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BASIC TOOLS OF FINANCIAL ANALYSIS IN UKRAINE

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Summary. Financial analysis is the examination offinancial information to reach business decisions. This analysis typically results in the reallocation of resources to or from a business or a specific internal operation.The key source of information for financial analysis is the financial statements of a business. The financial analyst uses these documents to derive ratios, create trend lines, and conduct comparisons against similar information for comparable firms.

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Financial analysis is an aspect of the overall business finance function that involves examining historical data to gain information about the current and future financial health of a company. Financial analysis can be applied in a wide variety of situations to give business managers the information they need to make critical decisions. The ability to understand financial data is essential for any business manager. Finance is the language of business. Business goals and objectives are set in financial terms and their outcomes are measured in financial terms. Among the skills required to understand and manage a business is fluency in the language of finance—the ability to read and understand financial data as well as present information in the form of financial reports.

The finance function in business involves evaluating economic trends, setting financial policy, and creating long–range plans for business activities. It also involves applying a system of internal controls for the handling of cash, the recognition of sales, the disbursement of expenses, the valuation of inventory, and the approval of capital expenditures. In addition, the finance function reports on these internal control systems through the preparation of financial statements, such as income statements, balance sheets, and cash flow statements.

Finally, finance involves analyzing the data contained in financial statements in order to provide valuable information for management decisions. In this way, financial analysis is only one part of the overall function of finance, but it is a very important one. A company's accounts and statements contain a great deal of information. Discovering the full meaning contained in the statements is at the heart of financial analysis. Understanding how accounts relate to one another is part of financial analysis. Another part of financial analysis involves using the numerical data contained in company statements to uncover patterns of activity that may not be apparent on the surface.

Although many investors are eager for financial analysis to advance to the point that projections of success and future earnings can be accurately provided, that is impossible to achieve. In the real world there will always be unpredictable events that limit the accuracy of analyses and projections. The financial

community’s desire for perfect evaluation may be out of reach, nevertheless the goal for financial analysts should be to attain perfection.

Financial analysts are rarely expected to predict the performance of organizations beyond a few years into the future. By extrapolating from present circumstances, the reports provided by financial analysts give investors and company managers enough information to prepare for the short window ahead in time. Though these projections are subject to external or unforeseen events, in most cases this is enough information to produce a business strategy that optimizes impending opportunities and limits risks.

Financial analysis in Ukraine– is the process of evaluating businesses, projects,budgetsand other finance–related entities to determine their performance and suitability. Typically, financial analysis is used to analyze whether an entity is stable, solvent, liquid or profitable enough to warrant a monetary investment. When looking at a specific company, a financialanalystconducts analysis by focusing on the income statement,balance sheetandcash flow statement.

The role of the financial analyst in Ukraine – is to provide reliable information that managers can utilize to anticipate impending events. In larger companies, analysts may evaluate only a portion of the organization’s performance, and then relay this information to the appropriate managers. They must be able communicators who have the ear of influential managers. If their analyses predict drastic perturbations in the immediate future, they must convince management to take precautionary measures. On the other hand, if the company is expected to perform extremely well, then the window of expectations may be elongated in order to emphasize that performance in the long term may require careful re–investment of profits.

Financial analysis is used to evaluate economic trends, set financial policy, build long–term plans for business activity, and identify projects or companies for investment. This is done through the synthesis of financial numbers and data.

Financial analysis can be conducted in both corporate finance and investment finance settings. In corporate finance, the analysis is conducted internally, using such ratios as net present value (NPV) and internal rate of return (IRR) to find projects worth executing. A key area of corporate financial analysis involves extrapolating a company's past performance, such as gross revenue or profit margin, into an estimate of the company's future performance. This allows the business to forecast budgets and make decisions based on past trends, such as inventory levels [1].

