Reformatting, Ratio Analysis and Reforecasting

Reformatting financial statements: separate operating activities from financing activities. This is done in order to better value operating performance independently from financing performance, which does not create value. By reformatting financial statements investors can value just operating activities obtaining a more accurate valuation of the company. Because of all the items in the reserves, CSP is always different from profit in P&L.

A firm creates value when it earns a return greater than the cost of capital. Business strategies are put in place to achieve this goal. Business strategies are implemented through business activities. A firm's value is determined by its profitability and growth. ROE=Net income/Shareholders' equity, a firm's value is determined by the relation between ROE and its cost of equity capital. ROE > cost of capital = firm is creating value and firm's market value > book value. ROE is affected by how a firm employs its assets and by the leverage → Net Income/Assets * Assets/Shareholders' equity = ROA * Leverage. Need to identify what creates value in a firm: