



Rose-Hulman Institute of Technology
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SV351, Managerial Economics

1-3: Financial Statements

Financial Statements: One Source of Information

1. **Income Statement** (also known as **Earnings Statement**) summarizes revenues, expenses, net income or earnings *during a specific accounting period*.
2. **Cash Flow Statement** (replaced the older **Statement of Changes in Financial Position**) provides information about cash inflows and outflows *during a specific accounting period*.
3. **Balance Sheet** shows the financial condition of a firm *on a particular date*.
4. **Statement of Owners' Equity** provides information about transactions that affect the balance sheet equity.

Income Statement (a.k.a. “P&L”)

Hypothetical Income Statement

| | |
|---|------------------|
| TOTAL REVENUE: | \$100,000 |
| Cost of Revenue (Cost of Goods Sold) | \$50,000 |
| Gross Income (Gross Profit) | \$50,000 |
| OPERATING EXPENSES: | |
| Research And Development | \$5,000 |
| Selling, General And Administrative Expenses (SG&A) | \$10,000 |
| Total Other Income and Expenses Net | (\$1,000) |
| Operating Income (Operating Profit, EBIT) | \$36,000 |
| Interest Expense | \$4,000 |
| Income Before Tax | \$32,000 |
| Income Tax Expense | \$10,000 |
| Net Income from Continuing Operatings | \$22,000 |
| NONRECURRING EVENTS: | |
| Discontinued Operations | \$10,000 |
| Extraordinary Items | N/A |
| Effect of Accounting Changes | N/A |
| Other Items | N/A |
| NET INCOME: | \$12,000 |

Cash Flow Statement

Hypothetical Cash Flow Statement

| CASH FLOW FROM OPERATIONS: | |
|--|------------------|
| Net Income | \$12,000 |
| Depreciaton and Amortization | \$4,000 |
| Receivables -- (Increase) Decrease | (\$1,000) |
| Payables -- Increase (Decrease) | \$2,000 |
| Inventories -- (Increase) Decrease | (\$3,000) |
| Other | |
| Cash Flow from Operations | \$14,000 |
| CASH FLOW FROM INVESTING: | |
| Purchases of Property and Equipment, net | (\$6,000) |
| Other | (\$2,000) |
| Cash Flow from Investing | (\$8,000) |
| CASH FLOW FROM FINANCING: | |
| Dividends Paid | (\$4,000) |
| Net Repayments of short-term borrowing | (\$1,000) |
| Proceeds from Issuance of Long-Term Debt | \$5,000 |
| Repayments of Long-Term Debt | (\$2,000) |
| Other | \$1,000 |
| Cash Flow from Financing | (\$1,000) |
| SUMMARY: | |
| Net Change in Cash and Cash Equivalents | \$5,000 |
| Cash and Cash Equivalents at Beginning of Year | \$5,000 |
| CASH AND CASH EQUIVALENTS | \$10,000 |

Balance Sheet

Hypothetical Balance Sheet

| ASSETS: | |
|---------------------------------------|------------------|
| Current Assets: | \$40,000 |
| Cash and Cash Equivalents | \$10,000 |
| Short-Term Investments | \$6,000 |
| Receivables | \$5,000 |
| Inventory | \$10,000 |
| Other Current Assets | \$9,000 |
| Other Assets: | \$110,000 |
| Property and Equipment | \$80,000 |
| Long-Term Investments | \$10,000 |
| Goodwill and Other Intangibles | \$8,000 |
| Other Long-Terms Assets | \$12,000 |
| Total Assets: | \$150,000 |
| LIABILITIES | |
| Current Liabilities: | \$10,000 |
| Short-Term Borrowings | \$6,000 |
| Payables | \$4,000 |
| Other Liabilities: | \$65,000 |
| Long-Term Debt | \$60,000 |
| Other | \$5,000 |
| Total Liabilities: | \$75,000 |
| SHAREHOLDER EQUITY (NET WORTH) | \$75,000 |

Income Statement



Consolidated Statements of Income

ELI LILLY AND COMPANY AND SUBSIDIARIES

(Dollars in millions, except per-share data)

