FINANCIAL STATEMENTS

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Financial Statements

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Financial Statements

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Key Concepts

- The two primary financial statements
  - **Balance Sheet**
  - **Income Statement**

- *Debt* vs *equity*
- *Book* vs *market* value
- *Income* vs *cash flow*
- *Average* vs *marginal* tax rate

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Key Terms Review

- Asset – something you have
- Liability – something you owe (debt)
- Equity – net value of the business
  - Equity = Assets – Liabilities

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New Terms

– **Liquidity** – Speed and ease of conversion to cash without significant loss of value
  – Valuable in avoiding financial distress

- Current vs fixed or long term
  – An **asset** or **liability** is "current" if it *converts to cash within a year*

The Balance Sheet

- *A snapshot of the firm's assets and liabilities at a given point in time ("as of …")*
- **Assets**
  - Left-hand side (or upper portion)
  - In order of decreasing liquidity
- **Liabilities** and **Owners' Equity**
  - Right-hand side (or lower portion)
  - In ascending order of when due to be paid
- Balance Sheet Identity
  - Assets = Liabilities + Owners' Equity (ALOE)

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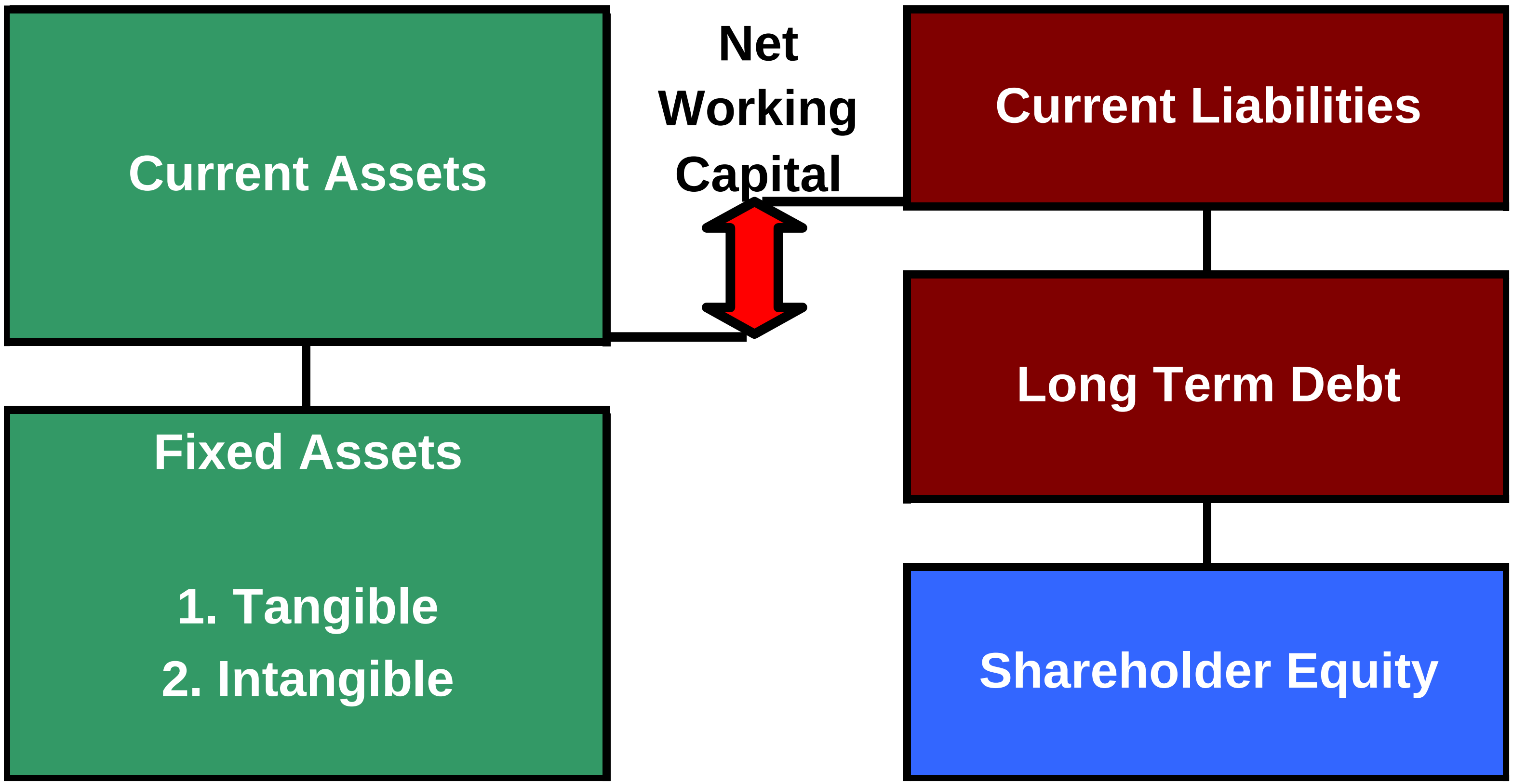
The Balance Sheet

Total Value of Assets

Total Value of Liabilities and Shareholders' Equity



The Balance Sheet

U.S. CORPORATION
Balance Sheets as of December 31, 2013 and 2014
($ in Millions)

	2013	2014		2013	2014
Assets			**Liabilities and Owners' Equity**		
Current assets			Current liabilities		
Cash	$ 104	$ 160	Accounts payable	$ 232	$ 266
Accounts receivable	455	688	Notes payable	196	123
Inventory	553	555	Total	$ 428	$ 389
Total	$1,112	$1,403			
Fixed assets					
Net fixed assets	$1,644	$1,709	Long-term debt	$ 408	$ 454
			Owners' equity		
			Common stock and paid-in surplus	600	640
			Retained earnings	1,320	1,629
			Total	$1,920	$2,269
Total assets	$2,756	$3,112	Total liabilities and owners' equity	$2,756	$3,112

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Balance Sheet Examples

- Let's examine some balance sheets!
- SCORE Balance Sheet
- FSA Balance Sheet

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Accrued Interest?

- Let’s get Investopedia to help!

- http://www.investopedia.com/terms/a/accruedinterest.asp

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Balance Sheet Activity

- **Balance Sheets** have a particular structure, but let's think more broadly…

- Let's come up with a **balance sheet** *for your life*
  - What do you have going for you?
  - What's working against you?
  - Keep things broad, no need to get too detailed

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The Balance Sheet

- **Net Working Capital**
  - Current Assets - Current Liabilities
  - Usually positive for a healthy firm
- **Solvency**
  - The ability to pay off your liabilities (debt)
- **Liabilities** versus **Equity**
  - Liabilities (debt) – borrowing money to buy assets
  - Equity – using your own money to buy assets

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Leverage

- **Financial Leverage** – the use of debt in a firm's capital structure
  - The more **debt** a firm has relative to its **assets**, the greater its degree of **leverage**
  - Increases the risk of bankruptcy/distress
  - Can also increase profitability

- *Who is paid first in the case of bankruptcy?*

Book vs Market Value

- **Book value** = the <u>balance sheet value</u> of the assets, liabilities, and equity
- **Market value** = *true value*; the price at which the assets, liabilities, or equity can <u>actually be bought or sold</u>
  - Market value and book value are often very different. Why?
  - Which is more important to the decision-making process?

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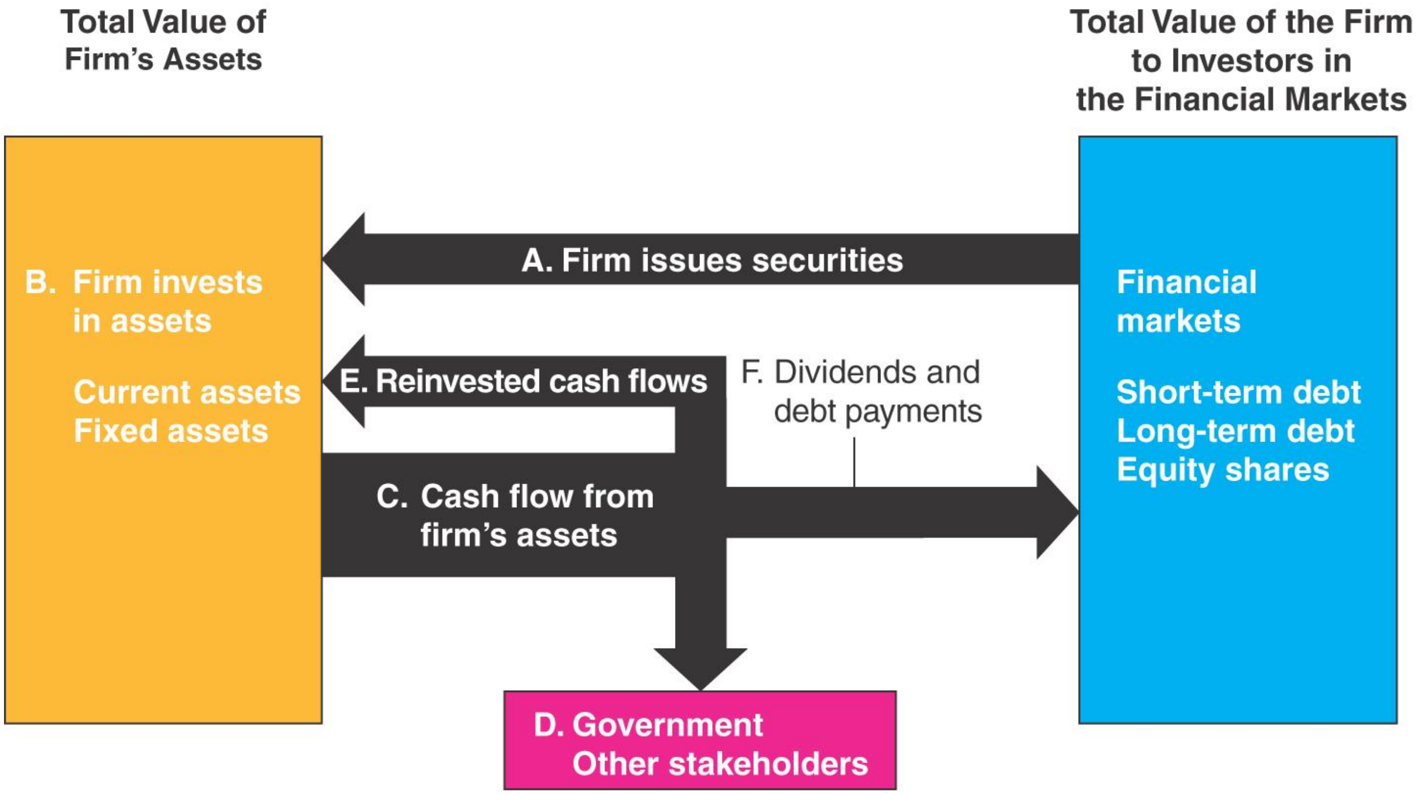
The Circle of Financing



A. Firm issues securities to raise cash.
B. Firm invests in assets.
C. Firm's operations generate cash flow.
D. Cash is paid to government as taxes. Other stakeholders may receive cash.
E. Reinvested cash flows are plowed back into firm.
F. Cash is paid out to investors in the form of interest and dividends.

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On to the Income Statement!

- The **balance sheet** paints a picture of your business
- The **income statement** tells us how your business makes money

Income Statement

- The **income statement** measures performance over a specific time period (quarter, year, etc.)
- Report revenues first and then deduct any expenses for the period
- End result = **Net Income** = "Bottom Line"
  - Dividends paid to shareholders (you in most cases)
  - Addition to retained earnings (reinvest)
- **Income Statement** Equation:
  - Net Income = Revenue - Expenses

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Basic Income Statement

U.S. CORPORATION
2014 Income Statement
($ in Millions)

Net sales		$1,509
Cost of goods sold (COGS)		750
Depreciation		65
Earnings before interest and taxes (EBIT and EBITA)		$ 694
Interest paid		70
Taxable income		$ 624
Taxes		212
Net income		$ 412
Dividends	$103	
Addition to retained earnings	309	

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Income Statement Example

- SCORE Income Statement
- FSA Income Statement
  - Also known as “Profit and Loss Statement”

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Discussion

- *Why do **Income Statements** often look so different?*
- *How does the **Income Statement** affect the **Balance Sheet**?*

Two Major Categories

- **Operating Revenues and Expenses**
  - Sales (revenue)
  - The day-to-day or "regular" costs of producing your product (or service)
- **Non-operating** or "**Overhead**"
  - Transactions that are not directly associated with your product, but necessary for the business

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Financial Statements

- **GAAP** Matching Principle:
  - **G**enerally **A**ccepted **A**ccounting **P**rinciples
  - Recognize revenue when it is "fully earned"
  - Match expenses required to generate revenue to the period of recognition
    - First-in, first-out (**FIFO**) and **LIFO** with **COGS**
- Noncash Items
  - Expenses charged against revenue that don't affect cash flow
  - **Depreciation** = most important

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Depreciation

- How do you value assets that depreciate in value over time?
  - **Book value** = Cost – Accumulated depreciation
  - **Straight-line depreciation** – the reduction in value is identical in each period
    - Several alternative depreciation methods
  - **Salvage value** – the value of an asset after it has been fully depreciated

Taxes

- Marginal vs. Average tax rates
  - **Marginal** – % tax paid on the <u>next</u> dollar earned
  - **Average** – total tax bill / taxable income

- *Which tax rate should you use for decision-making?*

Individual Tax Rates

Attention: 2018 Tax Year Individual Income Tax Rate Schedule

Important: You should only use the information below for your 2018 Tax Return filed in 2019.

