

A detailed Northern Renaissance painting by Marinus van Reymerswale, 1539. It depicts a money changer and his wife in a cluttered workshop. The man, on the left, wears a green robe and a large, ornate feathered hat. He is focused on counting coins on a green cloth-covered table. The woman, on the right, wears a red robe and a white headscarf with a red and blue band. She is looking down at an open book. The table is covered with various coins, a small wooden box, and a leather bag. In the background, there are shelves filled with papers, a candlestick, and a wooden wall.

Finance

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Last week

- The fundamental role of Finance.
- The Four Axioms of Finance:
 - Investors prefer more to less.
 - Investors are risk-averse.
 - Investors prefer money today to money tomorrow.
 - No arbitrage is possible
- **Note for next sessions: please bring a calculator**
- **Note for next week: the problem set will be online this evening.**

Today

- The objective of the firm
- Analysis of Financial Statements

The objective of the firm

The objective of the firm

- Firms managers have to take decisions.
 - Operating decisions: how much to produce, how much to hire, wage policy, etc.
 - Financial decisions:
 - Investing decision: which project or asset to pick? (*real assets*)
 - Financing decision: given a project or asset, how to finance it? (*financial assets*)
 - Payout decisions: reinvest cash, pay dividends, or repurchase shares?
- Relevant to firms, but also to investors, governments, etc.

The objective of the firm

Investing and financing decisions

Company (revenue in billions for 2008)	Recent Investment Decision	Recent Financing Decision
Boeing (\$61 billion)	Began production of its 787 Dreamliner aircraft, at a forecasted cost of more than \$10 billion.	The cash flow from Boeing's operations allowed it to repay some of its debt and repurchase \$2.8 billion of stock.
Royal Dutch Shell (\$458 billion)	Invested in a \$1.5 billion deepwater oil and gas field in the Gulf of Mexico.	In 2008 returned \$13.1 billion of cash to its stockholders by buying back their shares.
Toyota (¥26,289 billion)	In 2008 opened new engineering and safety testing facilities in Michigan.	Returned ¥431 billion to shareholders in the form of dividends.
GlaxoSmithKline (£24 billion)	Spent £3.7 billion in 2008 on research and development of new drugs.	Financed R&D expenditures largely by reinvested cash flow generated by sales of pharmaceutical products.
Wal-Mart (\$406 billion)	In 2008 announced plans to invest over a billion dollars in 90 new stores in Brazil.	In 2008 raised \$2.5 billion by an issue of 5-year and 30-year bonds.
Union Pacific (\$18 billion)	Acquired 315 new locomotives in 2007.	Largely financed its investment in locomotives by long-term leases.
Wells Fargo (\$52 billion)	Acquired Wachovia Bank in 2008 for \$15.1 billion.	Financed the acquisition by an exchange of shares.
LVMH (€17 billion)	Acquired the Spanish winery Bodega Numanthia Termes.	Issued a six-year bond in 2007, raising 300 million Swiss francs.
Lenovo (\$16 billion)	Expanded its chain of retail stores to cover over 2,000 cities.	Borrowed \$400 million for 5 years from a group of banks.

The objective of the firm

Investing and financing decisions

Electronic Arts Inc

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Video game maker Electronic Arts nears \$50bn deal to go private

Company behind 'Madden NFL' title in talks with investors including Jared Kushner's Affinity Partners

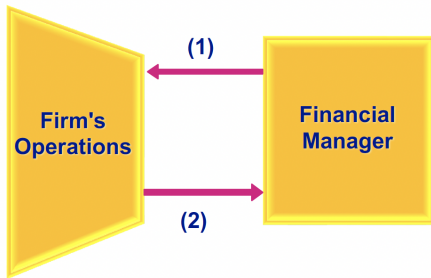


The objective of the firm

Investing and financing decisions

- A corporation can raise money from lenders or shareholders.
 - Lenders contribute cash and are repaid the debt plus fixed interest.
 - Shareholders put up the cash, but get no fixed return. They hold a *residual* right on future cash-flows and profits.
- The choice between the two is the choice of capital structure.
- A lender has many different choices: if a firm decides to borrow, does it do so through a bank or through bonds? For 1 year or 20 years? Does it negotiate the right to pay off the debt early if interest rates fall? *etc.*
- Equity financing can also be used, either through new shares, or by reinvesting past earnings (owned by shareholders).

