Financial Analysis- Notes Organizer

\\/hat	ic Ei	nancial Analysis?								
vviiat		ng financial tools:								
	03.	Enterprise budgets								
	0	iterprise buugets								
	0	Income statements								
•	То	identify a business' strengths and weaknesses								
	0	Helps the manager improve the business								
Why i	is it I	Necessary?								
•	Fin	ancial Analysis:								
	0	Helps a manager take actions to improve the business								
	0	Identifies potential problems before they occur								
	0	Helps lenders analyze loan applications for								
	0	Helps the manager understand the business more fully								
Types	of F	Financial Analysis								
	0	Use ratios and figures (net income, RAVC, etc.)								
	0	Compare those ratios and figures to "benchmarks"								
		Benchmarks are "goals" or "standards"								
•	Tre	nd Analysis								
	0	Look at changes in ratios and figures over time •								
Main	Area	as of Analysis								
•		, uidity								
_	0	Having enough current assets to cover your current liabilities								
J	0	Having enough total assets to cover your total liabilities								
•	Profitability									
_	0	"Are we making money above our expenses?"								
J	0	How well are we controlling our costs?								

Liquidity Analysis

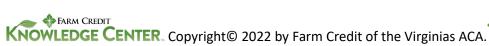
- Use the Balance Sheet
- Current Ratio is the main measure
 - Current Ratio = Current Assets / Current Liabilities
- Like to see:
 - o _____
 - Greater than 2.0 is strong
- Interpretation:
 - A Current Ratio of 2 means that you have \$2 of current assets for every \$1 of liabilities that are due within the next year (current liabilities)

Solvency Analysis

- Use the Balance Sheet
- Debt/Asset Ratio is the main measure
 - Debt/Asset Ratio = Total Liabilities / Total Assets
- Like to see:
 - Less than 40% for an existing business
 - Less than 70% for a new or start-up business
 - 0
 - The lower it is, the less risk you face
- Interpretation:
 - A Debt/Asset Ratio of 40% shows that you owe your lenders 40% of the value of your assets
 - Or –
 - Another way to look at it:
 - Your lenders "own" 40% of your assets
 - You own 60% of your assets

Profitability Analysis

- Use the Income Statement or Enterprise Budget
 - or Return Above Variable Costs
 - Net income or Return Above Total Costs
- _____
- Main ratio is Rate of Return on Assets (ROA)
- Like to see:
 - ROA > 0% at a minimum
 - ROA > interest rate (APR) on your loans
 - ROA > 8% is strong





- Growing over time
 - The higher, the more profitable your business
- Interpretation:
 - An ROA of 10% means that you earned \$0.10 of profit for every \$1 of asset used in your business.

Financial Efficiency Analysis

- We're just focusing on cost control here
- Operating Expense/Receipt Ratio
 - ∘ Op. Exp/Rec = (Total Exp. Int. Dep.) / Total Revenue
- Like to see:
- Interpretation:
 - A ratio of 75% means that the business spends \$0.75 in expenses to generate \$1 of revenue

Summary

- Look at your ratings for each area
- For the Floral Shop example:

Area	Rating	Strength or Weakness?
Liquidity	Strong/Okay	~ Strength
Solvency	Poor/Okay	~ Weakness
Profitability	Poor/Okay	~ Weakness
Financial Efficiency	Poor/Okay	~ Weakness

- Now the manager can see what areas need to be improved!
- Main ways to improve a business:

 - Without hurting production
 - Increase revenues
 - More units produced & sold
 - Get rid of unneeded or un-used assets

•	A manager must look at the financial and the production aspects of the business											ess	
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- Too often the financial aspects are ignored
- Lenders use this same analysis to review loan applications
 - Managers should know their own strengths and weaknesses _____ meeting with the lender!