Financial Analysis – Bonus Slides

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Analysis

Financial Analysis

Profit & Loss & Balance Sheet

Measures:

- Operational performance
  - ❑ Sales: Period on period %
  - ❑ Gross Margin %
  - ❑ Operating Profit %
  - ❑ Net Profit %
  - ❑ Return on Capital Employed %
  - ❑ Free Cash Flow
- Liquidity
  - ❑ Current Ratio
  - ❑ Acid Test Ratio
- Working Capital
  - ❑ Days Inventory Outstanding 'DIO
  - ❑ Days Sales Outstanding 'DSO'
  - ❑ Days Payables Outstanding 'DPO
  - ❑ Cash Conversion Cycle 'CCC'
- Debt
  - ❑ Debt to Equity Ratio
  - ❑ Debt to Assets Ratio
  - ❑ Interest Coverage Ratio
- Shareholder satisfaction
  - ❑ Earnings Per Share

Operational Success

Determinants of an organisation's operational success

Technical measures:	*Formulas:*
Sales: period-on-period	*(Current Sales-Past Sales) / Past Sales X 100*
Gross Margin %	*Gross Profit/ Sales X 100*
Operating Profit %	*Operating Profit / Sales X 100*
Net Profit %	*Net Profit / Sales X 100*
Return on Capital Employed %	*Operating Profit/(Total Assets – Current Liabilities)X100*
Free Cash Flow	*(*Operating Profit + Depreciation – Capital Expenditure)*

**simplified formula*

Key questions:

- ✓ *What direction are Sales going?*
- ✓ *Are profit measures consistent, improving or falling , what are the underlying reasons?*
- ✓ *How effectively is the organisation using its assets?*
- ✓ *Is the organisation creating cash from operations?*

Turnover is...........  Vanity

Profit is..................  Sanity

Cash is....................  Reality

Liquidity

The organisation's ability to meet its short term obligations

<u>Technical measures:</u>	<u>*Formulas:*</u>
Current Ratio	*Current Assets : Current Liabilities*
Acid-test Ratio	*Current Assets – Inventory : Current Liabilities*

<u>Key questions:</u>

- ✓ How secure are the current assets?
- ✓ Are there any timing variances between the assets & liabilities?
- ✓ How does the company compare to industry benchmarks?
- ✓ Are there any significant seasonal influences to consider?

Working Capital Performance

Indicators the organisation has operational control over Working Capital

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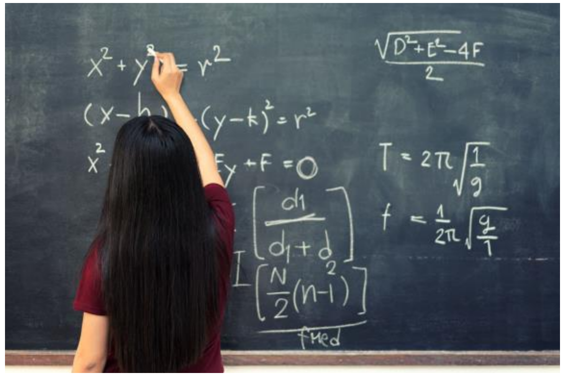
Technical measures:	*Formulas:*
Days Inventory Outstanding 'DIO'	*Inventory/ Cost of Sales X 365*
Days Sales Outstanding 'DSO'	*Receivables / Sales X 365*
Days Payable Outstanding 'DPO'	*Payables / Cost of Sales X 365*
Cash Conversion Cycle 'CCC'	*DIO + DSO - DPO*



Key questions:

- ✓ Are elements consistent with the operational profile?
- ✓ Are there any imbalances between the elements?
- ✓ Are any of the positive aspects unsustainable? (eg high DPO)
- ✓ How sensitive is the overall CCC to market & external influences?
- ✓ What risk mitigations are in place?

Debt Affordability

The organisation's ability to meet its long-term commitments

<u>Technical measures:</u>
Debt to Equity ratio
Debt to Assets ratio
Interest coverage ratio

<u>Formulas:</u>
(Short-term debt + Long-term debt) : Equity
(Short-term debt + Long-term debt) : Total Assets
Operating Profit : Interest expense

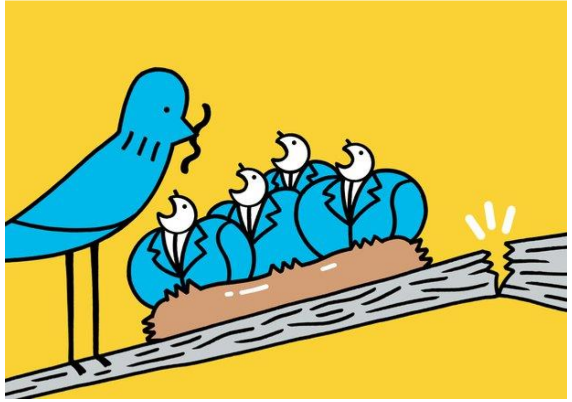
<u>Key questions:</u>

- ✓ How secure is the organisations credit rating?
- ✓ Has the company got a sensible mix of short & long term debt?
- ✓ Does the organisation have headroom under existing relationships?
- ✓ Does the organisation's liquidity position provide adequately for interest payments?
- ✓ Are there any debt covenants that represent a risk to the debt structure?

