When analyzing companies, we use three main financial statements: the **income statement, the balance sheet, and the statement of cash flows.** 

The income and cash flow statements show how much the company earned and spent over a period, while the balance sheet captures the values of assets and liabilities at a specific point in time.

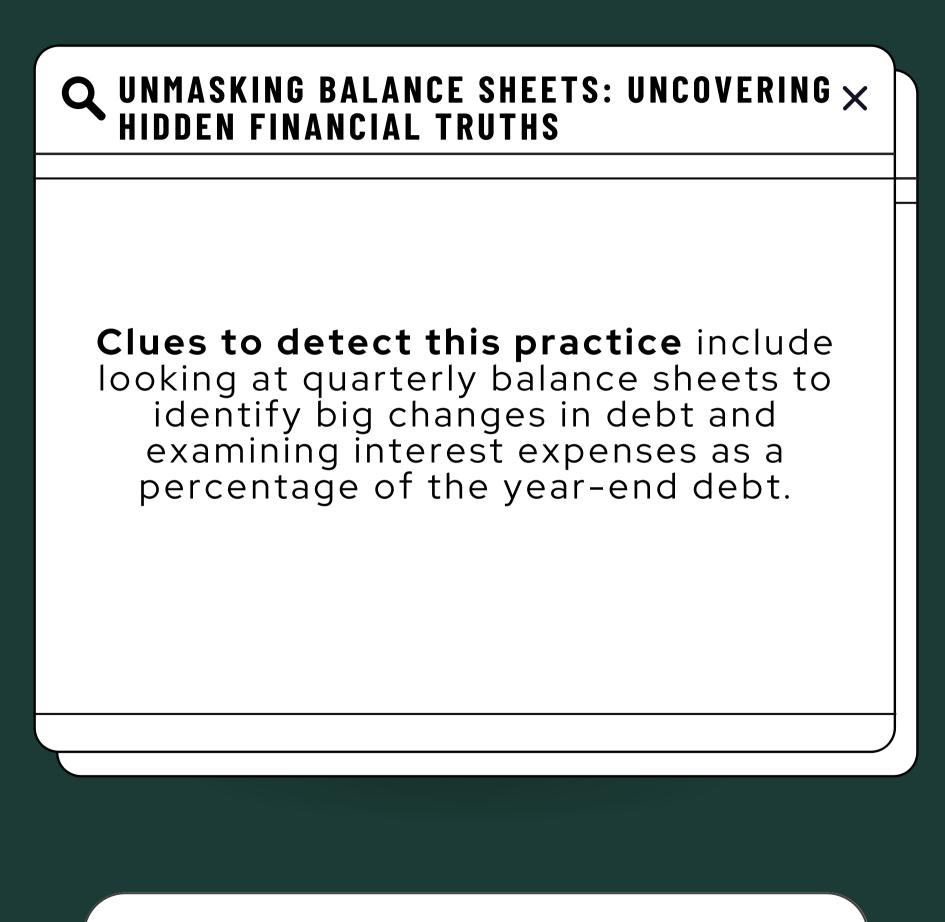
## $\mathbf{Q}$ unmasking balance sheets: uncovering $\mathbf{X}$ hidden financial truths

Income and cash flow statements represent **flow statements**, measuring how much the company earned and spent over the period.

Balance sheets capture the values of assets and liabilities at a point in time and thus represent "**stock" statements**.

