Auction rate security impairment	—	10	214
Asset impairment	6	18	13
Non-cash tax benefits	—	(24)	—
Change in fair value of fuel hedging instruments, net	—	(375)	496
Amortization of deferred credits and rent	(46)	(49)	(40)
Amortization of debt discount and issuance costs	17	23	15
Amortization of actuarial gains	(4)	(6)	(2)
Debt extinguishment costs	5	6	6
Other	(2)	(8)	—
Changes in operating assets and liabilities:			
Decrease (increase) in restricted cash	—	186	(184)
Decrease (increase) in accounts receivable, net	(34)	9	68
Decrease (increase) in materials and supplies, net	(2)	(25)	35
Decrease (increase) in prepaid expenses and other	(41)	164	(270)
Decrease (increase) in other assets, net	17	(13)	3
Increase (decrease) in accounts payable	29	(79)	114
Increase (decrease) in payables to related parties, net	(16)	257	(31)
Increase (decrease) in air traffic liability	83	80	(134)
Increase (decrease) in accrued compensation and vacation	65	24	(67)
Increase (decrease) in accrued taxes	7	—	(16)
Increase (decrease) in other liabilities	(74)	(43)	59
Net cash provided by (used in) operating activities	821	326	(1,025)
Cash flows from investing activities:			
Purchases of property and equipment	(187)	(677)	(1,041)
Purchases of marketable securities	(180)	—	(299)
Sales of marketable securities	325	52	505
Proceeds from sale of other investments	—	—	4
Decrease (increase) in long-term restricted cash	116	60	(74)
Proceeds from sale-leaseback transactions and dispositions of property and equipment	3	76	16
Net cash provided by (used in) investing activities	77	(489)	(889)
Cash flows from financing activities:			
Repayments of debt and capital lease obligations	(679)	(391)	(318)
Proceeds from issuance of debt	437	747	1,386
Deferred financing costs	(9)	(10)	(17)
Decrease in payables to related parties, net	—	—	(51)
Net cash provided by (used in) financing activities	(251)	346	1,000
Net increase (decrease) in cash and cash equivalents	647	183	(914)
Cash and cash equivalents at beginning of year	1,209	1,026	1,940
Cash and cash equivalents at end of year	$ 1,856	$1,209	$ 1,026