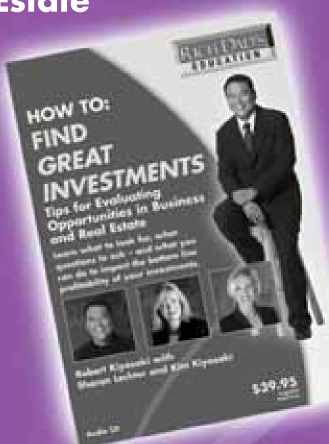
RICH DAD'S EDUCATION

HOW TO: FIND *GREAT INVESTMENTS*

Tips for Evaluating Opportunities in Business and Real Estate



Learn what to look for, what questions to ask – and what you can do to impact the bottom-line profitability of your investments.

Robert Kiyosaki with Sharon Lechter and Kim Kiyosaki

www.richdadeducation.com

"My banker has never asked me for my report card! My banker asks me for my financial statement. That is why I created the game CASHFLOW®. It teaches you the investing words and fundamentals that I wasn't taught in school."

- Robert Kiyosaki

How do you find great investments?

Finding great investment opportunities starts with understanding that you don't see investments with your eyes. You see them with your mind. Learn to train your mind to see investments that your eyes don't see.

What blinds people to finding great investments is thinking that "I can't do that..." or "I can't find that kind of opportunity..." If your mind is closed, so are your eyes. Ask yourself instead — like asking "How can I afford this?" instead of saying "I can't afford this..." — "How can I find great investments?"

A good first step is investing time in your education. That means learning the fundamentals of different types of investments as well as the vocabulary you need to master to be successful. It means learning what's going on in a specific industry and looking at the trends.

Investment opportunities are everywhere, but you need to look for them — and educate yourself — to see them.

Reading the Story That the Numbers Tell…

Financial statements tell a story and help you determine if the company's story is a good one… or a bad one. But sometimes you have to look *beyond* the numbers in the financial statements, and look to the industry and market conditions. A very successful company one year may find itself in trouble the next if it does not keep itself current with the technology and market for its products.

Two companies with the same numbers — but with very different stories — are presented to demonstrate this point. The two companies represent very different investment opportunities…

Widget Co. and New Gadget Co.
Balance Sheets
December 31, 2005

	Widget Co.	New Gadget Co.
Assets		
Current Assets		
Cash	$2,245,002	$1,757,389
Accounts Receivable	2,428,900	2,309,133
Inventory	3,542,011	3,631,961
Other	1,552,098	1,935,356
Total Current Assets	**9,768,011**	**9,633,839**
Total Property Plant and Equipment	**2,254,000**	**1,186,750**
Total Other Assets	**1,932,563**	**1,195,336**
Total Assets	**$13,954,574**	**$12,015,925**
Liabilities and Stockholders Equity		
Current Liabilities		
Accounts Payable	$4,112,023	$3,313,029
Income Tax Payable	242,021	492,269
Other Liabilities	197,932	150,000
Total Current Liabilities	**4,551,976**	**3,955,298**
Long-term Debt	**1,945,823**	**1,045,578**
Capital Stock	1,750,000	1,000,000
Retained Earnings	5,706,775	6,015,049
Total Stockholders Equity	**7,456,775**	**7,015,049**
Total Liabilities and Stockholders Equity	**$13,954,574**	**$12,015,925**

Take note:

High levels of inventory… is that good news or bad news? Let's look at the audited financial reports for each company to see what more we can discover.

Widget Co.

Excerpt from the Independent Auditor's Report:

"The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 5 to the financial statements, the Company may not be able to continue as a going concern. These conditions, related to market competitiveness and inventory obsolescence, raise substantial doubt about its ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty."

Excerpt from Note 5 to the Financial Statement — Subsequent Event:

"In December of 2005, a new product was released by New Gadget Co., Widget Co.'s primary competitor, with new patented technology which may severely impact current and future sales of Widget Co.'s products. Widget Co. had levels of inventory at the end of December 31, 2005 consistent with anticipated continued and growing demand for its products. Sales have dropped 50% in the first quarter of 2006 as compared to the first quarter of 2005. Based on these results Widget Co. terminated production of one of its main product lines. Widget Co. believes a portion of its inventory may no longer be marketable and may be obsolete."

Does this make Widget Co. a good investment? ________

New Gadget Co.

