



Income Statement and Earnings Analysis

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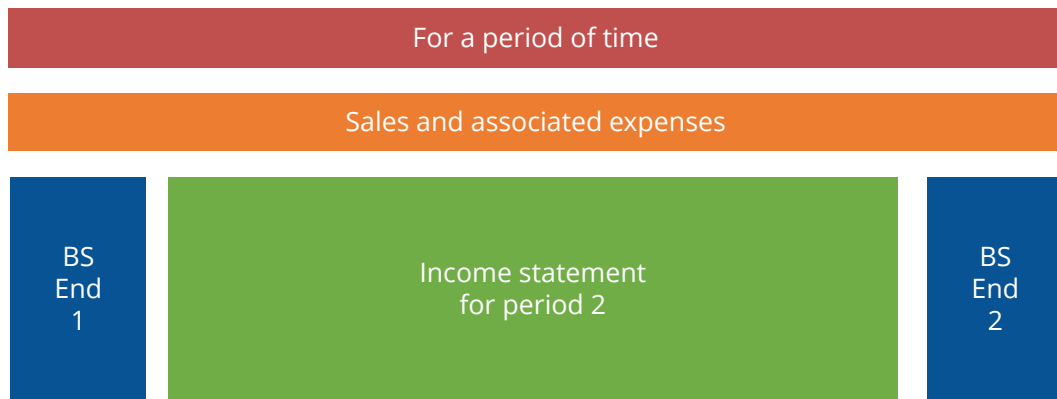
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- Revenue recognition
- Cleaning EBIT/EBITDA
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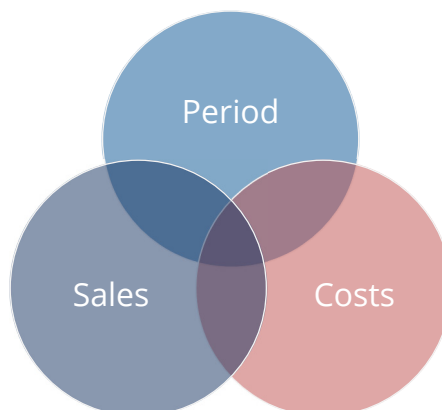
Income Statement Introduction



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Matching Principle

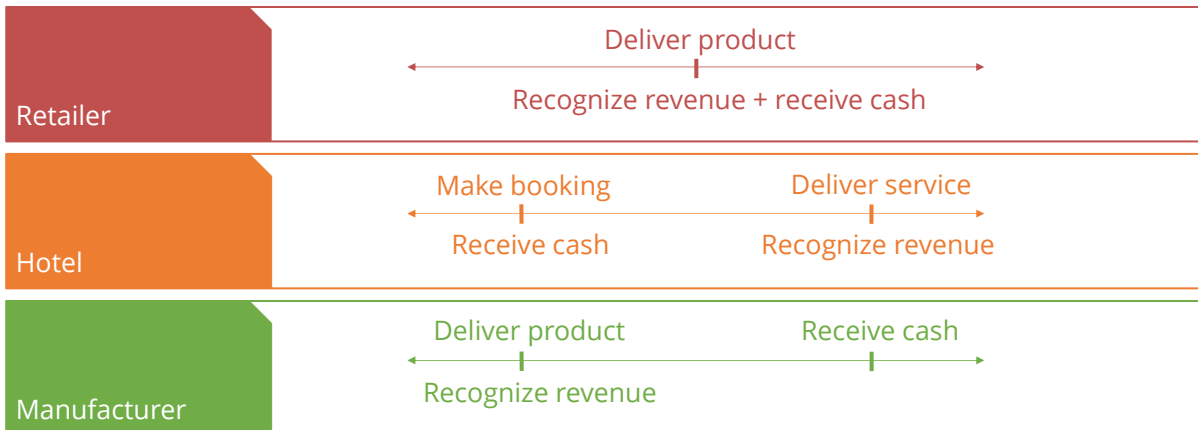


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Recognize revenue upon delivery or service performance

Sales (IS) and cash flow (CFS) are often at different times



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Income Statement Presentation and Expenses

Income Statement		
Sales	X	
Cost of goods sold (COGS)	(X)	Making/buying the product
Gross profit	X	
Selling, general and admin (SG&A)	(X)	Supporting the business
Operating profit	X	
Interest/finance expense	(X)	Financing the business
Profit before tax	X	
Tax expense	(X)	Paying the government
Net income	X	

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Operating Profit

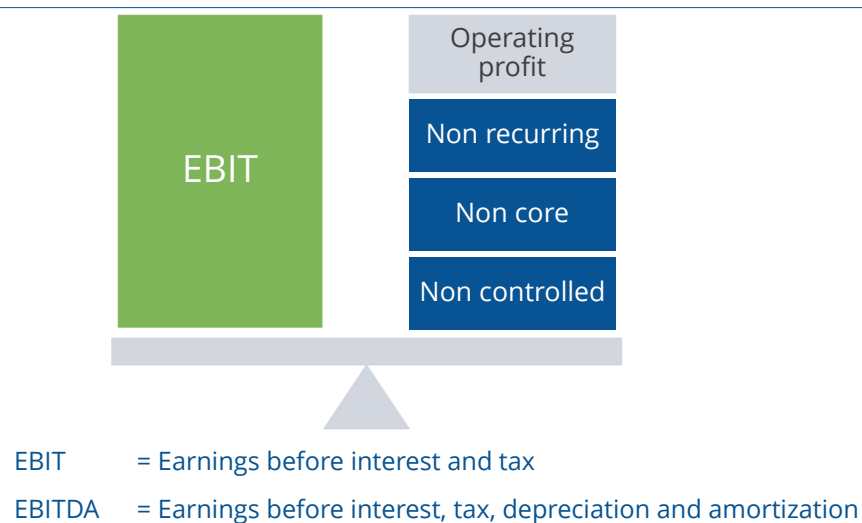
Profit before
financing and
government costs

Income Statement	
Sales	X
Cost of goods sold (COGS)	(X)
Gross profit	X
Selling, general and admin (SG&A)	(X)
Operating profit	X
Interest/finance expense	(X)
Profit before tax	X
Tax expense	(X)
Net income	X

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EBIT Equals Operating Profit?



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Cleaning EBIT / EBITDA

Historic EBIT / EBITDA can help predict future EBIT / EBITDA... but only if non recurring items are removed



Non core and non controlled items must also be removed

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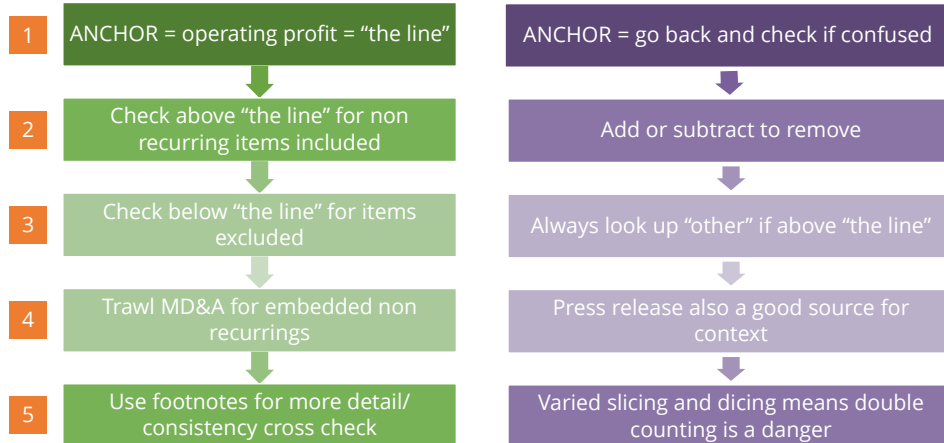
Finding Non Recurring Items

	Net revenue	55,870	
	Cost of sales	<u>20,261</u>	
	Gross margin	35,609	
	Research and development	11,537	
	Marketing, general and administrative	8,136	
2 Check above operating profit	Restructuring and asset impairment charges	295	
	Amortization of acquisition-related intangibles	<u>294</u>	
	Operating expenses	20,262	
1 Start at operating profit	Operating income	15,347	
	Gains (losses) on equity investments, net	411	3 Check below operating profit
	Interest and other, net	43	
	Income before taxes	15,801	
	Provision for taxes	<u>4,097</u>	
	Net income	11,704	