Shareholder Satisfaction

The organisation's ability to reward its Shareholders

Technical measure:	*Formula:*
Earnings per share	*Net Profit / Issued Shares*



Key questions:

- ✓ Does the organisation have a dividend policy?
- ✓ Are the shareholders actively engaged with the business?
- ✓ What are the shareholders motivation for ownership (dividends / growth)?
- ✓ Are the current shareholders willing to increase their investment?
- ✓ Have analysts outlook for the shares changed in recent times?

Test !

Profit & Loss	*2021*	*$ooo's* *2020*	*2019*
Sales	10,000	9,000	8,500
Cost of Goods Sold	(5,000)	(4,300)	(4,000)
Gross Profit	**5,000**	**4,700**	**4,500**
	50%	*52%*	*53%*
Overheads	(3,300)	(3,100)	(3,000)
Depreciation	(500)	(500)	(500)
Operating Profit	**1,200**	**1,100**	**1,000**
Finance costs	(170)	(120)	(100)
Profit before tax	**1,030**	**980**	**900**
Tax	(230)	(200)	(180)
Net Profit	**800**	**780**	**720**

Balance Sheet	*2021*	*2020*
Current Assets		
Inventory / Stock	500	450
Receivbables/Debtors	1,000	800
Cash	1,000	600
	2,500	1,850
Non-Current Assets		
Tangible Assets	10,000	10,500
Intangible Assets	1,000	1,000
	11,000	11,500
(Capital expenditure Zero for 21/20)		
Total Assets	**13,500**	**13,350**
Current Liabilities		
Payables/Creditors	(700)	(620)
Accruals	(300)	(250)
	(1,000)	(870)
Non-current Liabilities		
Loan	(7,000)	(7,000)
Equity		
Share Capital *($1 each)*	(4,700)	(4,700)
Retained Profit	(800)	(780)
	(5,500)	(5,480)
Total Liabilities & Equity	**(13,500)**	**(13,350)**

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Operational	**Current**	**Prior**
Sales: period-on-period	…………	…………
Gross Margin %	…………	…………
Operating Profit %	…………	…………
Net Profit %	…………	…………

Debt affordability:	**Current**	**Prior**
Interest coverage ratio	…………	…………

Working Capital:	**Current**	**Prior**
Days Sales Outstanding 'DSO'	…………	…………

Liquidity:	**Current**	**Prior**
Current Ratio	…………	…………

Shareholder satisfaction:	**Current**	**Prior**
Earnings per share	…………	…………

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Operational performance:		Curr
Sales: period-on-period %	(10,000-9,000)/9,000	= 11%
Gross Margin %	5,000/10,000	= 50%
Operating Profit %	1,200/10,000	=12%
Net Profit %	800/10,000	=8%

Liquidity:		Curr
Current Ratio	2,500:1,000	=2.5:1

Working Capital:		Curr
Days Sales Outstanding 'DSO'	1,000/10,000*365	=36.5 days

Debt affordability:		Curr
Interest coverage ratio	1,200:170	=7.1:1

Shareholder satisfaction:		Curr
Earnings per share	800/4700	=$0.17

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Answers!

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Operational	**Current**	**Prior**
Sales: period-on-period	11%	6%
Gross Margin %	50%	52%
Operating Profit %	12%	12%
Net Profit %	8%	9%
Return on Capital Employed %	10%	9%
Free Cash Flow	1,700	1,600

Liquidity:	**Current**	**Prior**
Current Ratio	2.5 : 1	2.1 : 1
Acid-test Ratio	2.0 : 1	1.6 : 1

Working Capital:	**Current**	**Prior**
Days Inventory Outstanding 'DIO'	36.5	38.2
Days Sales Outstanding 'DSO'	36.5	32.4
Days Payable Outstanding 'DPO'	(51.1)	(52.6)
Cash Conversion Cycle 'CCC'	21.9	18.0

Debt affordability:	**Current**	**Prior**
Debt to Equity ratio	1.3 : 1	1.3 : 1
Debt to Assets ratio	0.5 : 1	0.5 : 1
Interest coverage ratio	7.1 : 1	9.2 : 1

Shareholder satisfaction:	**Current**	**Prior**
Earnings per share	$0.170	$0.166

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