

# Financial Statement Analysis

Chapter 14

## Purpose

- ▶ To make informed decisions about a company
- ▶ Generally based on comparative financial data

## Learning Objective 1

Perform a horizontal analysis of financial statements

## Horizontal Analysis

- ▶ Compares two financial statements to determine dollar and percentage changes
  - Compute dollar changes

Current year balance — Prior year balance

- Compute percentage changes

Dollar change ÷ Base period



## Exercise 14-13

Verifine Designs Comparative Income Statements Years ended December 31, 2011 and 2010				
	2011	2010	Dollar change	Percent change
Net sales revenue	\$428,950	\$ 371,000	\$57,950	15.6%
Expenses:				
Cost of goods sold	\$ 203,850	\$ 189,350	\$14,500	7.7%
Selling and general expenses	99,350	93,000	\$6,350	6.8%
Other expense	6,750	5,000	\$1,750	35.0%
Total expenses	\$ 309,950	287,350	\$22,600	7.9%
Net Income	\$119,000	\$83,650	\$35,350	42.3%

## Trend Percentages

- ▶ Form of horizontal analysis
- ▶ Base year selected and set equal to 100%

$$\text{Trend \%} = \frac{\text{Any year \$}}{\text{Base year \$}}$$

## Learning Objective 2

Perform a vertical analysis of financial statements

## Vertical Analysis

- ▶ Shows relationship of each item to a base amount on financial statements

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## Learning Objective 3

Prepare and use common-size financial statements

## Common-Size Statements

Any Company Income Statement Year ended December 31, 2011	
	2011
Net sales revenue	100.0%
Expenses:	
Cost of goods sold	47.5%
Selling and general expenses	23.2%
Other expense	1.6%
Total expenses	72.3%
Net Income	27.7%

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## Benchmarking

- ▶ Comparing a company with another leading company

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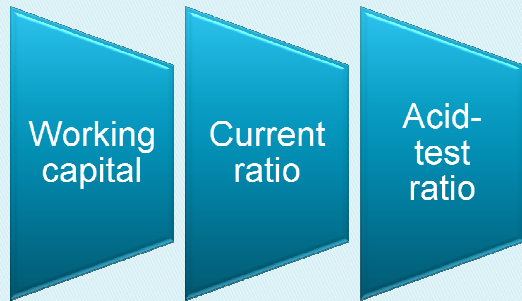
## Learning Objective 4

Compute the standard financial ratios

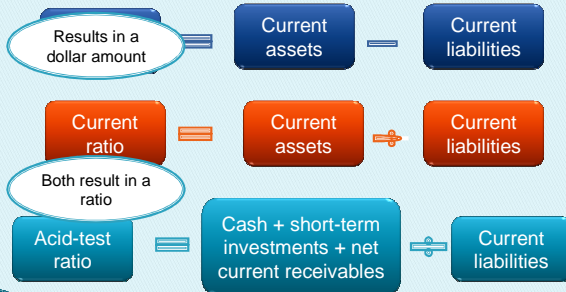
## Types of Ratios



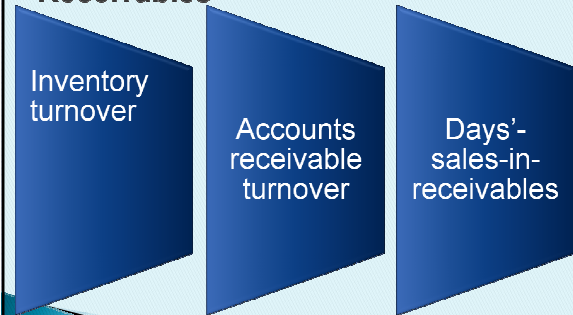
## Ability to Pay Current Liabilities



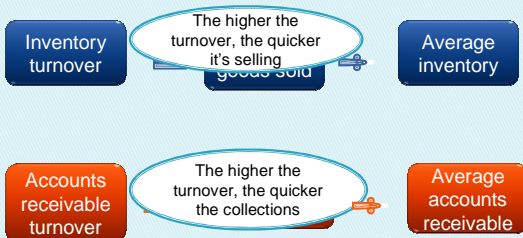
## Ability to Pay Current Liabilities



## Ability to Sell Inventory and Collect Receivables



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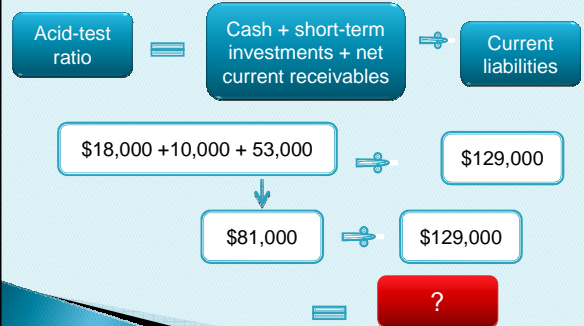
## Ability to Sell Inventory and Collect Receivables