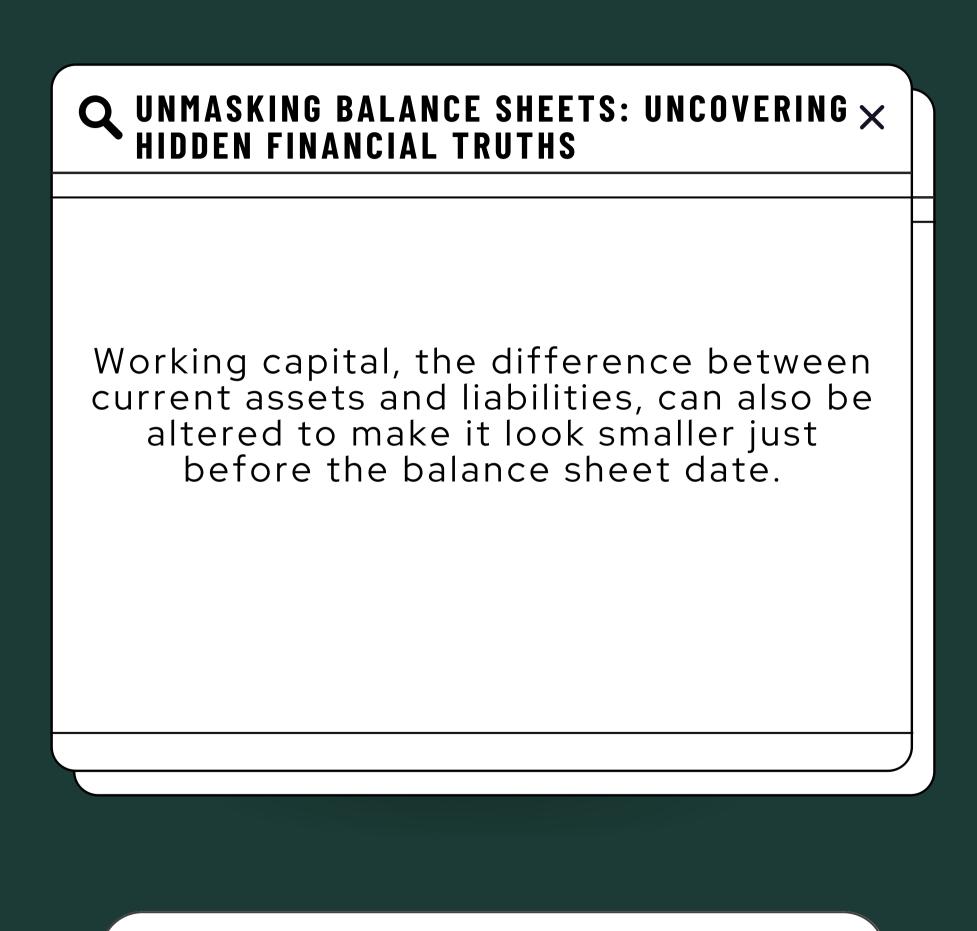
Stock statements (balance sheets) are **less reliable** than flow statements (income statement and cash flow statement) because they may not accurately represent what the company did throughout the year.

Debt on the balance sheet can be manipulated by paying it off just before the end of the year and borrowing again early the next year. Companies can also use lines of credit or seasonal financing to keep debt off the books.

