

Preface

Firms that manage their resources wisely prosper, while those that don't languish and ultimately fail. Individuals face the challenge of sorting the winners from the losers. Financial statements provide much of the raw data necessary to make such calls. The analysis of those financial statements helps people determine which firms will succeed and which will fail.

Financial statement analysis is a complex and challenging discipline, one that is both art and science. As such, *Financial Statement Analysis: Content and Context* teaches you how to interpret financial disclosures and place them in their appropriate context. Because people analyze financial statements to determine how to allocate their economic resources, this textbook is decision oriented. Moreover, *Financial Statement Analysis: Content and Context* takes a very broad view of financial statement analysis. A careful reading of this text improves investing, lending, and performance assessment decisions. This orientation differs from many traditional textbooks in this area that focus on only stock investment decisions.

Textbook Objective

The essence of financial statement analysis is to draw logical inferences about *future* cash flows from *current* data. Financial statement analysts continually estimate the amount of net cash that will flow into the business and when those cash flows will occur. Knowledge about the amount, timing, and riskiness of future cash flows enables the financial analyst to forecast future earnings, value the firm (or determine the intrinsic worth of a share of stock), determine the likelihood of prompt debt service by a debtor, and evaluate management's ability to create wealth for the firm's shareholders. *Financial Statement Analysis: Content and Context* is a book that helps you accomplish these goals.

We have written this text for the beginning financial statement analyst. You only need to understand basic business principles and the workings of a personal computer to master its contents. It builds on those two knowledge bases in a structured manner, teaching you how to analyze financial statements thoroughly. Moreover, this text instructs you about how to supplement financial statements with other information sources, thereby providing the framework necessary to produce valid analyses. This book's integrated nature, vivid examples, participatory format, and strong visual orientation actively engage you in financial

analysis. Consequently, you will find financial statement analysis a dynamic and exciting field of inquiry.

Themes

Financial Statement Analysis: Content and Context addresses important factors throughout the text.

- *Robust Financial Statement Analysis.* Financial statements provide useful information for making economic decisions. However, they do not contain all of the information necessary for making sound economic choices. This text supplements the financial statements with other information sources, both quantitative and qualitative in nature. These complementary information sets help people allocate their scarce economic resources rationally.
- *Wealth creation.* Shareowners risk their capital by investing in corporations; consequently, they expect firms to create value for them. This text helps you determine whether a reporting entity adds economic value to its stock of capital or diminishes it through its efforts. It guides its readers toward making logical inferences about wealth changes from the publicly disclosed data.
- *Earnings Quality.* Income is the financial reporting system's measure of the wealth created (or diminished) over a specific interval of time. Unfortunately, reported income occurs at many different levels, such as gross income, operating income, net income, and comprehensive income. In addition, not all of the events that compose a specific income level contain equivalent information about the amount, timing, and certainty of future cash flows. Financial analysts sometimes need to modify income disclosures to compensate for this deficiency. *Financial Statement Analysis: Content and Context* focuses reader attention to the issue of earnings quality. It instructs you how to extract the economic essence of wealth changes from reported income disclosures.

Learning Features

Financial Statement Analysis: Content and Context contains numerous learning features that enable you to master the important discipline of analyzing financial statements. You will learn the art, as well as the science, of financial statement analysis by

studying its material. This book systematizes facts, principles and methods, but it also develops your analytical perception, creativity, and resourcefulness. This text's unique approach to financial statement analysis strengthens comprehension of the subject matter, enlivens the material, and separates it from the competition. The following points list some of the innovative learning methods of this text:

- *Graduated Learning.* All financial statement analysts must competently apply specific techniques to data to develop information. Not all of these procedures are intuitive. Therefore, this text demonstrates the necessary analytical skills with a simplistic, fictional set of financial disclosures. Once you understand those techniques, this text leverages that knowledge to a variety of existing industries and companies.
- *Continual Learning.* You will learn to interpret actual corporate financial statements by studying companies in the airline, discount retail, computer hardware, fast-food restaurant, and soft drink industries. Examples from such iconic entities as American Airlines, Wal-Mart, Dell, McDonald's, and Coca-Cola illustrate key aspects of analysis. End-of-chapter assignments pack a practical punch! You use existing industry and corporate data to analyze financial performance and wealth creation. In addition, the book guides you in updating your analysis via Internet disclosures, so that your analyses never become outdated.
- *Practical Learning.* This book focuses on the "how to do it" and "what does it mean" aspects of analysis. As an important part of this philosophy, you become an active participant in the learning process. You investigate important issues, source data online, and draw conclusions about existing companies and industries.
- *Structured Learning.* Learning to analyze financial statements thoroughly is a progressive task. We have composed *Financial Statement Analysis: Content and Context* into four parts encompassing fifteen chapters. An overview of financial statements, financial reporting complexities, historical financial statement analyses, and prospective financial analysis are the four main sections of the text. Readers can cover the entire text, or only portions of it, depending on their learning objectives.
- *Supplemental Learning.* Sidebar features presented in every chapter, entitled *My Analysis*, require you to think about topical issues and answer stimulating questions about

financial statement analysis. Another in-chapter feature, called *Industry Insights*, applies the theoretical chapter constructs to five industries featured throughout the text.

- *Tabular Learning.* Sound financial statement analysis requires a logical structure for compiling and interpreting numerical information. To this end, this text presents numerous and easily understood numerical tables for tracking data, measuring their impact on financial statements, and analyzing their meaning.
- *Pictorial Learning.* A picture is worth a thousand words, according to the old adage. It may be worth even more than a thousand numbers. To this end, *Financial Statement Analysis: Content and Context* supplements narrative and financial data with pictorial exhibits. These visual presentations summarize complex financial concepts and disclosures; thereby increasing your understanding of the important analytical points contained in the data.

The best financial statement analysts possess financial reporting knowledge, common sense, an inquisitive nature, an understanding of the world, broad business knowledge, and outstanding research abilities. These skills lend context to the content contained in a company's financial statements. This textbook stresses a holistic approach to financial statement analysis. *Financial Statement Analysis: Content and Context* will help you to master the challenging and exciting discipline of financial statement analysis.