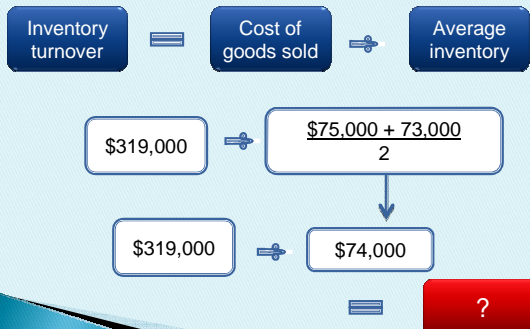
### Exercise 14-17



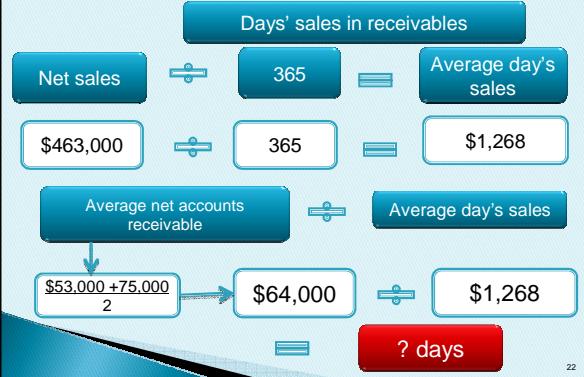
### Exercise 14-17 (continued)



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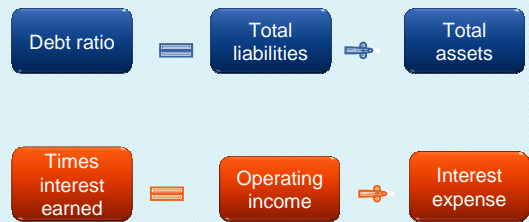
### Exercise 14-17 (continued)



### Ability to Pay Long-Term Debt



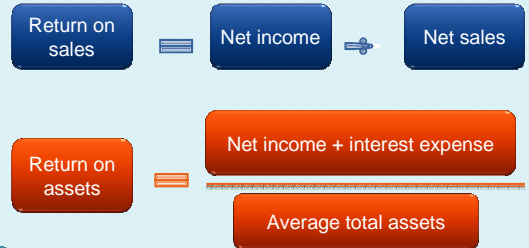
### Ability to Pay Long-Term Debt



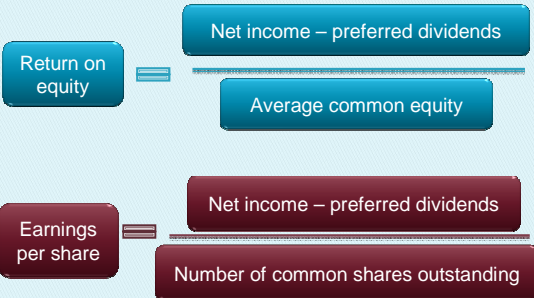
## Measuring Profitability



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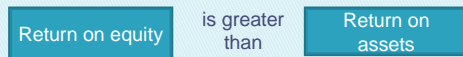


## Measuring Profitability



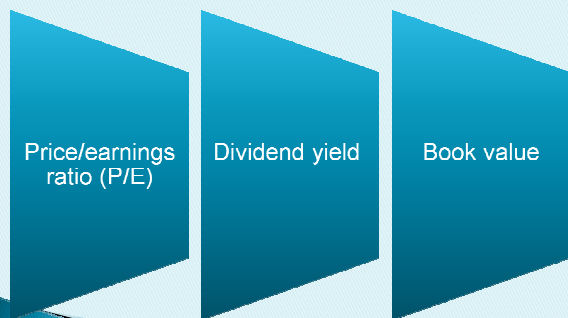
## Leverage

- Trading on the equity

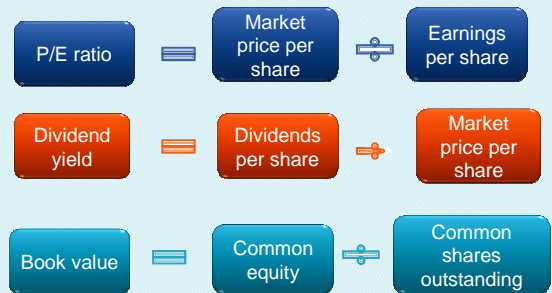


- Increases profits during good times

## Analyzing Stock Investments



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## Red Flags

- ▶ Suspect movement of sales, inventory, and receivables
- ▶ Earnings problems
- ▶ Decreased cash flow
- ▶ Too much debt
- ▶ Inability to collect receivables
- ▶ Inventory buildup

**End of Chapter 14**