CH10 - Financial Anaylsis

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🐋 Info — Horizontal Analysis

- Study of percentage changes from year-to-year
- $\frac{\text{New Dollar - Older Dollar}}{\text{Old Dollar}}$
- Trend % $= \frac{\text{Any Year}}{\text{Base Year}}$

🐋 Info — Vertical Analysis

- Shows relationship between financial statement to its base
- Vertical Analysis Income Statement % $= \frac{\text{Each income statement item}}{\text{revenue}}$
- Vertical Analysis Balance Sheet % $= \frac{\text{Each Asset Item}}{\text{Total Assets}}$ or $= \frac{\text{Each L + SE Item}}{\text{Total L + SE}}$

🐋 Info — Common Size Statement

- Report only vertical analysis percents, in % of revenue
  - Not dollar amount

-Help in the comparison of different companies

- Financial result in terms of a common denominator

Ratio

🐋 Info — Abilitiy to Pay Current Liability

- Working capital ($ amount) = Current Asset − Current Liability
- Current Ratio (not $ amount)= $\frac{\text{Current Asset}}{\text{Current Liability}}$ (preferrably 1.5)
- Quick Ratio (Acid Test) = $\frac{\text{Cash+Short-term investment + Net current receivables}}{\text{Current liability}}$ (stricter version of liquidity)

Turnover plus Cash Conversions

🐋 Info — Inv Turnover and Days Inventory Outstanding

- Inventory Turnover = $\frac{\text{COG}}{\text{Average Inventory}}$ or $\frac{2 \cdot \text{COG}}{\text{Beg. Inv. + End Inv.}}$
- Days Inventory Outstanding (DIO) = $\frac{365}{\text{Inventory Turnover}}$

(DIO is inversely proportional to Inventory Turnover)

Info — A/R Turnover and Days of Sales Outstanding

- A/R Turnover $= \frac{\text{Net Sales}}{\text{Average Net A/R}} = 2 \cdot \frac{\text{Net Sales}}{\text{Beg. A/R} + \text{End A/R}}$
- Days Sales Outstanding(DSO) $= \frac{365}{\text{A/R Turnover}}$

The higher the turnover the better

Info — A/P Turonver and Days Payables Outstanding

- A/P Turnover $= \frac{\text{COG}}{\text{Average A/P}}$
- Days Payables Outstanding (DPO) $= \frac{365}{\text{A/P Turnover}}$

Info — Cash Conversion Cycle

$$\text{Cash Conversion Cycle} = \text{DIO} + \text{DSO} - \text{DPO}$$

Cash Conversion Cycle can be negative number, (i.e DPO is very high, meaning not paying payables)

The lower the Cash Conversion Cycle the better. But it is the reason that DIO and DSO are lower but not DPO is higher.