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BENJAMIN GRAHAM
Author of the timeless investment bestseller THE INTELLIGENT INVESTOR
AND SPENCER B. MEREDITH

THE INTERPRETATION OF
FINANCIAL STATEMENTS



The Classic 1937 Edition

New Introduction by **MICHAEL F. PRICE**
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The Interpretation of Financial Statements: The Classic 1937 Edition

Benjamin Graham, Spencer Meredith, Spencer B. Meredith

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"All investors, from beginners to old hands, should gain from the use of this guide, as I have."

From the Introduction by Michael F. Price, president, Franklin Mutual Advisors, Inc.

Benjamin Graham has been called the most important investment thinker of the twentieth century. As a master investor, pioneering stock analyst, and mentor to investment superstars, he has no peer.

The volume you hold in your hands is Graham's timeless guide to interpreting and understanding financial statements. It has long been out of print, but now joins Graham's other masterpieces, *The Intelligent Investor* and *Security Analysis*, as the three priceless keys to understanding Graham and value investing.

The advice he offers in this book is as useful and prescient today as it was sixty years ago. As he writes in the preface, "if you have precise information as to a company's present financial position and its past earnings record, you are better equipped to gauge its future possibilities. And this is the essential function and value of security analysis."

Written just three years after his landmark *Security Analysis*, *The Interpretation of Financial Statements* gets to the heart of the master's ideas on value investing in astonishingly few pages. Readers will learn to analyze a company's balance sheets and income statements and arrive at a true understanding of its financial position and earnings record. Graham provides simple tests any reader can apply to determine the financial health and well-being of any company.

This volume is an exact text replica of the first edition of *The Interpretation of Financial Statements*, published by Harper & Brothers in 1937. Graham's original language has been restored, and readers can be assured that every idea and technique presented here appears exactly as Graham intended.

Highly practical and accessible, it is an essential guide for all business people--and makes the perfect companion volume to Graham's investment masterpiece *The Intelligent Investor*.

The Interpretation of Financial Statements: The Classic 1937 Edition Details

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Vilmantas says

It's an extra text to Security Analysis. It helps to understand and apply main concepts.

Ivan K. Wu says

A pretty basic, but nonetheless essential guide to understanding financial statements.

Vipin Pandey says

Good for someone who doesn't understand accounting. The book simplifies accounting principles. You can expect to understand I/S and B/S items.

Tirath says

A lot has changed since the 1930s. This book is an example of how financial analysis ought to be taught in a concise manner. It's a good book to have around especially for the beginner. A quick read with a fantastic introduction.

Mark Lawry says

It's a book by Graham so it is a must be read. Interesting to see the world from an accountant's perspective from 1937. Which is to say railroads and utilities. That's ok. Still a great little reference book to have on your shelf. Remember, Graham suggests in The Intelligent Investor to make regular investments to mutual funds and to stay away from individual stocks. He suggests if you do plan to not go with the smart money then you need to read books such as this. Then when you've learned your lesson go back to the smart money (mutual funds.)

Honestly probably worth more 3 stars, but it is just a few pages.

Saeed says

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Brentley Campbell says

Best book on accounting I could ever ask for. More information in this quick read than in my entire collegiate financial accounting course.

Anna S. says

At bottom the ability to buy securities-particularly common stocks-successfully is the ability to look ahead accurately. Looking backward, however carefully, will not suffice, and may do more harm than good." Ben Graham - The Interpretation of Financial Statements pg. 76

But it is all about looking past record in this book. Good in conjunction with other Graham's book - the intelligent investor.

Jack Parker says

basic top down dissection of standard financial statements. pretty high-level, not of use to anyone who has taken a financial accounting course. however, hearing this information from the father of value investing can't hurt at all.