The objective of the firm

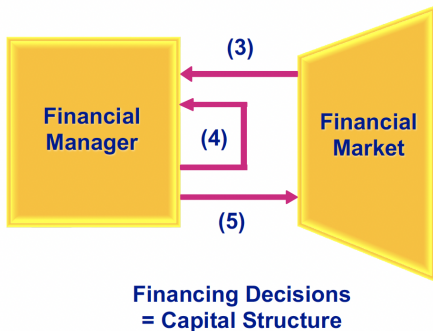


**Investment Decisions
= Capital Budgeting**

(1) Cash invested by firm

(2) Cash generated by operations

The objective of the firm

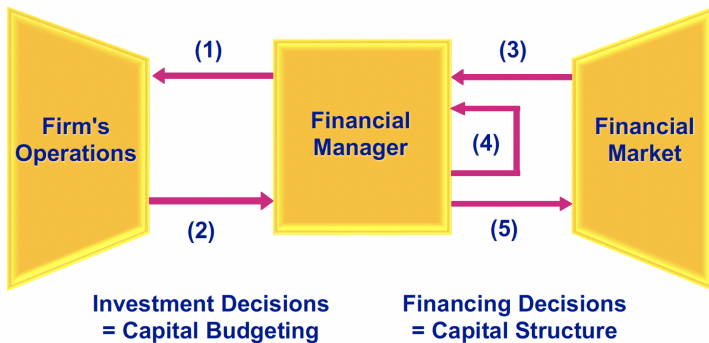


(3) Cash raised from investors (external finance)

(4) Cash reinvested (internal finance)

(5) Cash returned to investors

The objective of the firm



- (1) Cash invested by firm
- (2) Cash generated by operations
- (3) Cash raised from investors (external finance)
- (4) Cash reinvested (internal finance)
- (5) Cash returned to investors

The objective of the firm

- How should a firm's managers make their choices?
- Ownership is diluted → some corporations have more than 100,000 shareholders: not all of them can be involved in management.
- Modern corporations separate ownership and control.
 - Gives corporation permanence
- Can they have a common objective?
- Delegation solve a coordination problem but creates another one when management and control have different preferences.

The objective of the firm

Conflicts between managers and shareholders

- **Dodge vs. Ford (1919):** Henry Ford wanted to reinvest profits, expand production, lower car prices, and employ more workers. Minority shareholders wanted larger dividends. US. courts forced Ford to pay dividends
- **A.P. Smith v. Barlow (1953):** the board donated \$1,500 to Princeton University. Shareholders challenged whether corporate money could be used for philanthropy rather than distributed to owners. The court upheld the gift
- **Tyco (2002):** CEO Dennis Kozlowski used corporate resources for personal benefits, including a \$6,000 shower curtain and part of a \$2 million birthday party.
- **Danone (2020–21):** more than 99% of shareholders approved Danone becoming a *société à mission*, but CEO Emmanuel Faber was removed less than a year later after pressure over weak financial performance.

Disagreement may reflect private benefits—or different views of what the firm should maximize.

The objective of the firm

Firms' stakeholders beyond shareholders

- Shareholders: exercise control over management (board of directors, annual meetings).
- Banks and bondholders: have to be paid and can restrict corporate actions.
- Corporate managers: make financial and operating decisions.
- Competitors.
- Employees.
- Customers.
- Society: receive side benefits and bear side costs (*externalities*).

⇒ Which one is given primacy?

The objective of the firm

A long-standing debate

- **Rathenau, 1917:** The company is more than the sum of shareholders' interests. It has some duties with respect to the broader society.
- **Berle-Dodds debate, 1930'**
 - **Berle:** corporation's managers should follow shareholders' interests. Having a clear beneficiary makes managers accountable.
 - **Dodds:** the corporation is a social institution, and managers should be allowed to pursue broader goals such as economic security for workers, fair treatment of customers, etc.
 - **Legal consequences:** in the 30', creation of the SEC in the U.S. and implemented more transparency so that management choices can be checked.

The objective of the firm

Managerial decision as an agency problem

- Friedman (1970): managers are the agents of owners and must follow their interests.

→ Agency problems (Jensen and Meckling, 1976)

- Agency problems arise when *agents* work for *principals*.
- They create additional costs: monitoring costs.
- Need to design institutions to minimize these costs.
- Regulatory requirements, incentive schemes, *etc.*

The objective of the firm

Managerial decision as an agency problem

- Legal and regulatory requirements for managers.
 - *e.g.* Transparency of accounts, no insider trading.
- Compensation plans.
 - *e.g.* stock options.
- Board of directors.
 - Elected by shareholders to represent them.
- Shareholder pressure.
 - What if a shareholder decides to leave?

