FINANCIAL ACCOUNTING AND FINANCIAL STATEMENT ANALYSIS

INTRODUCTION TO FINANCIAL ANALYSIS AND THE RELATED CHAPTERS ON CORPORATE FINANCE AND EQUITY ANALYSIS

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Table of contents

1. Introduction to Financial Analysis and the related chapters on Corporate Finance and Equity Analysis

The first section of this course deals with company financial analysis. It shows the major accounting flows and the adjustments necessary to fully appreciate the real state of the enterprise. It reviews the principal ratios used to gauge the quality of the management, the financial solidity of the balance sheet and to prepare forecasts. It concentrates on the present and future profitability of the capital invested and on the financial resources available to the management. A company that can mobilise little capital to generate its cash flows will have a serious competitive advantage over its rivals.

The second section (corporate finance), looks at the company's strategy. A strategy implies financial objectives given to the general management by the board of directors. It sometimes leads to painful choices: a division whose profitability is too uncertain will need to be restructured or transferred in order to achieve a sustained improvement in the group's cash flow. In the wider sense, a company's strategy is analysed by examining its governance, in other words the structure of power within the company between management, the board of directors and the shareholders.

The third section, analysis of equities on the financial markets, will provide an understanding of the judgment the markets make on listed companies and the value they assign to them. It should also be noted that a listing on the stock exchange imposes very considerable constraints on the company over transparency and the amount of information that must be provided.

In these three sections we will use shareholder value creation analysis, popularised in the 1950s by the work of Alfred Rappaport and used extensively by companies since the 1990s. Using this approach, a company creates value if it makes investments with a rate of return that is higher than the cost of the capital.

We will take the Swiss pharmaceutical company, Novartis, as example with reference to the 2013 consolidated accounts. Analysts and the companies themselves sometimes use other figures that have been recalculated from the annual report. We will provide the necessary references for calculating both approaches.

The financial markets are intermediaries between the company that creates value and the shareholders who seek to optimise their cash position. In the short term, the stock market price does not always track the company's results. The macroeconomic situation may be poor, or the market may favour other sectors as the economic cycle accelerates or slows down. However, in the long term, there is a strong link between the process of creating shareholder value within the company and the rise in the stock market price. This is what we set out to demonstrate in these three sections.