Massgreen says

Some points worth noting:

1. A BALANCE sheet shows how a company stands at a given moment. There is no such thing as a balance sheet covering the year 1954;
2. In general, the more liquid the current assets, the less the margin needed above current liabilities. Railroads and public utilities have not generally been required to show a large current ratio, chiefly because they have small inventories and their receivables are promptly collectible.
3. If the inventory is of a readily salable kind, and particularly if the nature of the business makes it very large at one season and quite small at another, the failure of a company to meet this latter quick asset test" may not be of great importance.
In every such case, however, the situation must be looked into with some care to make sure that the company

is really in a comfortable current position.

4. Where the cash holdings are exceptionally large in relation to the market price of the securities, this factor usually deserves favorable investment attention. In such a case the stock may be worth more than the earning record indicates, because a good part of the value is represented by cash holdings which contribute little to the income account. Eventually the stockholders are likely to get the benefit of these cash assets, either through their distribution or their more productive use in the business.

5. As in the case of inventories, receivables should be studied in relation to the annual sales and in relation to changes shown over a period of years. Any sudden increase in receivables as a percentage of sales may indicate that an unduly liberal credit policy is being extended in an effort to sustain the volume.

6. The accounts receivable require the most careful scrutiny in the case of companies selling goods on a long-term payment basis. This group includes department stores, credit chains, and mail-order houses.

7. The comparison of inventory turnover among companies within an industry will in many cases reveal an important competitive advantage which marks the leading companies in the group. But this fact in itself is not conclusive unless all the companies being compared are using the same basis for valuing their inventory.

8. If the notes payable are substantially exceeded by the cash holdings, they can ordinarily be dismissed as relatively unimportant. But if the borrowings are larger than the cash and receivables combined, it is clear that the company is relying heavily on the banks. Unless the inventory is of unusually liquid character, such a situation may justify misgivings. In such a case the bank loans should be studied over a period of years to see whether they have been growing faster than sales and profits. If they have, it is a definite sign of weakness.

9. During the past forty years investors have come to pay less and less attention to the asset values shown by a company and to place increasing weight upon its earnings record and earnings prospects. This change in attitude was due in part to the frequent unreliability of the property-account figure, but it had separate justification in the fact that for the typical going business value does reside in earning power much more than in assets.

We think the pendulum has swung too far in the direction of ignoring balance sheet values. The property account should neither be accepted at face amount nor overlooked entirely. It deserves reasonable consideration in appraising the company's securities.

10. A consolidated balance sheet eliminates the securities held in wholly owned (and often in majority owned) subsidiary companies, including instead the actual assets and liabilities of the subsidiaries as if they were part of the parent company. But the interest in partly owned subsidiary and affiliated enterprises may appear even in consolidated balance sheets under the heading of "non-current investments and advances."

11. In general, it may be said that little if any weight should be given to the figures at which intangible assets appear on the balance sheet. Such intangibles may have a very large value indeed, but it is the income account and not the balance sheet that offers the clue to this value. In other words, it is the earning power of these intangibles, rather than their balance-sheet valuations, that really counts.

12. The book value really measures, therefore, not what the stockholders could get out of their business (its liquidating value), but rather what they have put into the business, including undistributed earnings.

13. It is true that in many individual cases we find companies with small asset values earning large profits, while others with large asset values earn little or nothing. Yet in these cases some attention must be given to the book-value situation. For there is always a possibility that large earnings on the invested capital may attract competition and thus prove temporary; also that large assets, not now earning profits, may later be made more productive, or they may be merged, sold as a whole, or liquidated piecemeal for well above the depressed market level of the stock.

14. BROADLY speaking, the price of common stocks is governed by the prospective earnings and dividends.

15. Thus two common stocks may show the same current earnings per share, may be paying the same dividend rate, and be in equally good financial condition. Yet stock A may be selling at twice the price of stock B, simply because security buyers believe that stock A is going to earn a good deal more than B next year and the years after.

16a. When neither boom nor deep depression is affecting the market, the judgment of the public on individual issues, as indicated by market prices, is usually fairly good. If the market price of some issue appears out of line with the facts and figures available, it will often be found later that the price is discounting future developments not then apparent on the surface. There is, however, a frequent tendency on the part of the stock market to exaggerate the significance of changes in earnings both in a favorable and unfavorable direction. This is manifest in the market as a whole in periods of both boom and depression, and it is also evidenced in the case of individual companies at other times.