The objective of the firm

Alternative European models

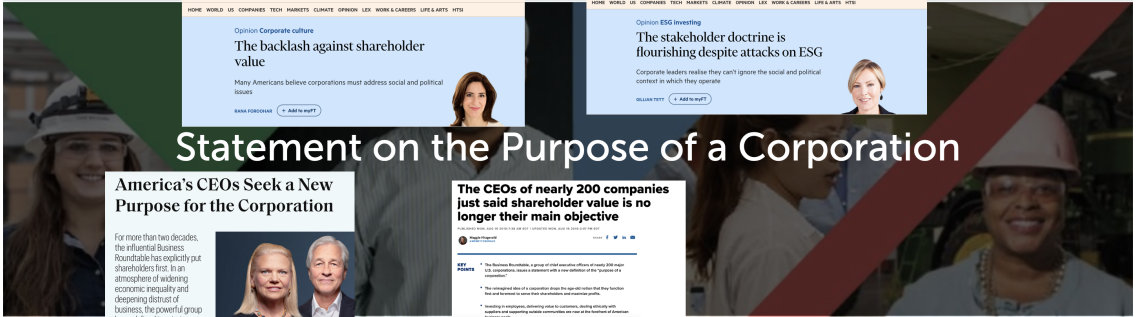
- Germany (e.g. 1951, 1952, 1976): in companies with more than 2,000 employees, employee representatives must occupy half of the supervisory-board seat.
- Nordics (e.g. Sweden, 1974, 1980, 1987): employees have statutory rights to board-level representation under specified conditions
- France (e.g. 2013, 2019): in very large firms (> 5000 employees), workers have 1 out of 12 seats in supervisory boards. Since 2019, the goal of the firm explicitly includes social and environmental concerns.

→ Worker interests receive institutional voice inside the firm.

→ Main goal stays maximizing shareholder value.

The objective of the firm

The contemporary discussion over broader goals



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Opinion Corporate culture
The backlash against shareholder value
Many Americans believe corporations must address social and political issues
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Opinion ESG investing
The stakeholder doctrine is flourishing despite attacks on ESG
Corporate leaders realise they can't ignore the social and political context in which they operate
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Statement on the Purpose of a Corporation

America's CEOs Seek a New Purpose for the Corporation

For more than two decades, the influential Business Roundtable has explicitly put shareholders first. In an atmosphere of widening economic inequality and deepening distrust of business, the powerful group has redefined its mission.

The CEOs of nearly 200 companies just said shareholder value is no longer their main objective

ALAN GREENBERG, CHAIR OF THE BUSINESS ROUNDTABLE, ISSUES A STATEMENT WITH A NEW DEFINITION OF THE "PURPOSE OF A CORPORATION"

KEY POINTS

- The Business Roundtable, a group of chief executive officers of nearly 200 major U.S. corporations, issues a statement with a new definition of the "purpose of a corporation."
- The reintegrated idea of a corporation drops the age-old notion that they function first and foremost to serve their shareholders and maximize profits.
- Investing in employees, delivering value to customers, dealing effectively with suppliers and supporting vibrant communities are now at the forefront of American business goals.

The objective of the firm

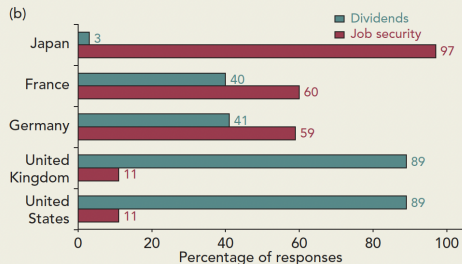
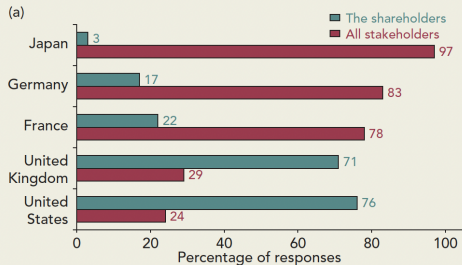
The role of corporate culture

FIGURE 1.3

(a) Whose company is it? The views of 378 managers from five countries.

(b) Which is more important—job security for employees or shareholder dividends? The views of 399 managers from five countries.

Source: M. Yoshimori, "Whose Company Is It? The Concept of the Corporation in Japan and the West," *Long Range Planning*, 28 (August 1995), pp. 33–44. Copyright © 1995 with permission from Elsevier Science.