4 Check MD&A and footnotes for more detail and embedded non recurring items. Use the lines above operating profit to guide your search, and use lines below operating profit as those you can safely ignore

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EBIT and EBITDA Calculations



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Cleaning EBITDA Without Double Counting Depreciation and Amortization

D&A always in the cash flow statement

Cash flows from operating activities:

Net earnings	\$ 4,545
Adjustments to reconcile net earnings to net cash provided by operating activities:	
Depreciation and amortization	4,016

D&A often includes hidden impairments. Always check footnotes



Footnote detail	
Depreciation	2,968
Amortization	913
Impairment	135
Total	4,016

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Taxes - Marginal and Effective Rates

Marginal tax rate

Rate paid on the next \$ of profit before tax

This is the statutory tax rate in the country (plus state tax rate in the US)

vs

Effective tax rate

Average tax rate actually expensed

Calculated as:

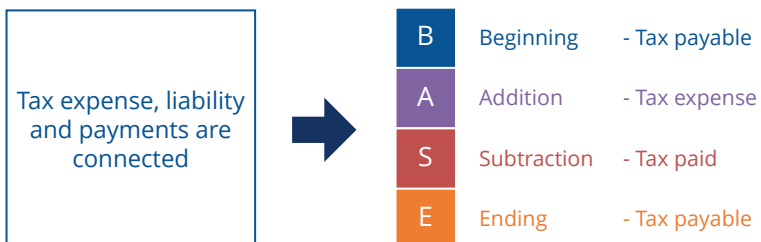
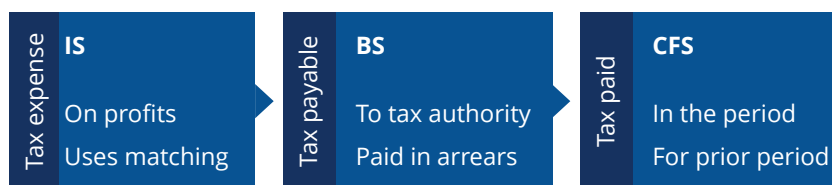
$$\frac{\text{Tax expense}}{\text{Profit before tax}}$$

Often lower than MTR

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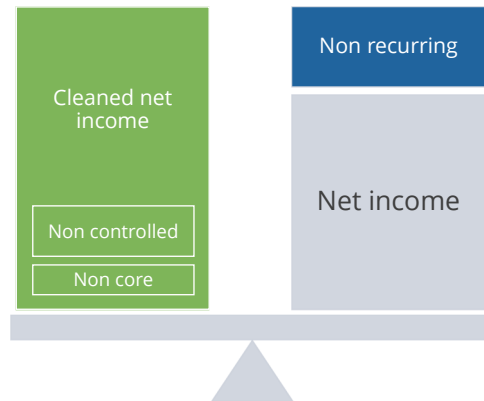
Taxes in the Financial Statements



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Cleaning Net Income



All continuing income, regardless of core or control, is assessed in net income. Only non recurring items are cleaned.

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Cleaning Net Income

		Current Figures	Non Recurring Item	Cleaned Figures
<div>1</div> <div>Add back non recurring item</div>	Revenue	500.0		500.0
	COGS	(100.0)		(100.0)
	SG&A	(90.0)		(90.0)
	Reorganisation	(10.0)	10.0	0.0
<div>2</div> <div>Tax impact of non recurring item 10 * 30%</div>	EBIT	300.0		310.0
	Interest	(100.0)		(100.0)
	Profit before tax	200.0		210.0
	Tax	(50.0)	(3.0)	(53.0)
	Net income	150.0	7.0	157.0
				<div>3</div> <div>Post tax non recurring item 10 * (1-30%)</div>

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Cleaning Effective Tax Rate

Non recurring items distort ETR. To forecast ETR it must be cleaned.

Reverse out the non recurring item and recalculate ETR

	Current Figures	Non Recurring Item	Cleaned Figures
Profit before tax	200.0	10.0	210.0
Tax	(50.0)	(3.0)	(53.0)
Net income	150.0	7.0	157.0
ETR	25.0%		25.2%

50.0 / 200.0

53.0 / 210.0

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