

when valuing the (soon to be) reorganized company at a contested plan confirmation hearing.

Financial Statement Analysis

As previously discussed, thorough financial statement analysis is a fundamental and critical component of the valuation process. Historical financial statements provide insight into what has occurred in the past and what may be expected in the future.

However, when dealing with companies coming out of a bankruptcy, or that have been restructured, an examination of company projections in light of new business plans or operating models is critical. For example, the expected future financial performance of a company that closed or sold unprofitable plants in a bankruptcy is, by definition, going to be different from the company's historical performance. Notwithstanding this, valuable information such as relationships between financial metrics can be gleaned from a thorough analysis of historical financial information.

The best indicator of the future is not always the past, particularly when dealing with companies that have been restructured in or out of bankruptcy. In situations in which a company has gone through significant operational or financial change, the historical financial analysis that is so important in a typical valuation assignment may play a less important role. Regardless, strong financial analysis provides insight to the valuation process.

The basic elements of financial statement analysis include:

1. Understanding the source of financial data and underlying accounting policies
2. Trend analysis and common-sized analysis
3. Ratio analysis
4. Comparison of financial statements to industry norms and peers

Understanding the Source of Financial Data and Underlying Accounting Policies Financial data used in a valuation may come from a variety of sources: data extractions from accounting systems, internal financial statements, audited financial statements, or tax returns. Each of these data sources provides the valuation practitioner with a different comfort level based on the reliability of the data. Audited financial statements and financial data that are tied to tax returns typically provide the greatest level of reliability.

In addition to the source of the data, the valuation analyst should understand the accounting policies used by the company and how these