Tax Rate	Single	Married/Joint & Widow(er)	Married/Separate	Head of Household
10%	$1 to $9,525	$1 to $19,050	$1 to $9,525	$1 to $13,600
12%	$9,526 to $38,700	$19,051 to $77,400	$9,526 to $38,700	$13,601 to $51,800
22%	$38,701 to $82,500	$77,401 to $165,000	$38,701 to $82,500	$51,801 to $82,500
24%	$82,501 to $157,500	$165,001 to $315,000	$82,501 to $157,500	$82,501 to $157,500
32%	$157,501 to $200,000	$315,001 to $400,000	$157,501 to $200,000	$157,500 to $200,000
35%	$200,001 to $500,000	$400,001 to $600,000	$200,001 to $300,000	$200,001 to $500,000
37%	over $500,000	over $600,000	over $300,000	over $500,000

Old Corporate Tax Rates

Taxable Income	Tax Rate
$ 0– 50,000	15%
50,001– 75,000	25
75,001– 100,000	34
100,001– 335,000	39
335,001–10,000,000	34
10,000,001–15,000,000	35
15,000,001–18,333,333	38
18,333,334+	35

New Corporate Tax Rates

21%!

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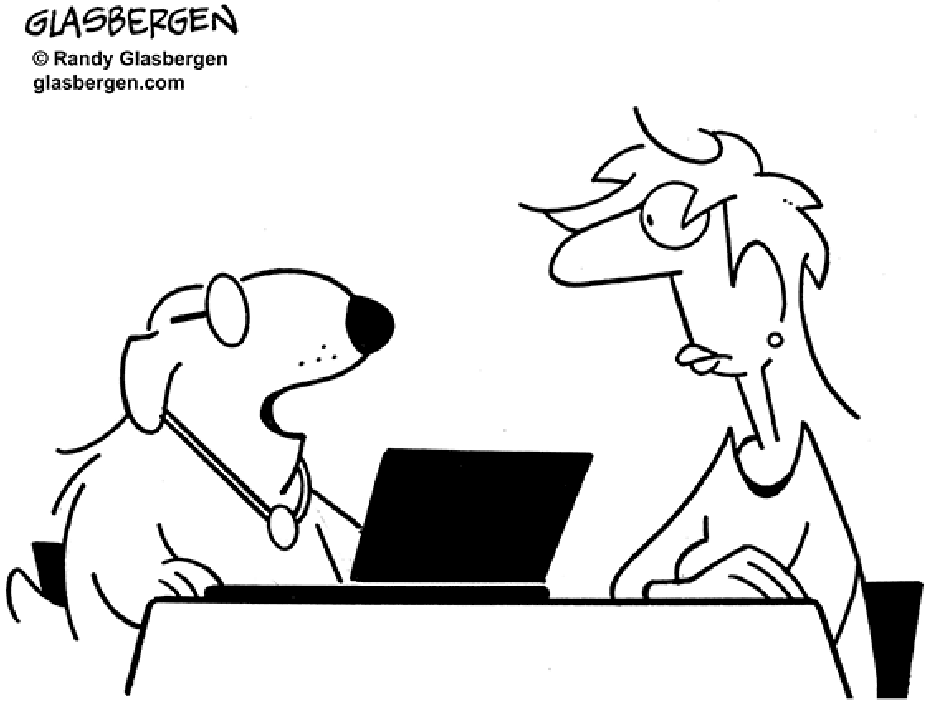
Tax Rates with Exemptions

Industry	Number of Companies	Average Tax Rate
Electric utilities (Eastern U.S.)	24	33.8%
Trucking	33	32.7
Railroad	15	27.4
Securities brokerage	30	20.5
Banking	481	17.5
Medical supplies	264	11.2
Internet	239	5.9
Pharmaceutical	337	5.6
Biotechnology	121	4.5

Discussion

- *How can decisions about depreciation affect taxes?*
- More on this later when we talk about cash flow…

Financial Statement Analysis



"According to my itemized cost analysis and fiduciary forecast, if expenditures continue to outpace earnings, insolvency is a foregone conclusion. My advice is, sell the cats."

