

Chapter 3

Analysis of Financial Statements

LEARNING OBJECTIVES

After reading this chapter, students should be able to:

- Explain why ratio analysis is usually the first step in the analysis of a company's financial statements.
- List the five groups of ratios, specify which ratios belong in each group, and explain what information each group gives us about the firm's financial position.
- State what trend analysis is, and why it is important.
- Describe how the Du Pont chart is used, and how it may be modified to include the effect of financial leverage.
- Explain "benchmarking" and its purpose.
- List several limitations of ratio analysis.
- Identify some of the problems with ROE that can arise when firms use it as a sole measure of performance.
- Identify some of the qualitative factors that must be considered when evaluating a company's financial performance.