Financial Analysis- Notes Organizer

What is Financial Analysis?

- Using financial tools:
  - Enterprise budgets
  - ________________________________
  - Income statements
- To identify a business' strengths and weaknesses
  - Helps the manager improve the business

Why is it Necessary?

- Financial Analysis:
  - Helps a manager take actions to improve the business
  - Identifies potential problems before they occur
  - Helps lenders analyze loan applications for ____
  - Helps the manager understand the business more fully

Types of Financial Analysis

- _________________________
  - Use ratios and figures (net income, RAVC, etc.)
  - Compare those ratios and figures to "benchmarks"
    - Benchmarks are "goals" or "standards"
- Trend Analysis
  - Look at changes in ratios and figures over time
    - ____

Main Areas of Analysis

- Liquidity
  - Having enough current assets to cover your current liabilities
- _________________________
  - Having enough total assets to cover your total liabilities
- Profitability
  - "Are we making money above our expenses?"
- ____
  - 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:
  - ____
  - 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
  - ____
    - 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)
  - ROA = (Net Income + Interest) / ____________________________
- 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
    - ____
    - 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!