FUNDAMENTALS OF FINANCE

Fundamental Analysis

by
Norazidah Shamsudin
Faculty of Industrial Management
norazidah@ump.edu.my

Chapter Description

- Synopsis

  This chapter is an introductory chapter to fundamental analysis. It focus on ratio analysis tools to access the financial performance of a firm.

- Expected Outcomes

  Students should be able to:

  1. Understand fundamental analysis and it’s importance.
  2. Explain the basic four (4) categories of ratio.
  3. Calculate financial performance using ratios formula.

Content Outline

- Definition of Fundamental Analysis
- Source of Data
  - Balance Sheet
  - Income Statement
- Ratio Comparison
  - Comparative Analysis
  - Trend Analysis
- Ratio Categories
  - Liquidity
  - Efficiency
  - Profitability
  - Leverage

Definition

- **Fundamental Analysis in finance is analyzing a firm's financial statement with the main tools of ratio analysis.**

- **The purpose is to evaluate a firm's financial performance.**

Source of Data

- **The source of data for the analysis:**

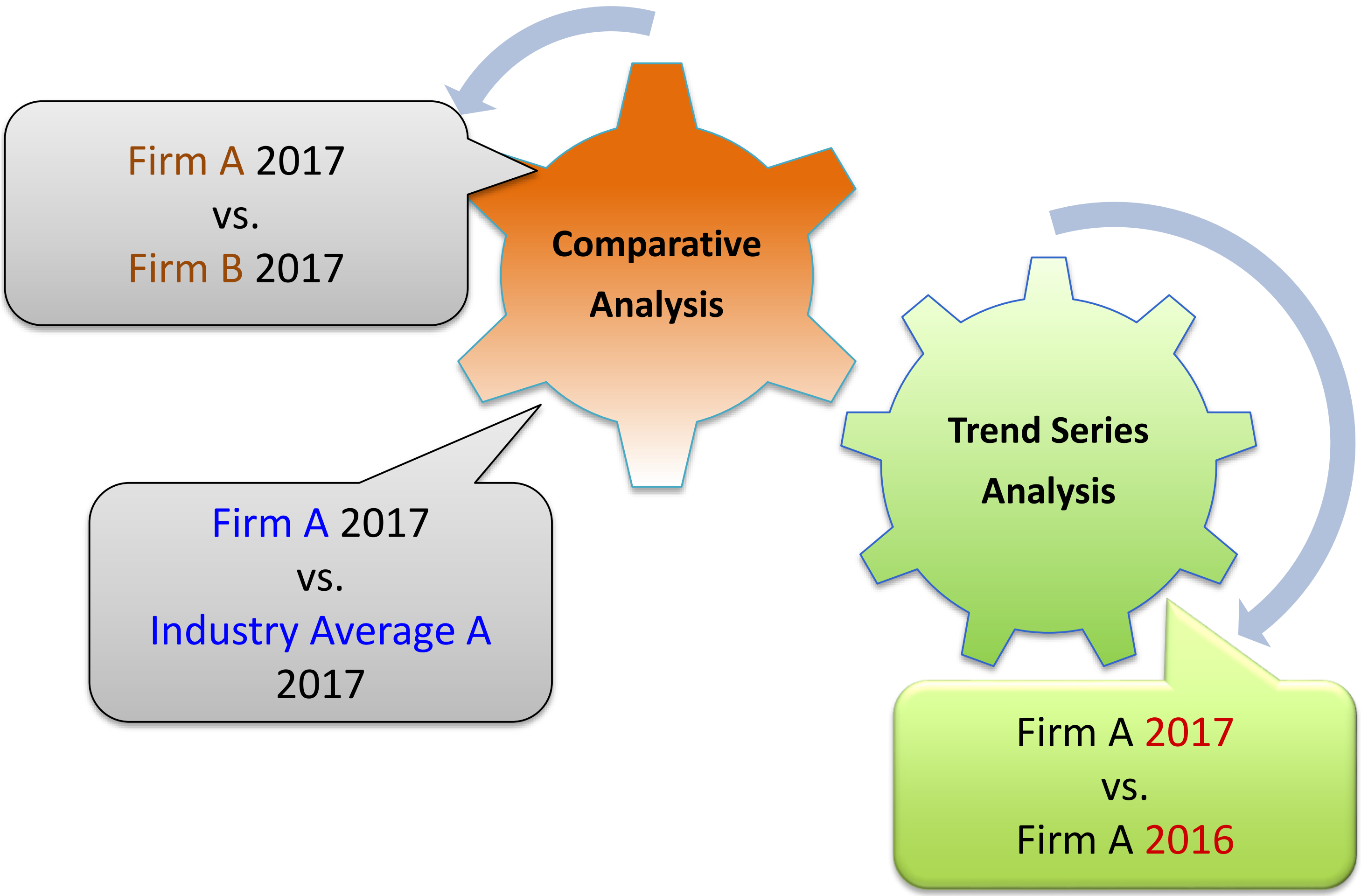
Balance Sheet

A financial statement published by a firm to represent its financial standing on asset, liability and equity since its establishment (accumulated basis).

