Financial analysis

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 # 2

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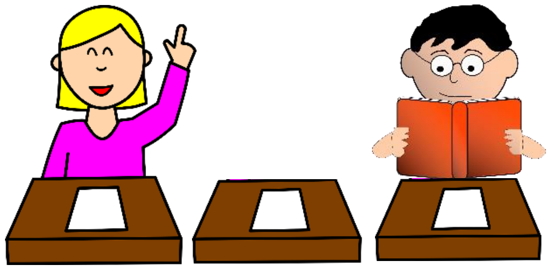
Students in class

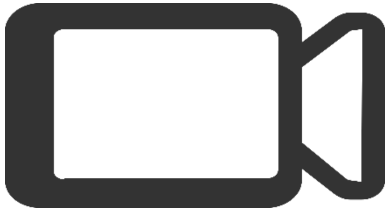
Speak loud to the class



Keep safety distance

Students online

Connect on zoom from your agenda link



Activate your camera

Mute your microphone

Be connected with a headset/mic

Pin the screen

Use Side-by-side mode

Case based class

Case NameVa	Time in class	reminder	Areas of financial analysis
Balance sheet detective	3 hrs	Balance sheet structure	Common size balance sheet matching
Financial Analysis Identifying the industry	3 hrs with time to search for industry information online	P&l structure Main Financial ratio	Common size + ratios industry wise matching
What value for ThermoCompact?	6 hrs (initial time to elaborate valuation methods)	Valuations method	Financial diagnosis; valuation method choice; value of firm
Yestudent	2 hrs	Context analysis	Valuation startup ; Seed financing ; Fundraising ; DCF Method ; Comparables Method

Analyze the different dimensions of the performance of a company in all types of activities (services, production or projects)

Balance sheet analysis

Profit and Loss analysis

Performance ratios

Present in writing and orally the results of a performance study and recommendations for decision-making.

Develop a first approach of valuation methods

Regulation

- **Cases are released on C@mpus**

- **The final exam will last 1 hour at the end of the last session.**
  - it will consist of 20 multiple-choice questionnaire.

Case 2

Identifying the industry

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Suggested approach

Use your knowledge of the industries 'financial characteristics and financial ratio.

- To organize the 12 companies in several groups with similar attributes
- To determine the detailed financial characteristics of those group (ie high technology-retail- ...)
- To match the firms to the specific industry

And guess who is who ?

Identifying the industry

Financial statement Reminder

Financial position of an entity is affected by:

Economic resources it controls

Financial structure (equity versus liabilities)

Liquidity and solvency (ability to pay its debts)

Capacity for adaptation (ability to convert assets to cash => to adapt to changes in its environment)

Statement of financial position
+ Changes in financial position

Performance ratios Profitability

Gross margin Ratio :

Gros Profit/sales :60/100

Return on sales :