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Key Concepts

- Standardizing financial statements
- Calculating and interpreting **financial ratios**
- Understanding *issues with financial statement analysis*

Standardized Financial Statements

- *Common-Size* **Balance Sheets**
  - All accounts = percent of <u>total assets</u>
- *Common-Size* **Income Statements**
  - All line items = percent of <u>sales or revenue</u>

- Standardized statements are useful for:
  - Comparing financial information year-to-year
  - Comparing companies of different sizes, particularly within the same industry

Standardized Financial Statements

PRUFROCK CORPORATION
Balance Sheets as of December 31, 2013 and 2014
($ in millions)

	2013	2014
Assets		
Current assets		
Cash	$ 84	$ 98
Accounts receivable	165	188
Inventory	393	422
Total	$ 642	$ 708
Fixed assets		
Net plant and equipment	$2,731	$2,880
Total assets	$3,373	$3,588
Liabilities and Owners' Equity		
Current liabilities		
Accounts payable	$ 312	$ 344
Notes payable	231	196
Total	$ 543	$ 540
Long-term debt	$ 531	$ 457
Owners' equity		
Common stock and paid-in surplus	$ 500	$ 550
Retained earnings	1,799	2,041
Total	$2,299	$2,591
Total liabilities and owners' equity	$3,373	$3,588

Standardized Financial Statements

PRUFROCK CORPORATION
Common-Size Balance Sheets
December 31, 2013 and 2014

	2013	2014	Change
Assets			
Current assets			
Cash	2.5%	2.7%	+ .2%
Accounts receivable	4.9	5.2	+ .3
Inventory	11.7	11.8	+ .1
Total	19.1	19.7	+ .7
Fixed assets			
Net plant and equipment	80.9	80.3	− .7
Total assets	100.0%	100.0%	0%
Liabilities and Owners' Equity			
Current liabilities			
Accounts payable	9.2%	9.6%	+ .3%
Notes payable	6.8	5.5	− 1.4
Total	16.0	15.1	− 1.0
Long-term debt	15.7	12.7	− 3.0
Owners' equity			
Common stock and paid-in surplus	14.8	15.3	+ .5
Retained earnings	53.3	56.9	+ 3.5
Total	68.1	72.2	+ 4.1
Total liabilities and owners' equity	100.0%	100.0%	0%

Standardized Financial Statements

PRUFROCK CORPORATION
2014 Income Statement
($ in millions)

Sales		$2,311
Cost of goods sold		1,344
Depreciation		276
Earnings before interest and taxes		$ 691
Interest paid		141
Taxable income		$ 550
Taxes (34%)		187
Net income		$ 363
Dividends	$121	
Addition to retained earnings	242	

Standardized Financial Statements

PRUFROCK CORPORATION
Common-Size Income Statement
2014

Sales		100.0%
Cost of goods sold		58.2
Depreciation		11.9
Earnings before interest and taxes		29.9
Interest paid		6.1
Taxable income		23.8
Taxes (34%)		8.1
Net income		15.7%
Dividends	5.2%	
Addition to retained earnings	10.5	

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Ratio Analysis

- Allow for better **comparison** through time or between companies
- Used both internally and externally
- For each ratio, ask yourself:
  - What the ratio is trying to measure
  - Why that information is important
- Remember, ratios reflect book values

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Categories of Financial Ratios

- Liquidity ratios or Short-term solvency
- Financial leverage ratios or Long-term solvency ratios
- Asset management or Turnover ratios
- Profitability ratios
- Market value ratios

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All the Major Ratios

I. Short-term solvency, or liquidity, ratios

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

$$\text{Quick ratio} = \frac{\text{Current assets} - \text{Inventory}}{\text{Current liabilities}}$$

$$\text{Cash ratio} = \frac{\text{Cash}}{\text{Current liabilities}}$$

II. Long-term solvency, or financial leverage, ratios

$$\text{Total debt ratio} = \frac{\text{Total assets} - \text{Total equity}}{\text{Total assets}}$$

Debt-equity ratio = Total debt/Total equity

Equity multiplier = Total assets/Total equity

$$\text{Times interest earned ratio} = \frac{\text{EBIT}}{\text{Interest}}$$

$$\text{Cash coverage ratio} = \frac{\text{EBIT} + \text{Depreciation}}{\text{Interest}}$$