Year Ended December 31

2007

2006

2005

| | | | |
|--|-------------------|-------------------|-------------------|
| Net sales | \$18,633.5 | \$15,691.0 | \$14,645.3 |
| Cost of sales | 4,248.8 | 3,546.5 | 3,474.2 |
| Research and development | 3,486.7 | 3,129.3 | 3,025.5 |
| Marketing, selling, and administrative | 6,095.1 | 4,889.8 | 4,497.0 |
| Acquired in-process research and development (Note 3) | 745.6 | — | — |
| Asset impairments, restructuring, and other special charges (Note 4) | 302.5 | 945.2 | 1,245.3 |
| Other income—net | (122.0) | (237.8) | (314.2) |
| | <u>14,756.7</u> | <u>12,273.0</u> | <u>11,927.8</u> |
| Income before income taxes and cumulative effect of a change in accounting principle | 3,876.8 | 3,418.0 | 2,717.5 |
| Income taxes (Note 11) | <u>923.8</u> | <u>755.3</u> | <u>715.9</u> |
| Income before cumulative effect of a change in accounting principle | 2,953.0 | 2,662.7 | 2,001.6 |
| Cumulative effect of a change in accounting principle, net of tax (Note 2) | <u>—</u> | <u>—</u> | <u>(22.0)</u> |
| Net income | <u>\$ 2,953.0</u> | <u>\$ 2,662.7</u> | <u>\$ 1,979.6</u> |
| Earnings per share—basic (Note 10) | | | |
| Income before cumulative effect of a change in accounting principle | \$2.71 | \$2.45 | \$1.84 |
| Cumulative effect of a change in accounting principle | <u>—</u> | <u>—</u> | <u>(0.02)</u> |
| Net income | <u>\$2.71</u> | <u>\$2.45</u> | <u>\$1.82</u> |
| Earnings per share—diluted (Note 10) | | | |
| Income before cumulative effect of a change in accounting principle | \$2.71 | \$2.45 | \$1.83 |
| Cumulative effect of a change in accounting principle | <u>—</u> | <u>—</u> | <u>(0.02)</u> |
| Net income | <u>\$2.71</u> | <u>\$2.45</u> | <u>\$1.81</u> |

See notes to consolidated financial statements.

Statement of Cash Flow

Consolidated Statements of Cash Flows



ELI LILLY AND COMPANY AND SUBSIDIARIES
(Dollars in millions)

Year Ended December 31

2007

2006

2005

Cash Flows From Operating Activities

| | | | |
|------------------|-----------|-----------|-----------|
| Net income | \$2,953.0 | \$2,662.7 | \$1,979.6 |
|------------------|-----------|-----------|-----------|

Adjustments To Reconcile Net Income To Cash Flows

From Operating Activities

| | | | |
|--|----------------|----------------|----------------|
| Depreciation and amortization | 1,047.9 | 801.8 | 726.4 |
| Change in deferred taxes | 122.9 | 346.8 | (347.5) |
| Stock-based compensation expense | 282.0 | 359.3 | 403.5 |
| Acquired in-process research and development, net of tax | 692.6 | — | — |
| Asset impairments, restructuring, and other special charges, net of tax | 181.5 | 797.4 | 1,128.7 |
| Other, net | (8.4) | (196.8) | (30.0) |
| | <u>5,271.5</u> | <u>4,771.2</u> | <u>3,860.7</u> |

Changes in operating assets and liabilities, net of acquisitions

| | | | |
|--|----------------|----------------|------------------|
| Receivables—(increase) decrease | (842.7) | 243.9 | (286.4) |
| Inventories—(increase) decrease | 154.3 | (60.2) | 72.1 |
| Other assets—increase | (355.8) | (43.0) | (269.4) |
| Accounts payable and other liabilities—(increase) decrease | 927.2 | (936.0) | (1,463.4) |
| | <u>(117.0)</u> | <u>(795.3)</u> | <u>(1,947.1)</u> |

| | | | |
|--|----------------|----------------|----------------|
| Net Cash Provided by Operating Activities | 5,154.5 | 3,975.9 | 1,913.6 |
|--|----------------|----------------|----------------|