Net income/sales

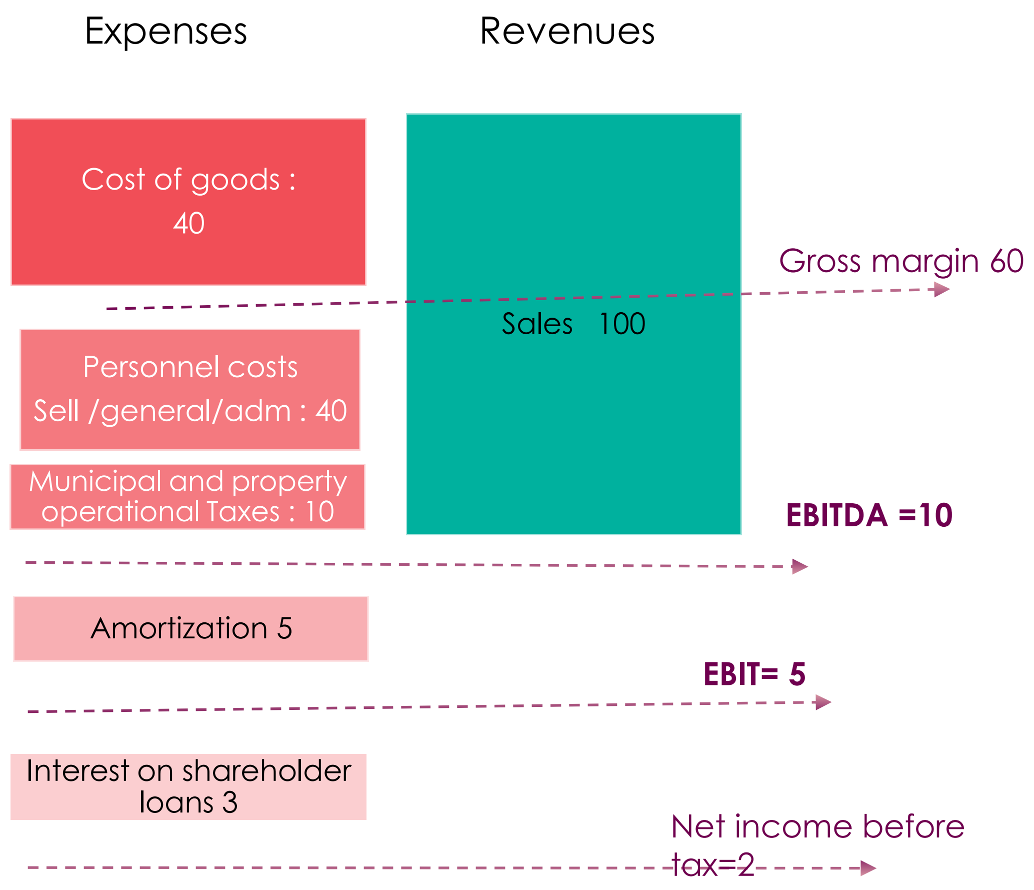
2/100

Financial leverage

Interest Coverage ratio :

Income before Tax +interest expenses/ Interest expenses :

2+3/3=1,666



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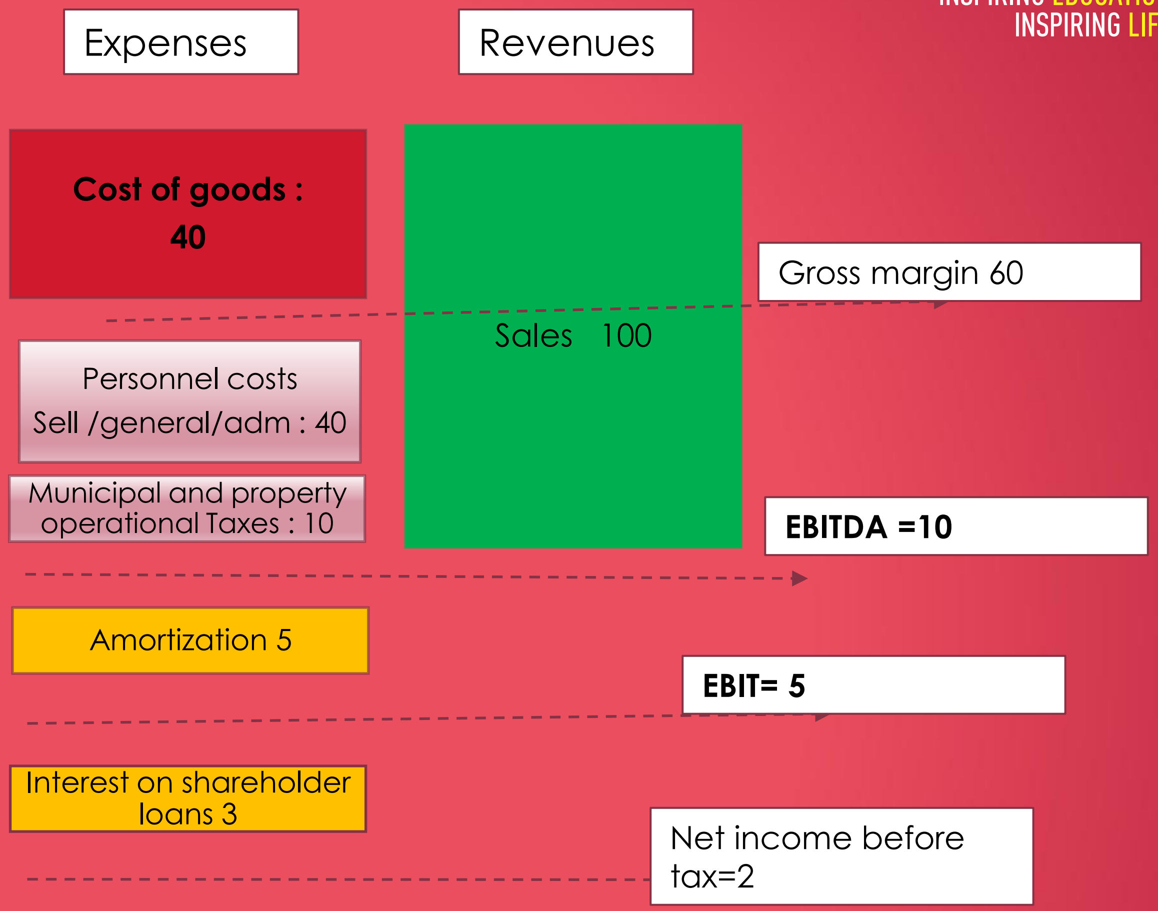

Question

What are the differences between EBIT and EBITDA?