III. Asset utilization, or turnover, ratios

$$\text{Inventory turnover} = \frac{\text{Cost of goods sold}}{\text{Inventory}}$$

$$\text{Days' sales in inventory} = \frac{\text{365 days}}{\text{Inventory turnover}}$$

$$\text{Receivables turnover} = \frac{\text{Sales}}{\text{Accounts receivable}}$$

$$\text{Payables turnover} = \frac{\text{Cost of goods sold}}{\text{Accounts payable}}$$

$$\text{Days' sales in receivables} = \frac{\text{365 days}}{\text{Receivables turnover}}$$

$$\text{Days' costs in payables} = \frac{\text{365 days}}{\text{Payables turnover}}$$

$$\text{Total asset turnover} = \frac{\text{Sales}}{\text{Total assets}}$$

$$\text{Capital intensity} = \frac{\text{Total assets}}{\text{Sales}}$$

IV. Profitability ratios

$$\text{Profit margin} = \frac{\text{Net Income}}{\text{Sales}}$$

$$\text{Return on assets (ROA)} = \frac{\text{Net income}}{\text{Total assets}}$$

$$\text{Return on equity (ROE)} = \frac{\text{Net income}}{\text{Total equity}}$$

$$\text{ROE} = \frac{\text{Net income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Assets}} \times \frac{\text{Assets}}{\text{Equity}}$$

V. Market value ratios

$$\text{Price-earnings ratio} = \frac{\text{Price per share}}{\text{Earnings per share}}$$

$$\text{Price-sales ratio} = \frac{\text{Price per share}}{\text{Sales per share}}$$

$$\text{Market-to-book ratio} = \frac{\text{Market value per share}}{\text{Book value per share}}$$

$$\text{EBITDA ratio} = \frac{\text{Enterprise value}}{\text{EBITDA}}$$

Financial Ratio Calculator

- SCORE Financial Ratios

Liquidity Ratios

- **Current Ratio** = Current Assets / Current Liabilities
  - Current accounts converted to cash within a year
  - Measures short-term liquidity
  - Want to be able to pay off debts
- **Quick Ratio** = (CA – Inventory) / CL
  - "Acid Test"
  - Inventory often the least liquid current asset
  - Inventory book values often inaccurate
  - Large inventories potentially a sign of trouble
- **Cash Ratio** = Cash / CL
  - Immediate cash available to pay off short-term debt

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Liquidity Ratios

PRUFROCK Balance Sheet - 2014				
ASSETS			**Liabilities & Owners Equity**	
Current Assets			**Current Liabilities**	
Cash	$	98	Accounts Payable	$ 344
Accounts Receivable	$	188	Notes Payable	$ 196
Inventory	$	422	Total	$ 540
Total	$	708	Long term debt	$ 457
			Owners' Equity	
			Common Stock and paid in surplus	$ 550
Fixed Assets			Retained Earnings	$ 2,041
Net Plant & Equipment	$	2,880	Total	$ 2,591
Total Asets	$	3,588	Total Liabilties & Owners' Equity	$ 3,588

- **Current Ratio** = Current Assets / Current Liabilities
  - 708 / 540 = 1.31 times
- **Quick Ratio** = (CA – Inventory) / CL
  - "Acid Test"
  - (708 - 422) / 540 = 0.53 times
- **Cash Ratio** = Cash / CL
  - 98 / 540 = .18 times

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Financial Leverage Ratios

- **Total Debt Ratio** = (Total Assets – Total Equity) / TA
  - Multiple ways to calculate
  - All debts of all maturities vs. assets
  - Importance depends on capital structure (future topic)
- **Debt/Equity** = Total Debt / TE
  - Variation on total debt ratio
  - Is the business more reliant on debt or equity for financing?
- **Equity Multiplier** = TA / TE = 1 + D / E
  - All of these ratios represent long-term solvency
  - Can you derive this relationship (remember ALOE)?

Financial Leverage Ratios

PRUFROCK Balance Sheet - 2014			
ASSETS		**Liabilities & Owners Equity**	
Current Assets		**Current Liabilities**	
Cash	$ 98	Accounts Payable	$ 344
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Fixed Assets		Retained Earnings	$ 2,041
Net Plant & Equipment	$ 2,880	Total	$ 2,591
Total Asets	$ 3,588	Total Liabilties & Owners' Equity	$ 3,588

- **Total Debt Ratio** = (Total Assets – Total Equity) / TA
  - (3,588 – 2,591) / 3,588 = 0.28 times
- **Debt/Equity** = Total Debt / TE
  - (0.28 / 0.72) = 0.38 times
- **Equity Multiplier** = TA / TE = 1 + D / E
  - ($1 / 0.72) = (1 + 0.38) = 1.38