Cash Flows From Investing Activities

| | | | |
|--|------------------|--------------|------------------|
| Purchases of property and equipment | (1,082.4) | (1,077.8) | (1,298.1) |
| Disposals of property and equipment | 32.3 | 65.2 | 11.1 |
| Net (repayments) proceeds of short-term investments | (376.9) | 1,247.5 | 62.7 |
| Proceeds from sales and maturities of noncurrent investments | 800.1 | 1,507.7 | 545.1 |
| Purchases of noncurrent investments | (750.7) | (1,313.2) | (1,183.1) |
| Purchases of in-process research and development | (111.0) | — | — |
| Cash paid for acquisitions, net of cash acquired | (2,673.2) | — | — |
| Other, net | (166.3) | 179.0 | (353.6) |
| | <u>(4,328.1)</u> | <u>608.4</u> | <u>(2,215.9)</u> |

| | | | |
|---|------------------|--------------|------------------|
| Net Cash Provided by (Used for) Investing Activities | (4,328.1) | 608.4 | (2,215.9) |
|---|------------------|--------------|------------------|

Cash Flows From Financing Activities

| | | | |
|---|----------------|------------------|------------------|
| Dividends paid | (1,853.6) | (1,736.3) | (1,654.9) |
| Net repayments of short-term borrowings | (468.5) | (8.4) | (1,988.7) |
| Proceeds from issuance of long-term debt | 2,512.6 | — | 3,000.0 |
| Repayments of long-term debt | (1,059.5) | (2,781.5) | (1,004.7) |
| Purchases of common stock | — | (122.1) | (377.9) |
| Issuances of common stock under stock plans | 24.7 | 59.6 | 105.9 |
| Other, net | (0.6) | 9.9 | 39.8 |
| | <u>(844.9)</u> | <u>(4,578.8)</u> | <u>(1,880.5)</u> |

| | | | |
|---|----------------|------------------|------------------|
| Net Cash Used for Financing Activities | (844.9) | (4,578.8) | (1,880.5) |
|---|----------------|------------------|------------------|

| | | | |
|---|-------|------|---------|
| Effect of exchange rate changes on cash | 129.7 | 97.1 | (175.8) |
|---|-------|------|---------|

| | | | |
|--|-------|-------|-----------|
| Net increase (decrease) in cash and cash equivalents | 111.2 | 102.6 | (2,358.6) |
|--|-------|-------|-----------|

| | | | |
|--|---------|---------|---------|
| Cash and cash equivalents at beginning of year | 3,109.3 | 3,006.7 | 5,365.3 |
|--|---------|---------|---------|

| | | | |
|---|------------------|------------------|------------------|
| Cash and Cash Equivalents at End of Year | \$3,220.5 | \$3,109.3 | \$3,006.7 |
|---|------------------|------------------|------------------|

Balance Sheet

Consolidated Balance Sheets



ELI LILLY AND COMPANY AND SUBSIDIARIES
(Dollars in millions)

December 31

2007

2006

Assets

Current Assets

| | | |
|--|------------|------------|
| Cash and cash equivalents | \$ 3,220.5 | \$ 3,109.3 |
| Short-term investments | 1,610.7 | 781.7 |
| Accounts receivable, net of allowances of \$103.1 (2007) and \$82.5 (2006) | 2,673.9 | 2,298.6 |
| Other receivables (Note 8) | 1,030.9 | 395.8 |
| Inventories | 2,523.7 | 2,270.3 |
| Deferred income taxes (Note 11) | 583.6 | 519.2 |
| Prepaid expenses | 613.6 | 319.5 |
| Total current assets | 12,256.9 | 9,694.4 |

Other Assets

| | | |
|---|---------|---------|
| Prepaid pension (Note 12) | 1,670.5 | 1,091.5 |
| Investments (Note 5) | 577.1 | 1,001.9 |
| Goodwill and other intangibles—net (Note 3) | 2,455.4 | 130.0 |
| Sundry (Note 8) | 1,252.8 | 1,885.3 |
| | 5,955.8 | 4,108.7 |

| | | |
|-----------------------------|------------|------------|
| Property and Equipment, net | 8,575.1 | 8,152.3 |
| | \$26,787.8 | \$21,955.4 |