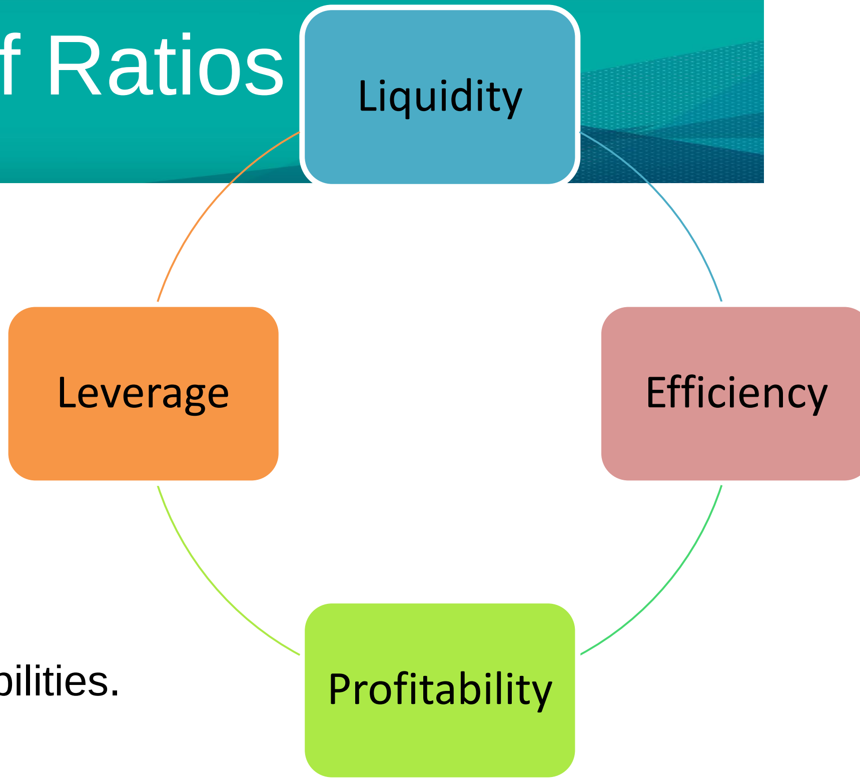
Income Statement

A financial statement published by a firm to represent its earnings and expenses for a financial year including income tax (yearly basis).

Two types of Ratio Comparison



Categories of Ratios



Financial Ratios

- *Liquidity Ratios* – the ability of a firm to payback liabilities.
- *Efficiency/ Activity Ratios* – how effective a firm is using its resources or assets.
- *Leverage / Debt Ratio* – measure the extent to which the firm had been financed by debt.
- *Profitability Ratios* – measure the profitability of the firm.
- *Market Ratios* – reflected by the firm's operation with consideration of marke

LIQUIDITY RATIOS

the ability of a firm to payback liabilities

CR	• Current Assets / Current Liabilities
QR	• (C.Asset–Inventory–Prepaid) / C.Liabilities
NWC	• Current Assets - Current Liabilities

EFFICIENCY RATIOS

how effective a firm is using its resources or assets

Inv. t/over	• Cost of Goods Sold / Inventory; @ • Net Sales / Average Inv.
ACP @ DSO	• (A/C Rcvble x 360) / Annual Credit Sales
ARTO	• 360 / Average Collection Period; @ • Net Sales / Acc Receivable

cont…how effective a firm is using its resources or assets

FATO
- Net Sales / Net fixed assets

TATO
- Net Sales / Total Assets

APP
- (A/C Payable x 360) / Annual Cr Purchases

LEVERAGE RATIOS

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measure the extent to which the firm had been financed by debt

DR
- Total Debt / Total Assets

DER
- LTD / Tangible Net Worth

TIE
- EBIT / Interest charges

PROFITABILITY RATIOS

measure the profitability of the firm

GPM	• (Net sales – COGS) / Net sales
OPM	• EBIT / Sales
NPM	• EAT / Net Sales

PROFITABILITY RATIOS

measure the profitability of the firm

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ROI @ ROA	• EAT / Total assets
ROE	• EAT / Equity

Conclusion of The Chapter

- Conclusion
  – Financial performance of a firm can be evaluate using ratios formula.
  – Ratios Analysis allows a firm to compare its performance with competitors, industry average and its own performance previously.

Disclaimer: The material prepared is for learning purpose only.