The objective of the firm

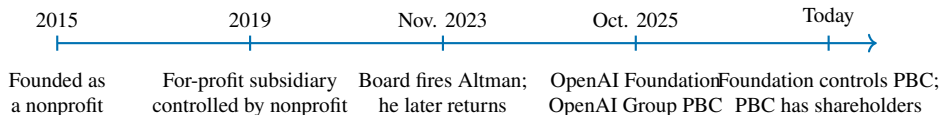
Environment, Sustainability and Governance (ESG)

- Recent importance of ESG concerns.
 - ESG can be seen as maximizing shareholder value by building trust, productivity, environmental policies
 - But shareholder might also value firm's consequence on society *per se*.
- Recent research illustrates the contemporary concerns:
 - Ericson (2026): Shareholder value consumers and environmental goals at the expense of pure profit maximization (only 7% favor it).
 - Giglio et al. (2025) study the main motives for ESG investment: 48% have no reason to invest in ESG, 24% do for ethical considerations, 22% for climate hedging, 6% for higher returns
 - Investors seem to favor value alignment rather than pure impact.

The objective of the firm

AI Governance

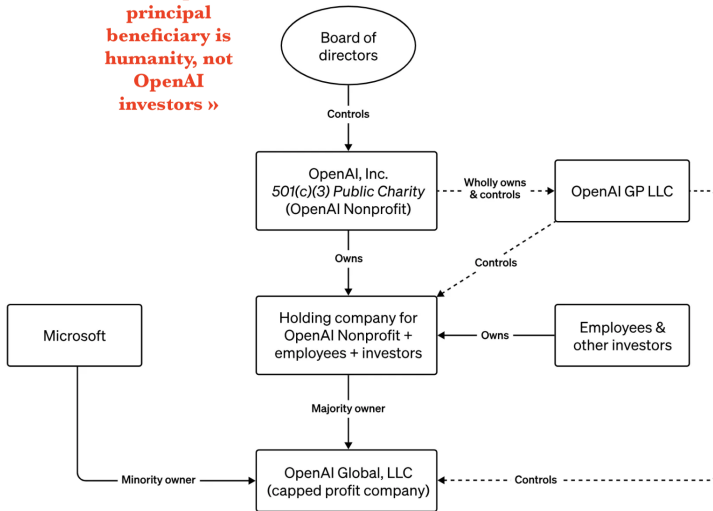
- AI Governance is of key importance: how to conciliate need for funding, for large investment, with social, environmental and existential risks raised by AI?
- The case of OpenAI



The objective of the firm

The case of OpenAI

« The Nonprofit's
principal
beneficiary is
humanity, not
OpenAI
investors »



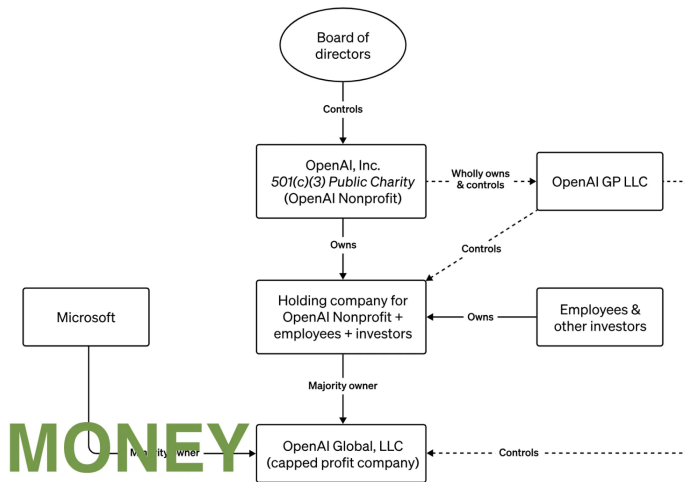
The objective of the firm

The case of OpenAI

- On November 17, 2023, the board fired Sam Altman, the founder of OpenAI.
- “He was not consistently candid. . . with the board.”
- On November 20, Microsoft announced that it had hired Altman and many engineers from OpenAI.
- On November 22, Sam Altman was back as CEO of OpenAI, and all but one director of OpenAI resigned.

The objective of the firm

The case of OpenAI



Financial statements

From the objective of the firm to its realization

Financial statements

- All the choices made by the financial manager will eventually be reflected in the firm's financial statements.
- Three types of statements:
 - Income statement: revenues and income generated over a given period of time based on the accrual concept.
 - Accrual accounting: a company records revenue and expenses before money is received or spent.
 - Balance sheet: Statement at a point in time of a company's financial position. Assets (on the left) sum to liabilities (on the right).
 - Cash flow statement: Accounting balance sheet $\neq$ Finance balance sheet. Notion of cash flow is very important (more than earnings).