Excerpt from the Independent Auditor's Report:

"In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of New Gadget Co., as of December 31, 2005, and the results of its operations and its cash flows for the year ended December 21, 2005, in conformity with U.S. generally accepted accounting principles."

Excerpt from Note 5 to the Financial Statement — Subsequent Event:

"In December, 2005, a new product was released by New Gadget Co., with new patented technology which has been met with increased sales of 300% for the first four months of 2006 as compared to the first four months of 2005. With this increase in annual sales, New Gadget Co. is now ranked among the top two companies in its industry in the U.S."

Which company do you think is a wiser investment?

Widget Co. ______________________

New Gadget Co.__________________

Ultra Apartments (10 Units)

123 Main Street
Anytown, USA 1

FINANCIAL ANALYSIS

Unit Mix and Rent Schedule

Units	Type	Unit Sq. Ft.	Rent/Unit	Total Rent/Unit	Rent/Sq. Ft
4	1/1	650	$510	$2,040	$0.78
6	2/2	800 5	$625	$3,750	$0.78 6
10		**Total: 7400**		**$5,790**	**(Avg.) $0.78**

EXECUTIVE SUMMARY

Number of Units	10
Year Constructed 2	1972
3 **Construction**	Block
Roof	Pitched Tile
Parking	12 Open
Amenities	Pool, Laundry

INVESTMENT INFORMATION

4 **Price**	$495,000
Price/Unit	$49,500
Price per Sq. Ft.	$66.89
Down Payment	$99,000
Cap Rate 9	8.5

Finance Terms

Type	New loan
Interest Rate	6.50%
Amortization	25 year
10 **Loan Payment**	$2,674

11

Cash Flow	$10,104
Cash on Cash Return	10.2%

PRO FORMA INCOME AND EXPENSES

Income

	Monthly	Annual
Gross Scheduled Rent:	$5,790	$69,480
Less: Vacancy (8%) 7	($463)	($5,556)
Net Rental Income	$5,327	$63,924
Plus: Other Income	$80	$960
Late Fees	$25	$300
Total Collected Income	**$5,432**	**$65,184**

Expenses 8

	Monthly	Annual
Advertising	$35	$420
Carpet Cleaning	$40	$480
Electricity	$260	$3,120
Insurance	$135	$1,620
Maintenance — Labor	$180	$2,160
Maintenance Supplies	$50	$600
Management	$271	$3,252
Office/Admin. Supplies	$30	$360
Painting	$120	$1,440
Permits	$30	$360
Phone	$20	$240
Postage	$15	$180
Referral Fees/Commissions	$50	$600
Reserves	$120	$1,440
Taxes	$275	$3,300
Pest/Termite Contract	$25	$300
Trash	$50	$600
Water	$80	$960
Yard Maintenance	$130	$1,560
Total Expenses	**$1,916**	**$22,992**
Net Operating Income	**$3,516**	**$42,192**
Less: Debt Service	($2,674)	($32,088)
Projected Net Cash Flow	**$842**	**$10,104**

On the preceding page is a pro forma of a 10-unit apartment building...

What is a pro forma?
A pro forma is a statement of projected income and expenses for a particular investment property. The numbers on a pro forma are typically not the actual numbers of the property but a proposed future scenario of how the property could operate and may include rent increases, decreases in expenses, and solving any problems that may exist. Your job is to separate the fact from the fiction. A pro forma will raise many questions for you to ask of the agent, the seller, the lender, and others.

How do you get pro formas?
You get pro formas from real estate agents and brokers. A pro forma is an agent's marketing tool for selling an investment property.

What do I look for on a pro forma?
The following are some key items to examine when reviewing any pro forma:

1. **Location of the property** – Is the property located in an area that is trending up or trending down? Is it an up-and-coming neighborhood or one that is deteriorating? Is it in a college town? High-end or low-end neighborhood? All of this determines the type of tenants, the rents, and the overall value of the property.
2. **Age** – How old is the property? Older buildings may require more maintenance, which could increase the expenses. This is one reason why it is important to do thorough inspections during your due diligence of the property.
3. **General info** – Many pro formas list various items which are unique to the property. These may include parking spaces (how many and are they covered or uncovered?), pool (may be a plus for attracting tenants, but there will be additional expenses incurred), roof and construction (what type?), washer/dryers (a laundry room or individual hook-ups in units?), and utilities (paid by tenant, or owner?) All of these items raise questions and affect the overall operation of a property.
4. **Price per square foot** – Divide the price of the property by the total number of square feet to calculate your price per square foot. This figure is important when comparing one property against others. For example, You could have two properties with the same number of units and same

price, but if one has small-sized units and one has larger units, then that will show up in the price-per-square foot ratio. The price per square foot is a more accurate figure to use in comparisons versus the price of the property or the price per unit (price divided by the number units) of a property.

