

Introduction to Financial Analysis

Introduction to Financial Analysis – Structured Study Notes

1. What Is Financial Analysis?

- **Definition** – The systematic evaluation of a company's financial statements and related data to assess its performance, stability, and future prospects.
 - **Goal** – Turn raw numbers into actionable insights for decision makers (investors, managers, creditors, regulators).
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2. Primary Users & Objectives

User	Typical Objective
Investors / Shareholders	Determine intrinsic value, estimate returns, assess risk.
Creditors / Lenders	Evaluate repayment capacity, set loan terms, monitor covenant compliance.
Management	Benchmark performance, allocate resources, plan strategic initiatives.
Regulators & Analysts	Ensure compliance, compare industry peers, issue ratings.

3. Core Financial Statements (the “three statement” foundation)

Statement	Main Purpose	Key Components
Income Statement	Shows profitability over a period.	Revenue, Cost of Goods Sold (COGS), Gross Profit, Operating Expenses, Net Income.
Balance Sheet	Provides a snapshot of financial position at a point in time.	Assets (Current & Non-Current), Liabilities (Current & Long-Term), Shareholders' Equity.
Cash Flow Statement	Tracks cash generation & usage.	Operating Activities, Investing Activities, Financing Activities, Net Change in Cash.

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Tip: All three statements are inter-linked; e.g., Net Income (Income Statement) → Retained Earnings (Balance Sheet) → Operating Cash Flow (Cash Flow Statement).

4. Fundamental Analytical Techniques

4.1 Horizontal (Trend) Analysis

- Compare line-item amounts **period-over-period** (e.g., YoY growth).
- Formula: $[(\text{Current Period} - \text{Prior Period}) \div \text{Prior Period}] \times 100\%$.

4.2 Vertical (Common-Size) Analysis

- Express each line item as a **percentage of a base figure** within the same statement.
 - Income Statement: % of Revenue.
 - Balance Sheet: % of Total Assets or Total Equity.

4.3 Ratio Analysis (the backbone of financial analysis)

Category	Typical Ratios	Interpretation
Liquidity	Current Ratio, Quick Ratio, Cash Ratio	Ability to meet short