Financial statements

- Cash flow statement: Accounting balance sheet $\neq$ Finance balance sheet. Notion of cash flow is very important (more than earnings).
 - Earnings can differ from CF because accounting records transactions when they occur, rather than when payment is received, and because capital expenses are spread over time (depreciation/amortization), unlike operating expenses.
 - $CF = \text{Earnings} + \text{non-cash expenses (depreciation/amortization that lower earnings but are not CF)} - \text{capital expenditures (which must be paid for)} - \text{change in non-cash working capital}$

The income statement

- Revenues and income generated over a given period of time based on the accrual concept
 - *i.e.*, accounted for even if there is no cash transaction.
 - *e.g.* **accounts payable**: employee bonuses that were earned in 2023 but won't be paid until 2024. The 2023 financial statements must reflect the bonus expenses earned by employees in 2023, as well as the bonus liability the company plans to pay.

The income statement

FT Alphaville Tesla Inc

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\$1.4bn is a lot to fall through the cracks, even for Tesla

When money spent on assets doesn't result in assets

Dan McCrum in London and **Stephen Morris** in San Francisco

Published MAR 19 2025



Looking at last year, in the third and fourth quarter combined, Tesla spent \$6.3bn on “purchases of property and equipment excluding finance leases, net of sales” according to its cashflow statements.

Over on the balance sheet, however, the gross value of property, plant and equipment rose by only \$4.9bn in that period, to \$51bn. Note seven to the financial statements has the breakdown:

The income statement

Dan McCrum

Published MAR 25 2025

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Mea culpa. Having last week [got rather excited](#) by the minutiae of Tesla's accounting, it's time to row back on the apparent \$1.4bn gap between capital investment and asset values.

Lessons below, including kind words from one of the expert correspondents who got in touch to say that “reconciling accrual-based accounts with cash accounts (especially with the cash flow statement in its indirect form) is always difficult.” Indeed.

Two things help to reconcile the numbers: payments for assets already purchased, and the possible disposal of depreciated property.

The income statement

TABLE 13.4 Income Statements for Walgreens (\$ MILLIONS)

	2014	2015
Revenue	\$76,392	\$103,444
Cost of goods sold	\$54,823	\$76,520
Selling, general and administrative expenses and depreciation	\$17,375	\$22,256
Operating income	\$4,194	\$4,668
Interest expense	\$156	0
Other expenses (income)	\$481	(\$643)
Income before taxes	\$3,557	\$5,311
Income taxes	\$1,526	\$1,056
Net income	\$2,031	\$4,255
Earnings per share	\$2.03	\$4.05

The income statement

- The large increase in revenues comes from a merger with a large European Company (Alliance Boots).
- COGS reflects the costs directly involved in production (raw materials, labor, etc.).
- Other expenses are stable or fixed in nature.
- Depreciation is the decrease in the value of a firm's asset due to production (*e.g.* depreciation of a robot). This is not linked to a cash outflow: it is a non-cash expense.
- Operating income is before interest and taxes (=EBIT).
- Net income: what is available to the firm's owners.
- Earnings per share divides net income by the number of shares.

The balance sheet

- Statement at a point in time of a company's financial position. Assets (on the left) sum to liabilities (on the right).
- Assets are what is owned by the firm and liabilities are the claims of creditors and owners.
- The balance sheet reveals a firm's financial structure.
- The balance sheet is always... balanced: $\text{Assets} = \text{Liabilities} + \text{Owner's equity}$.

The balance sheet

TABLE 13.5 Balance Sheets for Walgreens (\$ MILLIONS)

	2014	2015
Cash & Cash equivalents	\$2,646	\$3,000
Accounts receivable	\$3,218	\$6,849
Inventories	\$6,076	\$8,678
Other current assets	\$302	\$1,130
Total Current Assets	\$12,242	\$19,657
Net fixed assets	\$12,257	\$15,068
Other long-term assets	\$10,324	\$17,685
Goodwill & intangibles	\$2,359	\$16,372
Total Fixed Assets	\$24,940	\$49,125
TOTAL ASSETS	\$37,182	\$68,782
Accounts payable	\$4,315	\$10,088
Short-term debt	\$774	\$1,068
Other current liabilities	\$3,806	\$5,401
Total Current Liabilities	\$8,895	\$16,557
Long-term debt	\$3,736	\$13,315
Other liabilities	\$4,094	\$8,049
TOTAL LIABILITIES	\$16,725	\$37,921
Preferred equity	\$0	\$0
Common equity + Retained earnings	\$20,457	\$30,861
TOTAL STOCKHOLDERS' EQUITY	\$20,457	\$30,861
TOTAL LIABILITIES & EQUITY	\$37,182	\$68,782