Liabilities and Shareholders' Equity

Current Liabilities

| | | |
|---|----------|----------|
| Short-term borrowings and current maturities of long-term debt (Note 6) | \$ 413.7 | \$ 219.4 |
| Accounts payable | 1,018.5 | 789.4 |
| Employee compensation | 823.8 | 641.6 |
| Sales rebates and discounts | 706.8 | 508.3 |
| Dividends payable | 513.6 | 463.3 |
| Income taxes payable (Note 11) | 238.4 | 640.6 |
| Other current liabilities (Note 8) | 1,553.5 | 1,822.9 |
| Total current liabilities | 5,268.3 | 5,085.5 |

Other Liabilities

| | | |
|--|---------|---------|
| Long-term debt (Note 6) | 4,593.5 | 3,494.4 |
| Accrued retirement benefit (Note 12) | 1,145.1 | 1,586.9 |
| Long-term income taxes payable (Note 11) | 1,196.7 | — |
| Deferred income taxes (Note 11) | 287.5 | 62.2 |
| Other noncurrent liabilities (Note 8) | 632.3 | 745.7 |
| | 7,855.1 | 5,889.2 |

Commitments and contingencies (Note 13)

Shareholders' Equity (Notes 7 and 9)

| | | |
|--|-----------|-----------|
| Common stock—no par value | | |
| Authorized shares: 3,200,000,000 | | |
| Issued shares: 1,135,212,894 (2007) and 1,132,578,231 (2006) | 709.5 | 707.9 |
| Additional paid-in capital | 3,805.2 | 3,571.9 |
| Retained earnings | 11,967.2 | 10,926.7 |
| Employee benefit trust | (2,635.0) | (2,635.0) |
| Deferred costs—ESOP | (95.2) | (100.7) |
| Accumulated other comprehensive income (loss) (Note 14) | 13.2 | (1,388.7) |
| | 13,764.9 | 11,082.1 |

Less cost of common stock in treasury

| | | |
|---------------------|------------|------------|
| 2007—899,445 shares | 100.5 | 101.4 |
| 2006—909,573 shares | 13,664.4 | 10,980.7 |
| | \$26,787.8 | \$21,955.4 |

See notes to consolidated financial statements.

Return on Equity: A Common Metric

| | General Electric | Caterpillar | Lilly | Wells Fargo | Goldman Sachs | Wal-Mart |
|------------------------------------|------------------|---------------|---------------|---------------|---------------|----------------|
| (All amounts in millions) | | | | | | |
| From Income Statement: | | | | | | |
| Sales (Total Revenue) | 172,738 | 44,958 | 18,634 | 53,593 | 87,968 | 378,799 |
| <u>Less Cost of Sales</u> | <u>73,125</u> | <u>32,626</u> | <u>4,249</u> | <u>8,152</u> | <u>-</u> | <u>286,515</u> |
| Gross Profit | 99,613 | 12,332 | 14,385 | 45,441 | 87,968 | 92,284 |
| <u>Less Operating Expenses</u> | <u>49,228</u> | <u>5,959</u> | <u>10,280</u> | <u>27,763</u> | <u>28,383</u> | <u>69,983</u> |
| EBIT | 50,385 | 6,373 | 4,105 | 17,678 | 59,585 | 22,301 |
| <u>Less Interest, Taxes, Other</u> | <u>28,177</u> | <u>2,832</u> | <u>1,152</u> | <u>9,621</u> | <u>47,986</u> | <u>9,570</u> |
| Net Income | 22,208 | 3,541 | 2,953 | 8,057 | 11,599 | 12,731 |

| | | | | | | |
|-------------------------------|----------------|---------------|---------------|----------------|------------------|---------------|
| From Balance Sheet: | | | | | | |
| Total Assets | 795,337 | 56,132 | 26,788 | 575,442 | 1,119,796 | 163,514 |
| <u>Less Total Liabilities</u> | <u>679,778</u> | <u>47,249</u> | <u>13,123</u> | <u>527,814</u> | <u>1,076,996</u> | <u>98,906</u> |
| Stockholders' Equity | 115,559 | 8,883 | 13,665 | 47,628 | 42,800 | 64,608 |

ROE

- Profit Margin
- Asset Turnover
- Leverage

$$\frac{\text{Return On Equity}}{1} = \frac{\text{Net Income}}{\text{Stockholders' Equity}} = \text{Profit Margin} \times \text{Asset Turnover} \times \text{Leverage}$$

Evaluating Firm Performance ...

- Accounting measures
- Accounting ratios
- Market-determined measures
- Relative comparisons
- Risk analysis