16b. At bottom the ability to buy securities—particularly common stocks—successfully is the ability to look ahead accurately. Looking backward, however carefully, will not suffice, and may do more harm than good. Common stock selection is a difficult art, naturally, since it offers large rewards for success. It requires a skillful mental balance between the facts of the past and the possibilities of the future.

17. The investor who buys securities only when the market price looks cheap on the basis of the company's statements, and sells them when they look high on this same basis, probably will not make spectacular profits. But, on the other hand, he will probably avoid equally spectacular and more frequent losses. He should have a better than average chance of obtaining satisfactory results. And this is the chief objective of intelligent investing.

InvestingByTheBooks.com says

A typical way of valuing a business is with the discounted cash flow (DCF) method. Some value investors don't agree with the use of the method due to the need for forecasting uncertain future corporate prospects. Small changes in input values often result in huge swings in the estimated corporate value. Forecasting is deemed futile by investors such as Warren Buffett, Charlie Munger, Bruce Greenwald and James Montier among others. In today's world of competitive disruption there may be alternatives or complements to the DCF method with less dependency on the future that can be used. By studying the current state and the development of the balance sheet and income statement it's possible to understand the health of the business which, in turn, is essential for the firm's future prospects.

Benjamin Graham, the father of value investing, needs no further introduction. His co-author Spencer B. Meredith was an instructor in security analysis at the New York Stock Exchange Institute together with

Graham. In this book written before Graham's more influential books, *Security Analysis* and *The Intelligent Investor*, the authors describe how to understand a business and its health by studying the financial statements.

A quote from *The Interpretation of Financial Statements* concludes the authors' view on forecasting: "Of course, the success of an investment depends ultimately upon future developments, and the future may never be forecast with accuracy. But if you have precise information as to a company's present financial position and its past earnings record, you are better equipped to gauge its future possibilities. And this is the essential function and value of security analysis."

The Interpretation of Financial Statements is written for those who want to understand the language of business that consists of the financial statements. In the book, the authors describe the most important constituents of balance sheets and income statements one-by-one. The text is structured in three parts. The first part introduces the reader to balance sheets and income statements. Each chapter covers one piece of a financial statement. The authors explain the item and its significance which is essential to know for the security analyst. They also describe different key ratios that are of practical use in order to distinguish if the business is in a favorable condition or in bad shape. In the second part the authors present different financial ratios while the third part is a description of financial terms and phrases.

This is a book for those who would like to understand concepts such as earnings power and book value, which is of essence in the fundamental analysis of a company. By only considering the qualitative aspects of a business the investor is at risk of missing important details that are necessary in order to set a reasonable intrinsic value range. In order to get further guidance on how to use the knowledge in practice, Graham's *Security Analysis* is a great place for further study.

If I were to mention anything negative about the book it would be that the examples drawn are from a different time, meaning that they are typically limited to industrials, railroads and utilities. This is of course no criticism of the authors as the mix of listed companies was truly different in 1937. However, it's important to convert the reasoning and language to a broader set of modern businesses. Even more importantly, the financial statements were arguably more easily structured and read in the first half of the 20th century compared to today's often complex reports. This is also commented upon in the introduction.

I would like to conclude with a timeless statement from the book that summarizes the difficult challenge all investors face: "Common stock selection is a difficult art - naturally, since it offers large rewards for success. It requires a skillful mental balance between the facts of the past and the possibilities of the future."

Eric says

Take an accounting class then read this book or read it while taking the class or just read it. In any case it will give you an understanding of a company's financial strength if you ever want to know something like that.

Richard Muhumuza says

Good for beginners

Mohd Ashraf says

I like this book because of the clarity in the explanation of those financial terms. I guess, those terms are meant to be deceiving and confusing.

pavana Kumar Varanasi says

A very nice little book explaining what each term means in balance sheet and cash flow statement. Good for people who doesn't have accounting back ground