The balance sheet

Assets

- The most liquid assets are listed first.
- Current assets: assets that will be converted into cash in less than 1 year. This is the working capital needed to carry out the normal operations of a business.
- Fixed assets: physical facilities used for the production, storage, display, and distribution of the products (plants and equipment, land).
- It also includes intangible assets.
- Goodwill: difference between a firm's value (*e.g.* 100 million) and what another firm may pay to acquire it (*e.g.* 110 million). Assets then increase by $110 = 100 \text{ (assets)} + 10 \text{ (goodwill)}$.

The balance sheet

Liabilities

- Liabilities are the debt of a business: direct borrowing, credit, accrual of obligations (wages, income tax).
- Current liabilities are payable within one year.
- All businesses have owners' equity in one form or another. This can correspond to the cash initially used to buy the first machines, real estate, or equipment.
- Owners' claims are residual claims; they are represented by the difference between total assets and total liabilities.
- Main difference between preferred and common stock: preferred stock does not come with voting rights.

The Cash Flow statement

- Contrary to previous accounts, it is not on an accrual basis.
- Divided between operating activities, investing activities, and financing activities.
- Take net income in the income statement.
 - Add depreciation (noncash expense).
 - Add net changes in the asset, liability, and equity accounts.
 - Buying raw materials increases assets but decreases cash flows.
 - Borrowing money from the bank increases cash flows; paying interest decreases them.
 - Add cash dividends.

The income statement and the balance sheet

The WorldCom accounting scandal

- WorldCom (U.S. telecommunications) main operating expenses included **“line costs”**: payments to other telecom companies to use their networks.
- In 2001-2002, WorldCom improperly recorded about \$3.5bn of them as **capital assets**, not operating expenses.

⇒ This mechanically:

- ↘ expenses and ↗ reported profits and assets on the balance sheet.
- Large effect: in Q4 2001, WorldCom reported a \$401m pre-tax profit instead of a \$440m loss.
- Fraud was uncovered by WorldCom's internal audit in 2002.

Accounting question: is a payment an expense today, or an investment generating future benefits?

The Cash Flow statement

TABLE 13.6 Statement of Cash Flows, Walgreens, 2015 (\$ millions)

OPERATING ACTIVITIES	
Net income (Loss)	4,255
Other income	24
Depreciation & amortization	1,742
(Increase) Decrease in receivables	-338
(Increase) Decrease in inventories	719
(Increase) Decrease in other current assets	
Increase (Decrease) in payables	268
Increase (Decrease) in other current liabilities	-154
Other adjustments, Net	-852
CASH FROM OPERATIONS	5,664
INVESTING ACTIVITIES	
Capital expenditure	-1,251
Acquisitions	-4,018
Sale of property, plant & equipment	
Investments (increase)	-49
Other investing cash flow	1,042
CASH FROM INVESTMENTS	-4,276
FINANCING ACTIVITIES	
Issuance of capital stock	-1,226
Net debt increase (decrease)	1,587
Dividends	-1,384
Other cash in (out) flow	108
CASH FROM FINANCING	-915
Effect of exchange rates	-119
NET CHANGE IN CASH	354

Important ratios

- All these statements help to evaluate the current health of the company.
- But they also help predict the firm's future earnings and the associated risk.
- Ratio analysis is generally used to learn about a firm's strengths and weaknesses.
 - It helps standardize the balance sheet.
- Different types of ratio analysis.
 - Time series analysis, cross-sectional analysis, industry comparative analysis.
 - Liquidity ratios, asset management ratios, financial leverage ratios, profitability ratios, and market value ratios.

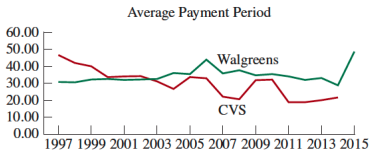
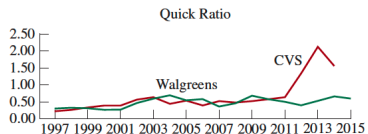
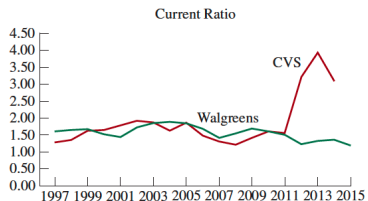
Liquidity ratios

- Liquidity is important as it determines the risk of insolvency or default.
- To pay its debt the firm needs cash.
- Liquidity ratios indicate the ability to meet short-term obligations to creditors.
- What's the relationship between current assets and current liabilities? How quickly do inventories and receivables turn into cash?

