Financial analysis for company valuation

Corporate Finance

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Abstract

Objectives

- Evaluate the financial health of the company to know its current status.
- Determine the causes that have led to the current situation.
- Make investment, financing and operating decisions.

Methodology: This project was carried out using a constructive methodology where the techniques of vertical analysis, horizontal analysis and financial ratios were used to value companies. In the vertical analysis, the integral percentage method was used to observe the main affected accounts of the statement of financial position and the income statement. The horizontal analysis compares two periods to determine the percentage variation from one period to another, in order to observe whether there is an increase or decrease in the accounts of the statement of financial position and income statement. Finally, the financial ratio method is useful to measure the company's level of liquidity, indebtedness and profitability.

Contribution: The contribution of this project is to provide the necessary tools for the valuation of a company in order to make decisions that are beneficial to the entity, such as investment, financing and operating decisions.

Introduction

Financial analysis is important within a company to evaluate its financial and economic performance in order to detect financial problems in a timely manner and provide solutions to them. According to Gitman (2003), financial statement analysis usually refers to the calculation of ratios to evaluate the past, present and projected performance of the company. Nowadays, companies constantly require a financial diagnosis, regardless of their size or business line, since the constant creation of new companies increases their competition, making it more difficult to remain in the market without good management of the resources available.

Figure 1

The company must manage its financial resources optimally, detecting conflicts or vulnerabilities that it may present either by lack of liquidity, insolvency and profitability, so it is important to know the financial situation through the main financial statements such as the statement of financial position and the income statement, observing in them the relevant variations of a period and the internal and external factors that are causing it. Financial analysis is important for a company because it helps to observe the level of liquidity, solvency, indebtedness and profitability, so that based on the results obtained through the financial ratios method, financing, investment and operating decisions can be made.

This information is important not only for the owners or partners of the company, but also for investors, creditors, to know the current status of the company and make decisions based on it.

Materials and methods

The different methods used for the present work are the vertical analysis of the statement of financial position and the income statement, which evaluates only one period, normally one year, although a quarterly evaluation of the company can also be made with this method, where the main affected accounts are observed and the values are exploited in percentages.
The horizontal analysis is performed with the financial statements for at least two periods, where its main function is to observe the increase or decrease from one period to another of the different accounts, where absolute values or percentages are obtained, with this method the different trends are observed in order to make decisions based on these data.
The financial ratios serve as parameters for decision making in order to plan and improve the financial health of the company, where the main financial ratios are liquidity, debt and profitability.

Vertical analysis
Vertical analysis relates a given total to the accounts of a financial statement. For the statement of financial position, an asset account is taken and divided by the total assets and finally multiplied by 100, this is done successively with all the asset accounts.

Figure 2

Horizontal analysis
The horizontal analysis takes into account two or more periods in order to see the percentage variation that has occurred from one period to another. Both the statement of financial position and the income statement take the same accounts.

Figure 3

Debt ratio
The debt ratio shows the company's financial risk due to its level of indebtedness.

Figure 4

Financial ratios
The financial ratios for the valuation of companies are: Liquidity ratio
Current ratio shows information to observe whether the company is able to meet its short-term debts.

Figure 5

Results

The results obtained by the vertical analysis method show a great relevance for the valuation of a company since it was possible to detect the main accounts affected during a period, with this we can have a better view of how they are being affected both assets, liabilities and capital in a given period. The horizontal analysis was useful to observe the variations from one period to another in the net sales obtained as well as in the profit with this information it will be possible to make decisions about the immediate future of the company. This method was important to see the trends that show the results of two periods by observing their absolute numerical data as a percentage in order to make financial decisions based on the increase or decrease of the accounts of two given periods. Finally, the financial ratios provided sufficient information to be able to give a financial diagnosis regarding the liquidity, indebtedness and profitability of the company in order to improve the vulnerable areas of the company. The financial ratios helped to understand more accurately the financial situation of the company, giving us an idea of its level of liquidity to see if the company was able to cover its short-term debts. Also its level of indebtedness to know how much outside capital the company is using to carry out its operations and to see if the company is at risk due to its level of indebtedness. Finally, the profitability of the company is another key factor to determine if the company is still a business that gives a good profit with the capital it has. All these methods together were useful for the valuation of companies as they help to have different financial points of view of the company for a better diagnosis in order to make better financial decisions for the entity.

Figure 6

Conclusions

A financial analysis is a great tool for observation and evaluation in which we have to carry out an investment that enhances in a certain way our decisions depending on the estimated term, an analysis is like knowing the company internally and externally, identifying the most relevant part of the financial information and determine based on indicators and models as this company can maintain a long-term financial health, a strategic planning must be maintained giving a projection of a future to the company that is being valued, it is necessary to be critical in a certain way about the information obtained and to have the best determination of the risks on the solvency and profitability of the company, it is always necessary to observe the companies that have a promising future based on the service offered to the society. A good diagnosis in time will always be advisable for a company since it will help to prevent future financial conflicts, besides helping to see the areas of opportunity that the company may have, in order to make better decisions for the good of the entity, make it more profitable, prevent the lack of liquidity, reduce the level of indebtedness and make better management decisions.

Figure 7

Future of research

The valuation of companies will be a fundamental part for any company no matter what line of business it is engaged in, this research will continue to be useful to improve future decision making for the company both direct and indirect investment, financing. Since it is intended to help not only large companies but also small and medium-sized companies, since statistical data have shown that most small companies go bankrupt in just over a year and manage to survive more than a year, they go bankrupt after 10 years of its constitution, so it is important to help with this research to these companies in order to improve the economic situation of the country.

Figure 8

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