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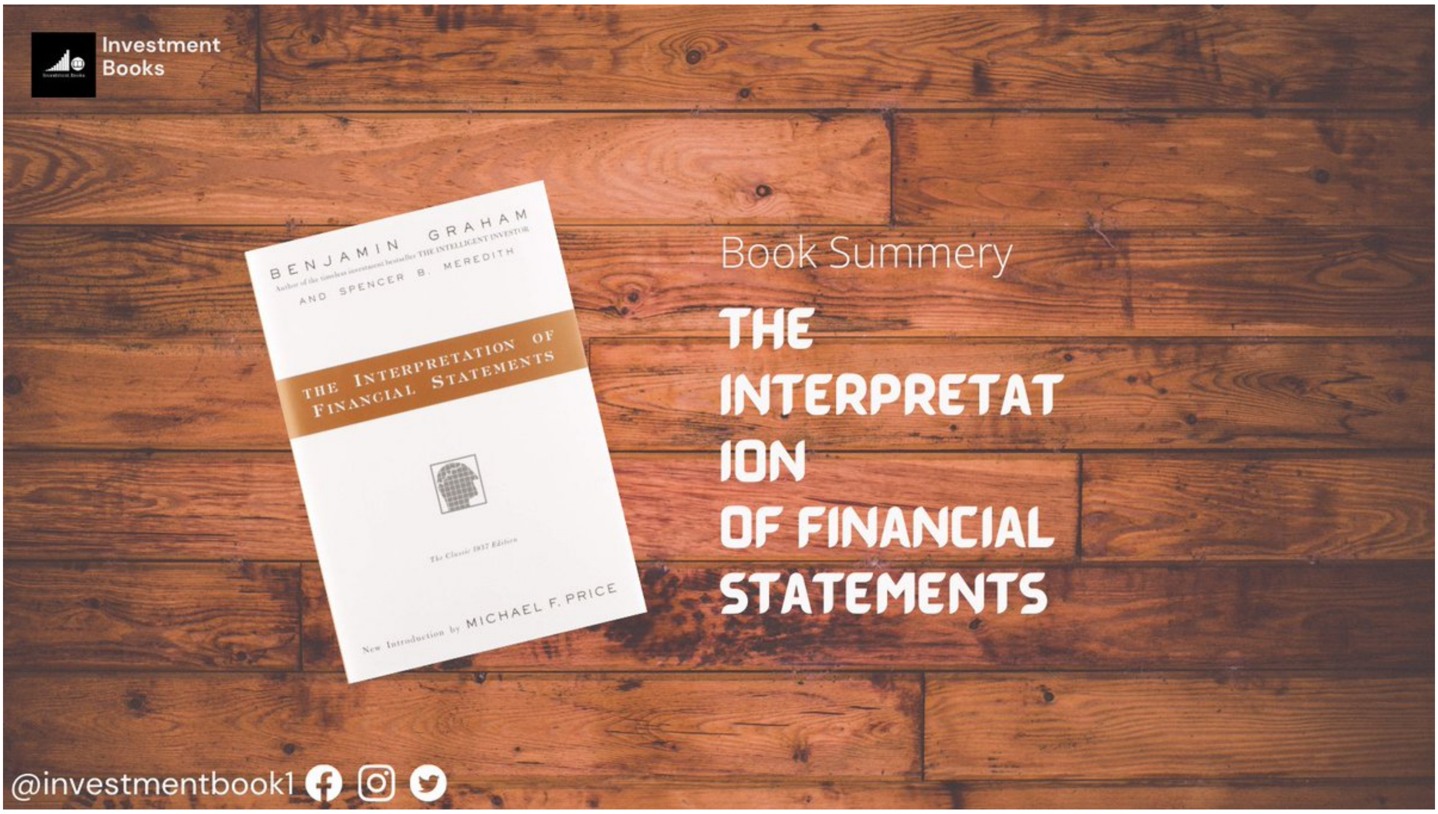
Knowledge sharing initiative Book 4: "The interpretation of financial statements" by Benjamin Graham.

This book was published around 1937 by investing legend Ben Graham. Ben is also regarded as the guy under whom the great Warren Buffett started his investing journey.



This book teaches financial statement analysis in a very simple manner. It also focuses on the key relationship between P&L, B/s & Cash flow statements of a company.