Liquidity ratios

- Current ratio = Current assets / Current Liabilities
 - It is 1.38 in 2014 and 1.19 in 2015 for Walgreens.
- Quick ratio (or acid test ratio) = (Cash + Marketable securities + accounts receivables) / Current liabilities → excludes inventories that are less liquid.
- A ratio around 1 indicates that liquid assets of the firm cover its liabilities.
 - It is 0.66 in 2014 and 0.59 in 2015 for Walgreens.
 - Low but fine for a retailer.
- Average payment period = year-end accounts payable / firm's average COGS per day
 - How long it takes on average to pay its suppliers.
 - It is 28.7 days in 2014 and 48.1 days in 2015 for Walgreens.
 - High but fine for a retailer.

Liquidity ratios



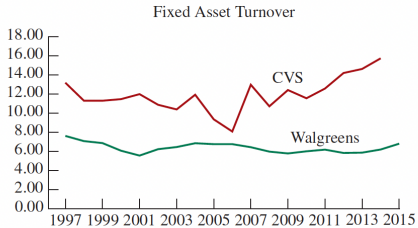
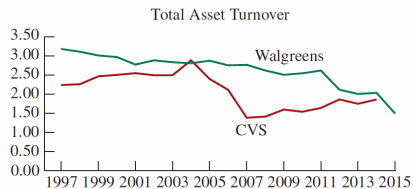
Asset Management Ratios

- Indicate the extent to which assets are turned over or used to support sales.
- Total assets turnover ratio = $\text{Net Sales} / \text{Total Assets}$.
- Measures how much a dollar of assets creates in terms of sales.
- Fixed assets turnover ratio = $\text{Net Sales} / \text{Net Fixed Assets}$.
- Same with fixed assets.
 - Careful: a large ratio can indicate that the firm uses obsolete and depreciated equipment.

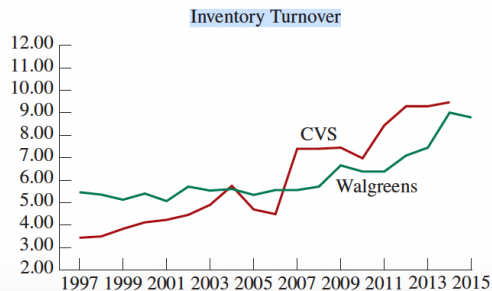
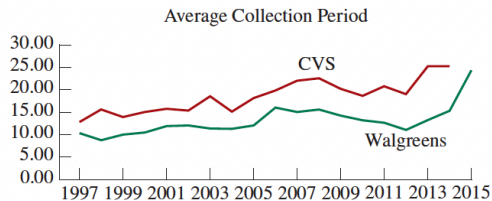
Asset Management Ratios

- Average Collection Period: $\text{year-end accounts receivables} / \text{Average net sales per day}$.
 - Number of days needed to collect credit sales made to the firm's customers. A shorter period is preferred.
- Inventory Turnover Ratio: $\text{COGS} / \text{year-end inventory}$.
 - How efficiently the inventory is being managed. It has to be compared with industry norms; you don't want it to be too large or too small.

Asset Management Ratios



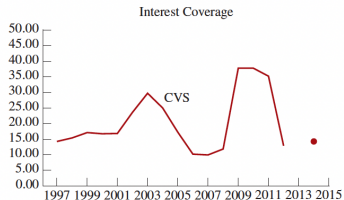
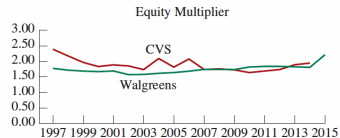
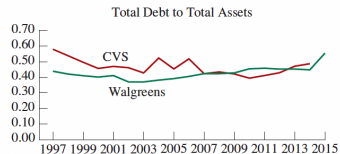
Asset Management Ratios



Asset Management Ratios

- How much borrowed funds and debt are used to finance assets, and the ability of the firm to pay its debt.
- Debt to total Assets: $\text{Total Debt} / \text{Total Assets}$.
 - 45% in 2014 and 55% in 2015. The firm took on debt as a result of the merger.
 - Too high: limited ability for additional borrowing. Lenders might ask for high rates because of the excessive risk of lending to a firm with a lot of debt.
 - Too low: the firm might have a more efficient use of debt.
- Equity Multiplier: $\text{Total Assets} / \text{Total Equity}$
 - A higher level of assets relative to equity means a higher level of debt, and then a greater use of leverage.
- Interest Coverage: $\text{Earnings before interest and taxes (EBIT)} / \text{Interest expense}$
 - Firm's ability to meet its interest and principal repayment obligations.