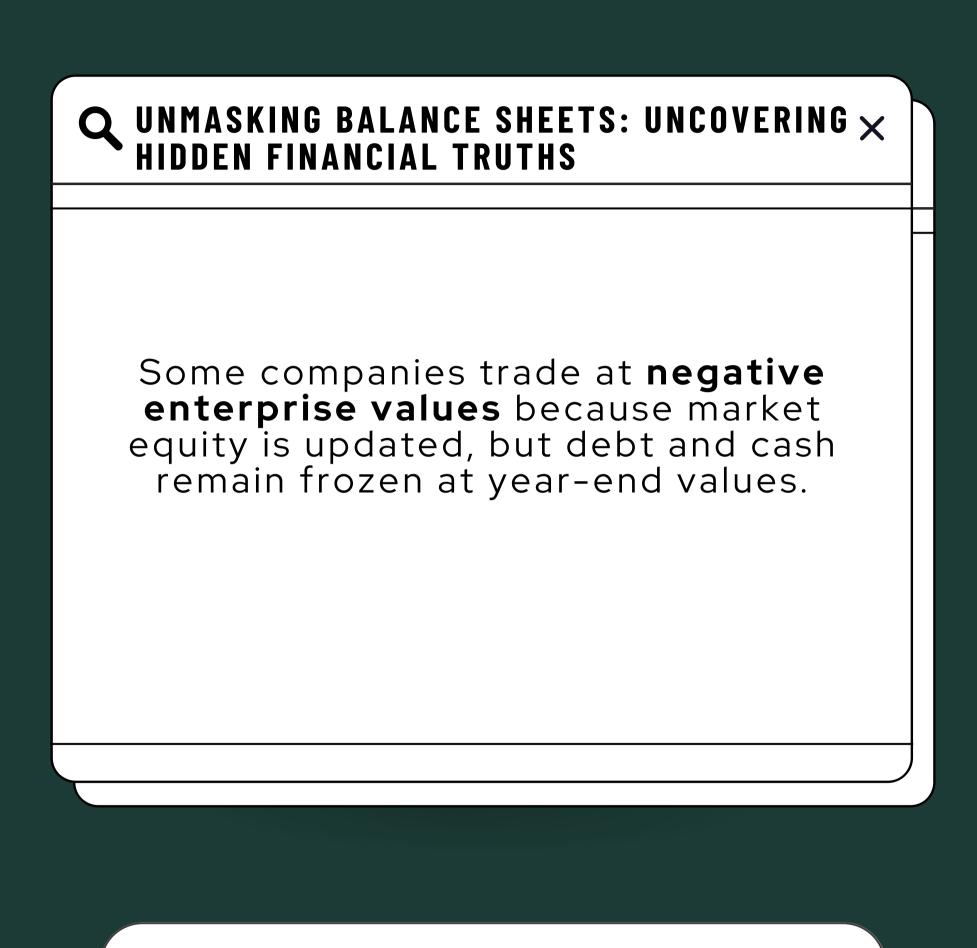


# $\mathbf{Q}$ unmasking balance sheets: uncovering $\mathbf{X}$ hidden financial truths

The cash balance on the balance sheet may not reflect the actual cash the company has today, which is important for accurate valuation.

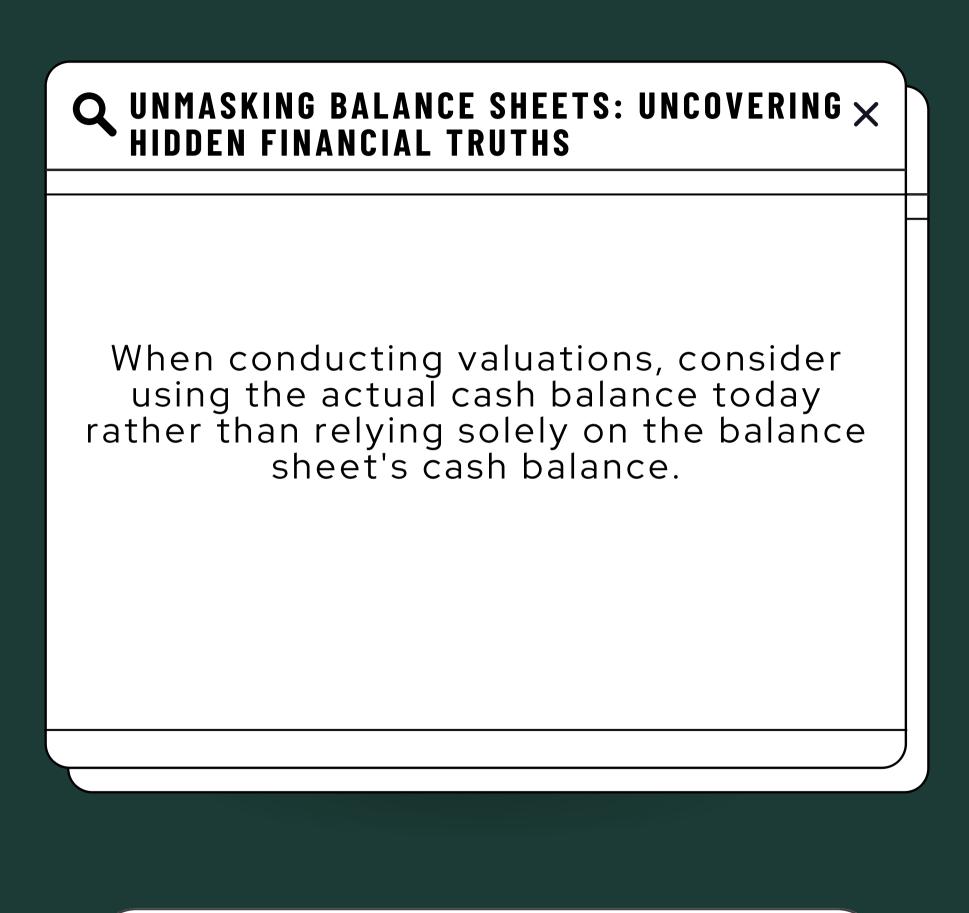


Be cautious about relying solely on balance sheet analysis. Instead, consider using other financial statements, such as the income and cash flow statements, to understand earnings and cash flow over time.



You can access quarterly balance sheets and the year-end balance sheet if possible. Analyzing quarterly changes in debt and other financial indicators can help identify potential manipulations.

Pay attention to interest expenses as a percentage of year-end debt. Disproportionately high-interest rates relative to expected payments could indicate potential manipulation.



Recognize that working capital numbers can be altered over short periods. Look for consistency and consider the timing of certain transactions, such as receivable collections and inventory clearance.

If you are involved in a friendly merger, demand and obtain current information on cash, debt, and working capital from the target company. This can provide a more accurate assessment of their financial situation.