

17<sup>th</sup> November 2008

Mr Matthew Tenkate  
38 Prairie Road  
Yatala Qld 4207

Dear Matthew

Following our meeting in our boardroom we set out some ideas to assist you to maximize your investment structure.

This is an overview of developing a business mentality to your investment planning. Building and managing your investments is a continuous process, a development process. Its foundation is three distinct yet thoroughly integrated activities which you can pursue its natural evolution. They are innovation, quantification and orchestration. Through a series of in-depth discussions and computer applications, you begin developing a plan to assist you in approaching future financial decisions with confidence.

In order to accommodate your financial needs today without compromising your goals for tomorrow, a strong emphasis is placed on balancing the elements and the use of real property with diversification, maximisation of growth and risk management.

Through a process of educating you learn how to protect yourself against future adverse changes while simultaneously learning to take advantage of opportunities created by changes in the financial market place.

In essence, its flexibility allows you to work with several variables within a continuing process until a single co-ordinated set of results are achieved.

Thus you are to be complemented in making the investment of time represented by this study and welcomed to the introductory phase of financial strategies.

**1. INTRODUCTION**

1.1 Starting On Square One

**2. STRATEGY NO 1**

2.1 Personal Financial Perspective

2.1.1 John Smith = A Business

2.1.2 The Good Life

2.1.3 Your Strategic Square

**3. STRATEGY NO 2**

3.1 Increase Net Worth By Understanding Business

3.1.1 Profit and Loss Statements

3.1.2 Business Profit and Loss Statements

3.1.3 Personal Profit and Loss Statements

**4. BALANCE SHEETS**

4.1 Personal Balance Sheet

**5. A WINNING PROGRESSION**

## **6. THE ROLE OF FINANCIAL STATEMENTS**

6.1 What Do Those Number Mean For You

6.2 Assets Buy Other Assets

6.3 The Value Of A Business Mentality

6.4 Profit Margins

6.5 Interpreting Personal Financial Statements

6.6 Trends In Personal Financial Statements

6.7 Evaluate The Balance Sheet

6.8 Important Point

6.9 Profit and Losses in the Real World

## **7. STRATEGY NO 3**

7.1 Compromise is Essential

7.2 Summary of Introductory Comments

# INTRODUCTION

## 1.1 STARTING ON SQUARE ONE

Most people know how to earn money, but not how to make it grow. They choose a career, learn how to excel in it, and receive a good salary.

But then what happens to their personal financial growth?

For too many individuals, nothing happens. Their bank accounts remain anemic. In school, we were never taught how to take the next step - that of increasing our net worth. Many individuals don't even know that this term refers to the value of their overall assets - their personal wealth. How can they reach for something they don't understand?

Your net worth is a living, dynamic figure - a statement of your financial accomplishment. -Successful people keep frequent tabs on this figure.

But you rarely hear average people ask one another, "What are you doing to increase your net worth?"

When was the last time you used the term "Net Worth" in the context of increasing your personal wealth?

You can't take steps to increase your net worth unless you understand the concept, think about it, talk about it, and do something about it.

If you think "I'd like to get rich", you can't achieve this goal unless you know what "Rich" is.

"Rich" is an increased net worth - but you aren't going to increase your net worth unless you have reasons for doing so.

How can you increase your net worth? Putting money in the bank is a conservative approach. Other investments bring greater financial rewards. This report will help you develop a long term philosophy and strategy for investing.

Historically, sensible investments in real estate have been one of the best ways to increase net worth on an accelerating basis.

The greater your net worth, the easier it is to enjoy "The Good Life". What does the good life mean to you?

This is an appropriate time to stop and define this concept for yourself.

## 2. STRATEGY NO 1

### 2.1 PERSONAL FINANCIAL PERSPECTIVE

Before making any investment decisions, you must understand yourself and your financial picture. Research yourself before analysing prospective investments. Evaluate the security of your job or business, the amount of time you can commit to investment research and your preference for active versus passive investing.

#### 2.1.1 Matthew Tenkate = A Business

Before making any investment decisions, develop the habit of thinking in business terms.

Take the first step by following the same practices used by owners of successful companies. These people evaluate their firm's success by focusing on balance sheets and profit and loss statements. We'll explain these accounting terms shortly.

As long as we live in a capitalistic society where money is the means of exchange and a measure of wealth, you should treat your financial picture just as if you are a business.

Consider that your personal business is Victoria Dimitrov Pty Ltd, with you as the Managing Director, in charge of long term planning. Then apply business principles to your financial picture. Prepare your own profit and loss statements and balance sheets periodically. Once you regard yourself as a business entity, it will be easier to relate to the business aspects of real estate investing or any other type of investing.

#### 2.1.2 The "Good Life"

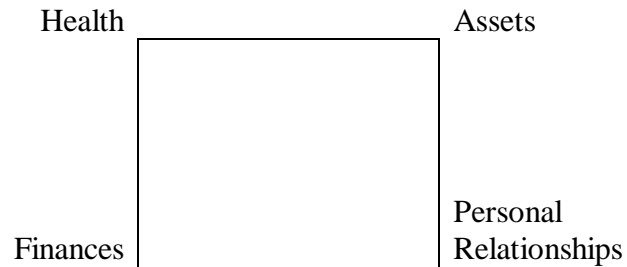
Recognising that there's more to life than financial statements, let's look at the broad picture before discussing investment.

Figure 1.1 highlights the four key essentials composing the square of life. You need to dedicate a reasonable time to each one if you want a productive, satisfying life. This square represents the sum of everything that contributes towards "The Good Life" for you and your family. When you enjoy good health, outstanding personal relationships with family, friends and business associates, plus a great deal of discretionary income (financial security), the quality of your life is enhanced.

If one of these four elements is diminished or missing, it's more difficult for you to be productive and make positive contributions to your personal and family well-being.

### 2.1.3 Your Strategic Square

**Figure 1.1**



## 3. STRATEGY NO 2

### 3.1 INCREASE NET WORTH BY UNDERSTANDING BUSINESS

#### 3.1.1 Profit and Loss Statements

A profit and loss statement is an accounting record that shows net profit or loss over a cumulative period of time. It consists of two parts - income and expenses. Although the time frame is generally one year, some businesses prepare profit and loss statements quarterly, monthly or even weekly.

The profit and loss statement is a cumulative total of all income that was taken in from business transactions during a fiscal period, minus all of the expenses for the same cumulative time. These expenses include tax liability and interest on debt. Anything left over is profit.



### 3.1.3. Personal Profit and Loss Statement

A personal profit and loss statement (See figure 1.3) shows whether you are spending too much or not earning enough. Have you ever prepared one of these statements by adding up your expenses during a particular time frame and subtracting them from your income?

When was the last time you did so?

Have you analysed the results?

Did you have money left over?

How Much?

What did you do with those funds?

**If you used them wisely, they could boost your net worth.**

**Figure 1.3**

<b>Personal Profit and Loss Statement</b>	
<b>for</b>	
<b>John Jones</b>	
<b>July 1, 2006 - June 30, 2007</b>	
<b>INCOME</b>	
Earnings	\$30,000
Interest Dividends	<u>\$1,000</u>
Total Income	\$31,000
<b>EXPENSES</b>	
Food Clothing Entertainment	\$12,000
Housing	\$9,000
Interest & Principal on Loans	\$1,000
Insurance	\$1,000
Taxes	<u>\$6,000</u>
<b>Total Expenses</b>	<b>\$29,000</b>
Profits (Money Left Over)	\$2,000
<b>Profit Margin</b>	<b>6.5%</b>

If we think of ourselves as a business we must keep records of our expenses. Some people divide their expenses into too many categories and this complicates matters.

Keep your list simple, include all expenses, but restrict the subject headings to major categories. Like any business, you can't evaluate your expenses or fine tune them unless you add them up and analyse them. Then, compare them to your income.

## 4. BALANCE SHEETS

A Balance Sheet is a statement showing the assets and liabilities of a business at a particular point in time.

The Bottom Line indicates net worth - What you would have left if you liquidated all your assets. It represents a summary that is true at a single point in time.

You can't have a balance sheet without a profit and loss statement first. What is the impact of a profit and loss statement? It increases or decreases the net worth on your balance sheets, depending upon the extent of profits (cash flow) that make up the bottom line.

Businesses prepare balance sheets quarterly and annually. By comparing the results of various times, they can see whether their net worth is growing or shrinking. Financial Experts measure a company's success by its balance sheet, not by its earnings.

Figure 1.4 is a sample Balance Sheet for a typical business.