Financial Leverage Ratios



Profitability ratios

- Indicate firm's ability to generate returns on its sales, assets and equity.
- Operating Profit Margin: $\text{EBIT} / \text{Net Sales}$
 - Ability to control operating expenses relative to sales.
- Net Profit Margin: $\text{Net Income} / \text{Net Sales}$
 - Similar, but it also includes interest and tax obligations.
- Return ratios: Return on assets ($\text{Net Income} / \text{Net Assets}$) and Return on Equity ($\text{Net Income} / \text{Common Equity}$). This last ratio measures the return investors earned by investing in the firm.

Profitability ratios

The DuPont method

- Note that: $\text{Return on assets} = \text{Net Profit Margin} \times \text{Total Asset Turnover}$
 - Allows us to separate the change in ROA into its two components.
- Similarly the Return on Equity can be decomposed as:
 - $\text{Return on Equity} = \text{Net Profit Margin} \times \text{Total Asset Turnover} \times \text{Equity multiplier}$.
- ROE can change because of net profit margin, total asset turnover, or leverage.
- Represents leverage: if a firm uses relatively more liabilities to finance assets, the equity multiplier will rise and ROE will increase.
- Here: not a greater operating efficiency, only a greater use of debt financing.
- This method is called the DuPont method of ratio analysis.

Market-Value Ratios

- Indicate how investors value the firm compared to its financial values.
- When markets are efficient, a firm's profitability, risk, quality of management, and many other factors should be reflected in its stock and security prices.
- Price-earnings ratio: stock price / earnings per share.
 - Willingness of investors to pay for an additional dollar of EPS.
- Price-to-book value: market value / balance sheet equity.
 - In an efficient market, it reflects investors' pessimism or optimism about a company's future.

Ratio Analysis: summary

1. **Liquidity** → Can we pay our bills?
2. **Efficiency** → How well do we use our assets?
3. **Leverage** → How much debt risk do we carry?
4. **Profitability** → Are we generating adequate returns?
5. **Market Value** → What do investors think?

Ratio Analysis: summary

- Ratios must be compared:
 - **Over time** → Are we improving or declining?
 - **To competitors** → Are we better or worse than rivals?
 - **To industry standards** → What's normal for this business?
-  **Warning:** Ratios tell a story, but context matters!
 - A "good" ratio in one industry might be terrible in another.
 - Seasonal businesses need quarterly comparisons.
 - One-time events can distort ratios.

Ratio Analysis: summary

Example of WeWork's Failed IPO (2019)

- **How it begins**
 - Valued at \$47 billion in January 2019
 - "Technology company" transforming real estate
 - Lease offices long-term, renovate them and rent offices short-term
 - Future lease payments $\approx$ \$47bn
 - Charismatic founder Adam Neumann
- **How it ends:**
 - Filed for IPO in August 2019
 - Investors analyzed the financials
 - IPO withdrawn in September 2019, CEO fired, value fell to \$8 billion
- **The Question:** What did the financial analysis reveal?

Ratio Analysis: summary

Example of WeWork's Failed IPO (2019)

- **The Numbers (2018):**

- Revenue: \$1.8 billion
- Gross margin ((Gross Profits) / COGS): 48% (looked great!)
- Net loss: \$1.9 billion
- Net margin ((Net profits) / Total Costs): -105% (terrible!)

- **The Issue:**

- WeWork created "Community Adjusted EBITDA"
- Excluded marketing, sales, and other "one-time" costs
- Made losses look like profits!

⇒ **Lesson:** Beware of non-GAAP metrics that seem too good to be true.

Ratio Analysis: summary

Example of WeWork's Failed IPO (2019)

- **Access to cash**
 - Operating cash flow: -\$2.2 billion (2018)
 - Free cash flow: -\$2.5 billion
- **Current Ratio Analysis:**
 - 2017: 0.6 (already concerning)
 - 2018: 0.4 (getting worse)

⇒ **Verdict:** The company was heading towards a liquidity crisis.