Here are key takeaways from the book ■■

1.B/s shows how much a company owns (assets) & owes (liabilities) at a particular point in time mostly prepared on a semi-annual & annual basis.

2.Assets=Tangible (PP&E, inventories, accounts receivable, cash)+intangible Assets (trademark, lease rights, goodwill)

3.Liabilities=Short term debt (accounts payable,current portion of long term debt,advances from customers) + Long term Debt (bank loans,bonds,lease liability)
4.Tangible assets are written down through depreciation & intangibles are written down through amortization or impairment

5. Depreciation & amortization means normal wearing out assets over its typical lifespan. It allows the cost of the asset to be charged off (in the income statement) over a number of years.

6. Depletion gets applied in commodity businesses like cement, mining, and crude oil.

7.Special term for companies doing big write-offs: “watered stock”

As they inflated their asset value leading to inflated book value, which was later written off as one-time charges against earnings/profit
8.True value of a company’s assets may be different from the B/s total

9. Company’s size/scale is measured by its assets size or revenues by comparing to the other companies(peer group)

10. It is not so essential to invest only in cos. with dominant size, as countless e.g of smaller cos. prospering more than larger ones can be seen in the mkts

11. The real value of intangible assets is more likely found in the income statement than on the B/s. “It is the earning power of these intangibles rather than their balance sheet valuation, that really counts."

12. Current assets are cash or assets that are easily converted into cash like receivables/inventory and Current liabilities are debts incurred during normal business operations/current portion of long-term debts to be paid or maturing within one year.

13.Current Ratio=current assets/current liabilities.
High ratio indicates-co. will easily meet short-term obligations
14.Working capital(WC)=current assets–current liabilities
WC makes it easier for a co. to run daily operations & meet emergency needs without taking new financing

A lack of working capital means it's harder to cover current liabilities and likely means forgoing business growth, with a worst-case scenario of bankruptcy.

15. Quick Ratio = (Current Assets – Inventory)/Current Liabilities

16.Inventory Turnover=Revenues/avg inventory
Inventory turnover can be compared on a year-to-year basis. Measures how efficiently the company turns inventories into profits.

17.Stocks selling below their cash value pershare may be worth more than their value by the mkt. Shareholders may benefit from an appreciation in price or distribution of cash

18.Valuing companies on book value is majorly applied in banks, insurance cos, & holding companies

19. If accounts payable is larger than cash & receivables the company may be too reliant on credit. When looked at over several years, if accounts payable grow faster than sales and profits (payable/Revenue ratio & payable/profit ratio) , then its a sign of weakness.

20. Direct Losses reported in equity: Investor must examine both the income & the surplus account over several yrs, & make due allowance for any amounts changed to surplus or reserves which really represent business losses during the period.

21. Book value attempts to show the liquidation value of all the tangible assets, but in reality, the true liquidation value can be less than book value. As sometimes inventory and fixed assets are likely to be sold at a significant loss due to urgency.

22. Book value actually measures not what the shareholder will get out of the business if liquidated but rather what they have invested into the business (including retained earnings)

23. Net Current Asset Value (NCAV)=Current assets–liabilities & preferred stock.

NCAV might be a good representation of liquidation value if current assets are a large portion of total assets. Stocks selling below NCAV may be extremely undervalued.

24. Depreciation can be manipulated to overstate or understate earnings. Check Volatility in year-on-year depreciation rates of a company.

25. Earning Power of a company = Expected earnings in the future
26. We take current & past earnings as a guide to predict future earnings.

Note:If there have been reasonably normal business conditions for a period of yrs in the past, the avg of the earnings over the period may afford a better index of earning power than the current figure alone

27.Buying & selling securities due to over-valuation or undervaluation based on reported financials ONLY will not allow you to make spectacular returns but also will save you from big losses
28.Investing requires a balance between facts of the past and possibilities of the future

29. Future Trends Vs Past Trends: Before purchasing a stock bcoz of its favorable trend it is well to ask two questions:

a) How certain am I that this favorable trend will continue,&

b) How large a price am I paying in advance for the expected continuance of the trend?”

30. Future earnings estimates explain why two stocks with similar earnings per share can trade at vastly different P/E ratios. A low P/E stock has a low expected earnings growth priced in while a high P/E stock reflects a high expected earnings

growth

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Here is the book link: https://t.co/fjfj11MKLf