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Financial Leverage Ratios

- **Times Interest Earned** = EBIT / Interest
  - *Can a company pay off its interest expenses?*
  - If you can't cover the interest you probably can't pay off the loan
  - Higher generally better
- **Cash Coverage** = (EBIT + Depreciation) / Interest
  - Depreciation not actually a cash outflow, but interest is paid in cash
  - Ratio sometimes includes amortization (like depreciation but with intangible assets)
    - Amortization can also refer to paying off debt with a fixed repayment schedule (future topic)

Financial Leverage Ratios

PRUFROCK Income Statement - 2014		
Sales	$	2,311
COGS	$	1,344
Depreciation	$	276
EBIT	$	691
Interest	$	141
Taxable Income	$	550
Taxes	$	187
Net Income	$	363
Dividends	$	121
Addition to RE	$	242

COGS: Cost of Goods Sold

EBIT: Earnings Before Interest and Taxes

- **Times Interest Earned** = EBIT / Interest
  - 691 / 141 = 4.9 times
- **Cash Coverage** = (EBIT + Depreciation) / Interest
  - (691 + 276) / 141 = 6.9 times

Current Events: Caesars

- Caesars Entertainment Operating Unit Plans Chapter 11 Bankruptcy
- https://www.youtube.com/watch?v=BT44zAs_GHA

Asset Management:
Inventory Ratios

- **Inventory Turnover** = COGS / Inventory
  - *How efficiently is inventory used?*
  - <u>Storage costs</u>
  - Higher generally better

- **Days' Sales in Inventory** = 365 / Inventory Turnover
  - *How long does it take for inventory to be sold?*
  - Indicates the <u>liquidity</u> of current inventory
  - The same information in both ratios

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Asset Management: Inventory Ratios

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- **Inventory Turnover** = COGS / Inventory
  - 1,344 / 422 = 3.2 times
- **Days' Sales in Inventory** = 365 / Inventory Turnover
  - 365 / 3.2 = 114 days

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Asset Management:
Receivables Ratios

- **Receivables Turnover** = Sales / Accounts Receivable
  - *How quickly can the business collect on sales?*
  - Higher generally better

- **Days' Sales in Receivables** = 365 / Receivables Turnover
  - Indicates the liquidity of accounts receivable
  - The same information in both ratios

Asset Management:
Receivables Ratios

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- **Receivables Turnover** = Sales / Accounts Receivable
  - 2,311 / 188 = 12.3 times
- **Days' Sales in Receivables** = 365 / Receivables Turnover
  - 365 / 12.3 = 30 days

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Asset Management: Payables Ratios

- **Payables Turnover** = COGS / <u>A</u>ccounts <u>P</u>ayable
  - *How long does it take the company to pay its bills?*
  - Lower generally better
- **Days' Costs in Payables** = 365 / Payables Turnover
  - Represents the <u>liquidity</u> of accounts payable
  - The same information in both ratios

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Asset Management: Payables Ratios

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Addition to RE	$ 242

- **Payables Turnover** = COGS / Accounts Payable
  - 1,344 / 344 = 3.9 times
- **Days' Costs in Payables** = 365 / Payables Turnover
  - 365 / 3.9 = 94 days

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Asset Management:
Asset Turnover Ratios

- **Total Asset Turnover** = Sales / Total Assets
  - *How much does a business generate in sales compared to its assets?*
  - Higher generally better
- **Capital Intensity Ratio** = 1 / TAT
  - Same information as TAT

Asset Management:
Asset Turnover Ratios

PRUFROCK Balance Sheet - 2014			
ASSETS		Liabilities & Owners Equity	
Current Assets		Current Liabilities	
Cash	$ 98	Accounts Payable	$ 344
Accounts Receivable	$ 188	Notes Payable	$ 196
Inventory	$ 422	Total	$ 540
Total	$ 708	Long term debt	$ 457
		Owners' Equity	
		Common Stock and paid in surplus	$ 550
Fixed Assets		Retained Earnings	$ 2,041
Net Plant & Equipment	$ 2,880	Total	$ 2,591
Total Asets	$ 3,588	Total Liabilties & Owners' Equity	$ 3,588

PRUFROCK Income Statement - 2014	
Sales	$ 2,311
COGS	$ 1,344
Depreciation	$ 276
EBIT	$ 691
Interest	$ 141
Taxable Income	$ 550
Taxes	$ 187
Net Income	$ 363
Dividends	$ 121
Addition to RE	$ 242

- **Total Asset Turnover** = Sales / Total Assets
  - 2,311 / 3,588 = 0.64 times
- **Capital Intensity Ratio** = 1 / TAT
  - 1 / 0.64 = 1.56