**Figure 1.4**

<b>Balance Sheet</b>	
<b>for</b>	
<b>Idealic Real Estate</b>	
<b>30th June, 2007</b>	
<b>ASSETS</b>	
Land	\$100,00
Building	\$900,000
Cash	\$10,000
Appliances	\$20,000
Equipment	\$5,000
<b>Total Assets</b>	<b>\$1,035,000</b>
<b>LIABILITIES</b>	
Mortgage	\$600,000
Debt on Equipment	\$10,000
<b>Total Liabilities</b>	<b>\$610,000</b>
<b>Equity in Investment \$425,000 = NET WORTH</b>	

## 4.1 PERSONAL BALANCE SHEET

A personal balance sheet shows the assets you own - anything that has value. Estimate the monetary values of your home, car, shares, bonds and savings; and your personal possessions such as furniture, books, clothing, jewelry etc. From that total, subtract money you owe, such as your mortgage, credit card debt and money owed on your car.

**What does your personal balance sheet tell you?** If you sold everything you own and paid off all your debts, the money left would be your networth at the moment.

A negative net worth signifies impending or actual bankruptcy. You cannot have a negative net worth and survive in the business world. If your net worth stays the same from one year to the next, you're not going anywhere. If your net worth has increased, how can you use that money effectively.

Figure 1.5 shows typical entries in a personal balance sheet.

Although magazine articles frequently print sample balance sheets that encourage you to break down your assets, into numerous categories, it's not necessary to go into great details for your personal balance sheet. You're not working on a budget analysis but an overall picture.

For example, it's not necessary to list the individual values of your first car, second car and boat when one total figure for all vehicles will suffice.

**Figure 1.5**

<b>Personal Balance Sheet</b>	
<b>for</b>	
<b>Susan Jackson</b>	
<b>30th June, 2007</b>	
<b>ASSETS</b>	
Vehicles	\$15,000
Personal	\$5,000
Cash	\$3,000
Furniture	\$6,000
House	\$80,000
Shares & Bonds	\$5,000
<b>Total Assets</b>	<b>\$114,000</b>
<b>LIABILITIES</b>	
Debt on Car, Fumrnture	\$20,000
Mortgage	\$60,000
<b>Total Liabilities</b>	<b>\$80,000</b>
Net Worth	\$34,000

**(NETWORTH = Total Assets Minus Total Liabilities = Personal Wealth)**

## 5. WINNING PROGRESSION

- Convert excess earnings from your profit and loss statement to good investments
- Use part of that money to invest in real estate, this moves tangible assets to your Balance Sheet
- As your investments increase in value, your net worth increases

## 6. FINANCIAL STATEMENTS

### 6.1 WHAT DO THOSE NUMBERS MEAN FOR YOU?

What role do these financial statements play in your Life?

They represent one of the key essentials in the Strategic Square of Life. Your profit and loss statement represents income available to pay for such items as food, clothing and entertainment. Your current earnings finance these expenditures.

Your balance sheet represents Assets. When you buy a home, a car, a boat or finance your child's education, the money for these and other major capital expenditures comes from your balance sheet - your net worth - not from your current earnings.

These expenditures are financed by the strength of your balance sheet.

Your income may make the monthly payments, but your balance sheet provides funds for the down payment.

Income buys daily necessities and little frills.

### 6.2 ASSETS BUY OTHER ASSETS

You can replace one asset with another - buying a larger home by selling your first home or buying a new car by selling your older one.

A balance sheet reflects how well you manage your income. Each year you try to add more and more to the bottom line. When you compare your balance sheets at yearly or half yearly intervals, you'll know whether your net worth is growing or shrinking. How well you are managing your income?

This trend over a period of time will answer that question. That's why it's important to prepare these statements periodically.

### **6.3 THE VALUE OF A BUSINESS MENTALITY**

We've talked about using a businesslike approach to increasing your net worth - but how should we define the term business?

It is any entity that attempts to produce profits from the sale and/or leasing of goods and/or services.

A business is an activity involving many different types of decisions.

These include the employment and training of personnel, obtaining clients and servicing them, managing income and expenses so there will be more income and less expenses.

Real Estate is a business that buys, sells or leases a floor area. Why are profits so important?

Since we use money as the medium of exchange for all goods and services, the more money you can generate, the greater its value.

If you are an individual, develop skills than can generate money, people will employ and pay you.