In investment finance, an outside financial analyst conducts financial analysis for investment purposes. Analysts can either conduct a top–down or bottom–up investment approach. A top–down approach first looks for macroeconomic opportunities, such as high–performing sectors, and then drills down to find the best companies within that sector. A bottom–up approach, on the other hand, looks at a specific company and conducts similar ratio analysis to corporate financial analysis, looking at past performance and expected future performance as investment indicators.

Financial analysis is the process of selection, relation and evaluation and interpretation.Steps in financial analysis are:

1. Selecting the information relevant to the decision under consideration from the total information contained in the financial statements.
2. Arranging the information in a way to highlight significant relationships.
3. Interpretation and drawing of inferences and conclusions.

There are two types of financial analysis: technical analysis and fundamental analysis. Technical analysis looks at quantitative charts, such as moving averages, while fundamental analysis uses ratios, such as a company's earnings per share (EPS).

There are 5 key elements of a financial analysis (table 1).

Table 1 – Five key elements of a financial analysis

Elements of a financial analysis	**Characteristics of the elements**
1. Revenues	Revenues are probablyyour business'smain source of cash. The quantity, quality and timing of revenues can determine long–term success(**revenue growth, revenue concentration, revenue per employee)**
2. Profits	If you can'tproduce quality profits consistently, your business may not survive in the long run (**gross profit margin, operating profit margin, net profit margin)**
3. Operational Efficiency	Operational efficiency measures how well you're using the company's resources. A lack of operational efficiency leads to smaller profits and weaker growth (**accounts receivables turnover, inventory turnover)**
4. Capital Efficiency and Solvency	Capital efficiency and solvency are of interest to lenders and investors (**return onequity, debt to equity**)
5. Liquidity	Liquidity analysis addresses yourability to generate sufficient cash to cover cash expenses. No amount of revenue growth or profits can compensate for poor liquidity (**current ratio, interest coverage).**

The three main sources of data for financial analysis are a company's balance sheet, income statement, and cash flow statement (table 2).

Table 2 – Main sources of data for financial analysis

Documents used in financial analysis	**Characteristics of thedocuments**
Balance Sheet	The balance sheet outlines the financial and physical resources that a company has available for business activities in the future. It is important to note, however, that the balance sheet only lists these resources, and makes no judgment about how well they will be used by management. For this reason, the balance sheet is more useful in analyzing a company's current financial position than its expected performance.
Income Statement	The income statement provides information about a company's performance over a certain period of time. Although it does not reveal much about the company's current financial condition, it does provide indications of its future viability. The main elements of the income statement are revenues earned, expenses incurred, and net profit or loss. Revenues consist mainly of sales, though financial analysts may also note the inclusion of royalties, interest, and extraordinary items. Likewise, operating expenses usually consists primarily of the cost of goods sold, but can also include some unusual items. Net income is the «bottom line» of the income statement. This figure is the main indicator of a company's accomplishments over the statement period.
Cash Flow Statement	The cash flow statement is similar to the income statement in that it records a company's performance over a specified period of time. The difference between the two is that the income statement also takes into account some non–cash accounting items such as depreciation. The cash flow statement strips away all of this and shows exactly how much actual money the company has generated. Cash flow statements show how companies have performed in managing inflows and outflows of cash. It provides a sharper picture of a company's ability to pay bills, creditors, and finance growth better than any other one financial statement.

The final part of the financial analysis is to establish a proper basis for comparison, so you can determine if performance is alignedwith appropriate benchmarks. This works for each data point individually as well as for your overall financial condition.

The first basis is yourcompany’s past, to determine if your financial condition is improving or worsening. Typically, the past three years of performance is sufficient, but if access to older data is available, you should use that as well.

Looking at your past and present financial condition also helps you spot trends. If, for example, liquidity has decreased consistently, you can make changes [2].

The second basis is your direct competitors. This can provide an important reality check. Having revenue growth of 10 percent annually may sound good, but if competitors are growing at 25 percent, it highlights underperformance.

The final basis consists of contractual covenants. Lenders, investors and key customers usually require certain financial performance benchmarks. Maintaining key financial ratios and data points within predetermined limits can help these third parties protect their interests.

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