Profitability Measures

- **Profit Margin** = Net Income / Sales
  - *How much money does a business actually make on a sale?*
  - Concept review: demand elasticity
  - Very important
- **Return on Assets (ROA)** = NI / TA
  - Profit per dollar on assets
- **Return on Equity (ROE)** = NI / TE
  - Purpose of the business is to benefit shareholders (you)
  - Bottom-line measure of performance

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Profitability Measures

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- **Profit Margin** = Net Income / Sales
  - 363 / 2,311 = 15.70%
- **Return on Assets (ROA)** = NI / TA
  - 363 / 3,588 = 10.12%
- **Return on Equity (ROE)** = NI / TE
  - 363 / 2,591 = 14.01%

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Market Value Measures

- These only apply if you issue stock…

Market Value Measures

- **Price-Earnings (PE) ratio** = Price per share / Earnings per share
  - *How much are investors willing to pay per dollar of current earnings?*
  - Higher may indicate potential for future growth
- **Price/Sales ratio** = PPS / Sales per share
  - Similar to PE ratio
  - Useful when companies have negative earnings
- **Market-to-book ratio** = PPS / Book value per share
  - *How much has the business grown?*
  - Higher generally better

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Market Value Measures

- Market Price = $88 per share = Price per share (PPS)
- Shares outstanding = 33 million
- **Earnings per Share (EPS)** = NI / shares outstanding
  - $363 / 33 = $11
- **Price-Earnings (PE) ratio** = PPS / EPS
  - $88 / $11 = 8 times
- **Price/Sales ratio** = PPS / Sales per share
  - $88 / ($2,311 / 33) = 1.26 times
- **Market-to-book ratio** = PPS / Book value per share
  - Book value per share = Total Equity / shares outstanding
    = $2,591 / 33 = $78.52
  - Market-to-book = $88 / 78.52 = 1.12 times

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Market Value Measures

- **Enterprise value** = Total market value of the stock
  + Book value of all liabilities – Cash
  - Estimates the market value of the company's <u>operating</u> assets
  - Used because it is often difficult to calculate the market value of each asset and liability on the balance sheet
  - Represents a theoretical <u>takeover price</u>

- **EBITDA ratio** = Enterprise value / EBITDA
  - Relates the market value of operating assets to cash flow
  - Similar to the PE ratio

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Market Value Measures

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- **Enterprise value** = Total market value of the stock + Book value of all liabilities – Cash
  - Enterprise value = ($88 x 33) + (3,588 – 2,591) – (98) = 3,803
- **EBITDA ratio** = Enterprise value / EBITDA
  - EBITDA = EBIT + Depreciation & Amortization
    = (691 + 276) = 967
  - EBITDA ratio = (3,803 / 967) = 3.93 times

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Table 3.6

	Lowe's	Home Depot
Sales	$50,208	$70,395
Net income	1,839	3,883
Current assets	10,072	14,520
Current liabilities	7,891	9,376
Total assets	33,559	40,518
Total debt	17,026	22,620
Total equity	16,533	17,898
Price per share	27.20	44.50
Book value per share	13.78	11.78
Earnings per share	1.53	2.55
Current ratio	1.28	1.55
Debt-equity ratio	1.03	1.26
Total asset turnover	1.50	1.74
Profit margin	3.66%	5.52%
ROE	11.12%	21.70%
ROA	5.48%	9.58%
Market-to-book ratio	1.97	3.78
Price-earnings ratio	17.75	17.42

Ratio Analysis

- https://www.youtube.com/watch?v=TZZFBkbC2lA

Discussion

- *So <u>why</u> do we analyze financial statements?*
- *Why do creditors care?*

Why Evaluate Financial Statements?

- Internal uses
  - Performance evaluation – compensation and comparison between divisions
  - Planning for the future – guide in estimating future cash flows
- External uses
  - Creditors
  - Suppliers
  - Customers
  - Stockholders

Benchmarking

- Ratios need to be compared to something
- **Time-Trend Analysis**
  - How the firm's performance is changing through time
  - Internal and external uses
- **Peer Group Analysis**
  - Compare to similar companies or within industries
  - Standard Industrial Classification (SIC) and North American Industry Classification System (NAICS)

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Problems with Financial Analysis

- Conglomerates / diversified operations
  - *No readily available comparable*
- Global competitors
- Different accounting procedures
- Book vs. market value
- Different fiscal year ends
- Differences in capital structure
- Seasonal variations and one-time events

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Activity

Financial Statement Analysis!

Connect. Explore. Engage.

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