5. **Unit mix**–What type of units make up this property? Are they studios, 1-bedrooms, 2-bedrooms? Are they all one bath? If so, you probably cannot rent to families of three or more. How large are the units? These are all factors in determining the amount of rent you can charge. Also consider the unit mix in relation to who your tenants are. If senior citizens are the primary tenants, then studios and 1-bedrooms may be a plus. If single professionals are the tenants, then 2-bedrooms may be desirable with one bedroom being a home office.

6. **Rent per unit and rent per square foot**–The first question to ask: Are the rents listed in the pro forma projected rents or actual rents? Often the rents are projected. You will want to get the actual numbers on properties you are considering purchasing. Once you have the actual rents, then compare the rents to other similar apartments in the area. The rent per square foot is a good figure to use for comparison. This number takes into account the rent and the size of the unit and gives you a more accurate picture when matching rents of various properties. Are the rents low? Is there an opportunity to raise the rents? Also discover what specific amenities are included when making comparisons because a washer/dryer hook-up, cable TV, high-speed internet connection, etc. all affect the rents.

7. **Vacancy rate**–This is an important number because vacancies mean turnover and turnovers, are one of your greatest expenses on investment properties. Often the vacancy rate is not an actual figure, so you want to determine the actual vacancy rate. A few things to consider:

   a. If the actual vacancy rate is low, then there may be an opportunity to raise rents. If you can get the property at a lower price and then solve the vacancy problem and fill the empty units, then the overall value of the property increases, and so does the cash flow.

   b. Vacancies are directly related to expenses. What happens when someone moves out? Carpets are cleaned. Units are painted. Repairs are made. Advertising is placed. The turnover of a unit is costly. This is why one of the most important items to focus on with investment properties is finding great tenants and keeping them happy. One key way to keep them happy is to respond to their requests, complaints, and questions quickly. They may not always get what they want, but communicating with them promptly is a must.

8. **Expenses** – This is where some knowledge and experience can improve your bottom line. The success of a property can be as simple as increasing your income and lowering your expenses. Again, get the actual expenses of the property. A poorly managed property can show up as high expenses. Lower the expenses and improve your cash flow. Review the expenses and look for opportunities where specific items can be reduced. For example, a high water expense could signify a leak in the system. A high electricity, bill may mean that the owner pays for the tenants' electricity and that expense may be able to be reduced by charging the electric bill expenses back to the tenants. Remember that the numbers tell the story and the story can reveal many opportunities.
9. **Financing terms** – Your debt payment is typically your largest cost. The question to ask is: How can I get the best financing terms possible? A mortgage broker could be a good resource for you. Their job is to secure a favorable loan on the property. Items that make up the financing terms include the type of lender, the interest rate, the number of years over which the loan is amortized, the down payment, plus any and all items that can be negotiated.
10. **Cash flow** – The cash flow is very simply the income of the property less the expenses, less the debt or loan on the property. You want this number to be positive. The cash flow listed on the pro forma will be different from the cash flow calculated after you've done your analysis of all the numbers.
11. **Cash-on-cash return on investment** – As an investor, the number one question to ask is: If I put up X amount of money, then how much money do I get back? For example, if I pay $20,000 cash as a down payment on an investment property and at the end of the year my net profit (income less expenses less debt) is $2,000, then I have a 10% cash-on-cash return. The equation is simply the annual net profit divided by the amount of cash outlayed to purchase the property. As an investor, this is your bottom line.

12. **Upside**–Now that you have a clearer understanding of the numbers, the decisive question to ask is: Where is my upside on this property? How can I increase the value of this property? It could take the shape of a large problem that can be solved. Can you add more units to the property? Are there improvements that can be added? Can you change the usage of the property, (such as change it from apartments to condos) to make it more valuable? The list can go on and on.

    This is where creativity and vision come into play. Exhaust the possibilities. If you can see and implement a good upside on a property, then you increase the value, the cash flow, and the return of that property.

Enjoy the process!

RICH DAD'S EDUCATION

A valuable addition to
your Rich Dad® Financial Library

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