What is the use?

Glossary : income statement

Gross profit.

The direct profit from selling goods and services before overheads. This is often calculated differently in different companies

EBIT (earnings before interest and tax).

Operating profit adjusted for non-operating items.

EBITDA (earnings before interest and tax, depreciation and amortisation).

A rough approximation of cash from operations, by adding back non-cash items to profits.

Operating profit. (operating income).

The surplus from normal trading activities before tax and financing charges are taken into account.

Extraordinary items.

Items within a statement of profit or loss which are a not a normal part of business activity and are therefore deemed to be extraordinary.

Financial analysis for Valuation

In conjunction with the strategic analysis, financial analysis will ensure that the assumptions and figures used in the valuation process are objective and can be justified.

Financial statement

A thorough understanding of both the current financial position and performance of the enterprise : Balance sheet-profit and loss-ratios

Forecasts

An assessment of its future prospects, are essential to carrying out a valuation

Understanding of cash flow : inflow-outflow

Accounting environment

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Analysis of the most recent statements of financial position and statements of profit or loss, especially by analytic review, enables to :

Measure the profitability and evolution of the enterprise concerned

Determine exceptional items and get closer to sustainable profits

- Specific unusually high contract
- Specific issues with costumers
- Welcome Bonus if considered as unusual, Restructuration, …

Assess, in a general way if the forecasts made are prudent or overly optimistic

This analysis must also take into account season-related issues.

In this sense, when the financial year ends may influence the whole truth, especially the level of cash flow and variations in working capital requirements.

Ratio disclosed in the case : Liquidity Ratio

Cash& marketable Securities to Total assets

Information on level of cash available

Acid Test ratio (without inventories-quick ratio)

Sufficient short-term assets to cover immediate liabilities ? >1,

When too high, mean no investments or low dividends paid

Current Ratio = Acid ratio +inventories

also known as working capital ratio : cash mobilized to run current business

If the acid-test ratio is much lower than the current ratio, it means that current assets are highly dependent on inventory.

Comparisons are most meaningful within a given industry: example : level of inventories in retail

Day’s receivable (DSO : Days Sales Outstanding)

Information on the deadlines for payment granted and customer satisfaction in specific industry as consulting

Day’s Inventory

Information on the level of inventories : disposal of stocks- quality …

Asset Turnover

efficiency with which a company is using its assets to generate revenue

Trend overs different period is more relevant as this ratio depends on the level of CAPEX of the period

Ratio disclosed in the case : Financial leverage

if a company's operations can generate a higher rate of return than the interest rate on its loans, then the debt is helping to fuel growth in profits.

Long term debt to Total assets

Capacity to contract new debts

Long term debt to stockholders' Equity

How a company is financed : Evaluating Solvency and Capital Structure

Coverage ratio

Capacity to pay the debt cost and distribute dividends

Ratio disclosed in the case : Profitability

Return on assets

efficiency with which a company is using its assets to generate revenue.

Return on equity (ROE)

Return on the capital invested :Capacity to paid dividends :

Dupont Analysis

breaks down (ROE) into three components,

asset turnover : efficiency of assets

Profit margin ; efficiency of “product” sales

Financial leverage : split among banks and shareholder.

Identifying the industry

Suggested approach :

organize the different industries in groups with similar attributes

Define specific financial attributes of each group

Classify the companies

Inside each group , match the company making more detailed analysis of the financial statements and ratio

Questions ?

The 12 companies are members of the following 12 different industries:

Advertising
Airline
Commercial banking (items fitted into the same categories as the non-financial firms)
Computer software development
Department store chain (with its own in-store credit card)
Electric utility (producer and distributor)
Liquor (producer and distributor)
Oil and gas (upstream explorer and producer)
Pharmaceutical
Retail drug
Retail grocery
Sporting (organized as a master limited partnership (MLP), hence no corporate taxes)

Identifying the industry

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