If a business generates money, people will be willing to buy the business for a higher price.

If you buy good real estate, maintain it well, and have the ability to attract clients willing to pay higher rents, you've increased the value of that building. You'll be able to sell it at a profit.

### **6.4 PROFITS**

Profits refer to the financial gain from a transaction.

What's the difference between profits and profit margin?

Prior to the ultimate sale of real estate you own, one of the key measurements in determining how much profit you can sell the real estate (or any business) for is the profit margin.

The profit margin is the relationship between the money you have left after paying all your expenses and the amount of money you've taken in along the way.

Suppose your income is \$100. After paying expenses and taxes you have \$1 left. That's a 1 percent profit margin. Such a small profit margin doesn't leave much room for error. If your income doesn't increase, you must manage expenses very carefully.

## 6.5 **PROFIT MARGINS**

What do profit margins tell you? They are continuing measurement within the profit and loss statement of the relationship between income and expenses.

You must always analyse income and expenses on a separate basis, but it is equally important to measure the relationship between the two. Profit margins indicate trends over a period of time.

Business people watch out for the danger signal of deteriorating profit margins, which means that income isn't going up fast enough while expenses are going up too fast.

Ideally, you want to widen the gap between income and expenses. You can achieve this in two ways:-

1. Income increases while expenses decrease
2. Income increases at a faster rate than expenses.

Businesses pay accountants to analyse profit and loss statements. Keep tabs on your financial health regularly. If your profit and loss statement for last year shows that you had 2 percent of your income left after all expenses and you have 4 percent left over this year, you're moving in the right direction.

Your profit margin is a key ingredient in determining the relation of your income to your expenses.

You MUST be aware of this figure before you can ask yourself questions such as, "Am I spending too much money on entertainment? Have I borrowed too much, with high interest due? Am I paying too much in taxes?"

## 6.5 **INTERPRETING PERSONAL FINANCIAL STATEMENTS**

What trends do Profit and Loss Statements and Balance Sheets reveal.

We'll examine financial statements for three individuals.

The first person is twenty-five years old, owns a car and rents an apartment.

The second person is forty years old and owns two cars and a house.

The third person is fifty years old and owns three cars, the house he lives in and has invested in additional real estate.

Person A, the twenty five year old, has a total income of \$31,000 and expenses of \$29,000. That leaves \$2,000 for a profit margin of 6.5 percent.

Person B, the forty year old, has an income of \$42,000 and expenses of \$37,000. His profit margin is 11.9 percent. Almost twice the bottom line of Person A

Figure 1.6

**Trends Revealed In Personal Financial Statements**

**Profit and Loss Statements**

	<b>Person A Age 25</b>	<b>Person B Age 40</b>	<b>Person C Age 50</b>
<b>INCOME</b>			
Earnings	\$30,000	\$40,000	\$55,000
Interest & Dividends	<u>\$1,000</u>	<u>\$2,000</u>	<u>\$5,000</u>
<b>Total Income</b>	<b>\$31,000</b>	<b>\$42,000</b>	<b>\$60,000</b>
<b>EXPENSES</b>			
Food, Clothing, Entertainment	\$12,000	\$13,000	\$15,000
Housing	\$9,000	\$11,000	\$20,000
Interest & Principal On Loans	\$1,000	\$2,000	\$3,000
Insurance	\$1,000	\$1,000	\$3,000
Taxes	<u>\$6,000</u>	<u>\$10,000</u>	<u>\$12,000</u>
Total Expenses	\$29,000	\$37,000	\$53,000
Net Earnings (Profit)	\$2,000	\$5,000	\$7,000
<b>Profit Margin</b>	<b>6.5%</b>	<b>11.9%</b>	<b>11.7%</b>

## Balance Sheets

	Person A Age 25	Person B Age 40	Person C Age 50
<b>ASSETS</b>			
Cars	\$15,000 *	\$25,000 **	\$30,000 ***
Personal	\$5,000	\$10,000	\$20,000
Cash	\$3,000	\$20,000	\$50,000
Furniture	\$6,000	\$15,000	\$25,000
Shares & Bonds	\$17,000	\$40,000	\$60,000
House		\$150,000	\$200,000
Other Real Estate	\$ -	\$ -	\$100,000
<b>Total Assets</b>	<b>\$46,000</b>	<b>\$260,000</b>	<b>\$485,000</b>
<b>LIABILITIES</b>			
Debt (Cars, Furniture, Share Margin Account)	\$20,000	\$40,000	\$60,000
Home Mortgage	\$ -	\$100,000	\$75,000
Mortgage on other Real Estate	\$ -	\$ -	\$75,000
<b>Total Liabilities</b>	<b>\$20,000</b>	<b>\$140,000</b>	<b>\$210,000</b>
Net Worth (Assets minus Liabilities)	\$26,000	\$120,000	\$275,000
* One Car	** Two Cars		*** Three Cars

### 6.7 EVALUATE THE BALANCE SHEET

Person C, the fifty year old, has the highest income (\$60,000) but his profit margin is 11.7 percent a fraction less than Person B.

All of these people are in reasonably good health financially. If you were lending money to one of these people, which one would you choose? Which one has a better ability to save money? Which one appears to be managing earnings his/her affairs best?

Earnings don't tell the entire story. To determine who is the best manager, look at the profit margins.

Now let's evaluate their balance sheets. These simplified statements ignore potential tax liabilities. If Person A sold everything he owned and paid off his debts, he would have a net worth of \$26,000. Person B has a net worth of \$120,000 and Person C has amassed a net worth of \$275,000.

Observe that his assets also include investment real estate worth \$100,000. At retirement, this individual can augment his income from investment real estate with earnings from a PPP - Personal Pension Plan.

## 6.8 IMPORTANT POINT

If you take control and manage your affairs well when you're young, you won't have to let the tide carry you along.

If Person B owned investment real estate, his net worth might be closer to that of Person C, but he would have achieved his goal ten years earlier on the time scale.

Take charge now, and you might be in the position of Person C long before you reach fifty.

## 6.9 PROFITS AND LOSSES IN THE REAL WORLD

"How high can it go"? That's the first question most people ask before they invest. They're overly optimistic, with visions of making bundles of money.

But when someone recommends an investment, it's smarter to ask, "How low can it go?".

If an investment doesn't work out, you face an uphill battle waiting for the value to struggle back to its original amount. Recovering a loss is much more difficult than most people realise. Business is a matter of percentages.

Figure 1.7 demonstrates how difficult it is to get back to where you've started.

If you invest \$100 and the value of the investment declines to \$50, you lose 50 percent of your money. What percentage does it have to increase to get your money back? A hefty 100 percent, since the value must double.

Let's see how continuing losses work against you geometrically (we use this term because losses involve a situation that expands and continues to worsen).

The gap widens as the value keeps dropping. Suppose you continue to lose money - another \$30 this time - and your investment is now worth only \$20. That's a total decline of 80 percent

### **Figure 1.7**

#### **The Sad Truth About Losses**

Purchase Price = \$100

- 80% Decline
- 
- 
- 
- Current Value = \$20

Purchase Price = \$100

- Increase
- Necessary
- To Regain
- Original
- Value = 400%

In this case, a 100 percent increase would only bring the value up to \$40. To climb back to its original value, your investment would now have to increase 400 percent.

## 7. STRATEGY NO 3

### 7.1 COMPROMISE IS ESSENTIAL

Look at somewhat less appreciation to make sure you're protected on the downside. People are attracted by big returns, but its often wiser - and safer - to make a trade off.

Using a stock market analogy, you might be better off with a low yielding AAA Bond instead of a high yielding non-rated bond.

The high risk bond might go up 50 percent if you choose well, but it could decline 40 percent if you're made a wrong decision.

The safer choice might be a AAA Bond with an upward potential of 20 percent and a downside risk of 5 percent. Always be aware of the risk - versus - return element in your investments. If you settle for a lesser upward movement this compromise might mean the difference between big profits and sleepless nights.

The choice is yours.

There is nothing wrong with attempting to achieve high gains, but understand that this is accompanied by high risk. You need to understand the perils of high risk; therefore let risky investments represent an intelligent percentage of our overall assets.

### 7.2 SUMMARY ON INTRODUCTORY COMMENTS.

- Think of yourself as a business
- Prepare profit and loss statements and balance sheets regularly
- Use your net worth, not your earnings, as a measure of your financial accomplishments
- Look for trends in your financial statements
- Analyse risk versus reward. Be prepared to spend time researching potential investments
- Be realistic

Look forward to our next meeting

