# BASIC FINANCIAL ANALYSIS

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# Agenda

- Solvability (balance sheet)
- Liquidity (balance sheet)
- Profitability (profit & loss statement)
- Other financial ratios
- Ratings
- Practice

# Balance sheet

| Assets | = | Equity + Liabilities |
|---|---|---|
| Fixed assets | | Equity |
| Current assets | | Capital |
| Inventory | | Reserves |
| Receivables | | Long term liabilities |
| Cash | | Current liabilities |
| Other current assets | | Suppliers |
| | | Short term loan |
| | | Other current liabilities |
| | | |
| Total assets | = | Total Equity + liabilities |

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*How did the company finance its assets ?*

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*In which assets did the company invest its equity and external financial resources?*

# Solvability

- Solvability ratio* = Total net worth/total assets * 100
- Preferred minimum value : 25%
- Meaning 25% own capital + reserves versus 75% foreign capital (suppliers and banks)

** Also called solvency ratio*

# Balance sheet

| | | | |
|---|---|---|---|
| FIXED ASSETS | 54,005 | EQUITY | 41,142 |
| CURRENT ASSETS | 52,142 | CAPITAL | 10,000 |
| INVENTORY | 10,369 | RESERVES | 31,142 |
| RECEIVABLES | 39,872 | LONG TERM LIABILITIES | 22,031 |
| CASH | 919 | CURRENT LIABILITIES | 42,974 |
| OTHER | 982 | SUPPLIERS | 15,427 |
| | | SHORT TERM LOAN | 20,606 |
| | | OTHER | 6,941 |
| **TOTAL ASSETS** | **106,147** | **TOTAL LIAB+EQUITY** | **106,147** |

*Solvability ratio = 41,142 / 106,147 * 100 = 38,75%*
*Also shown as debt/equity ratio 61/39*

# Liquidity

- Working capital = current assets – current liabilities
- Should always be positive, meaning that the short term assets (e.g. receivables, inventory, cash) are sufficient to cover the short term obligations (e.g. suppliers, short term bank loan, social security, salaries, ...)

- Current ratio = current assets/current liabilities
- Should be greater than 1

# Balance sheet

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| **TOTAL ASSETS** | **106,147** | **TOTAL LIAB+EQUITY** | **106,147** |

*Working capital = 52,142 – 42,974 = 9,169*

*Current ratio = 1.21*

*Quick ratio = (current assets – inventory)/current liabilities = 0.97*
*The quick ratio measures the company's ability to meet its short term obligations with its most liquid assets*

| Profit & Loss statement |
|---|
| Revenues / Total sales |
| - Cost of goods sold |
| **Gross profit/loss** |
| - Staff costs |
| - Depreciations |
| - Other operating expenses |
| **Operating Income/loss** |
| + Financial income |
| - Financial expenses |
| **Profit/loss before exceptional items** |
| + Exceptional income |
| - Exceptional expenses |
| **Profit/loss before taxes** |
| - Income tax |
| **Net profit/loss** |

# Profitability

- Return on sales = Net profit or loss/total sales * 100
- Should be ideally minimum 2%

# Profit & loss statement

| | |
|---|---|
| REVENUES/TOTAL SALES | 96,016 |
| COST OF GOODS SOLD | 81,714 |
| **GROSS PROFIT** | **14,302** |
| STAFF COSTS | 7,035 |
| DEPRECIATIONS | 3,250 |
| OTHER OPERATING EXPENSES | 1,452 |
| **OPERATING INCOME** | **2,565** |
| FINANCIAL INCOME | 20 |
| FINANCIAL EXPENSES | 873 |
| **PROFIT/LOSS BEFORE EXCEPTIONAL ITEMS** | **1,712** |
| EXCEPTIONAL INCOME | 231 |
| EXCEPTIONAL EXPENSES | 0 |
| **PROFIT/LOSS BEFORE TAXES** | **1,943** |
| INCOME TAX | 80 |
| **NET PROFIT/LOSS** | **1,863** |

*Return on sales = 1,863 / 96,016 * 100 = 1.94%*

*Gross margin = ((Total sales – Cost of goods sold) / Total sales)*100*
*((96,016 – 81,714) / 96,016)*100 = 14.89%*

# Other financial ratios

- **EBIT: Earnings Before Interests, Taxes (and Special Items):**

An indicator of a company's profitability – It is the profit before taking into account interest payments and income taxes.
It eliminates the effects of a different capital structure and tax rates when comparing different companies.

- ***EBITDA: Earnings Before Interests, Taxes, Depreciations, Amortizations (and Special Items)***

*A metric to evaluate how much profit a company generates from its operational activities, without taking into account financial expenses and non cash expenses such as depreciations and amortizations, also called the operational cash flow.*
*This measure is of particular interest in cases where companies have large amounts of fixed assets or intangible assets which are subject to heavy depreciation or amortization charges and/or for companies with significant amounts of debt financing.*
*Since the EBITDA is the income that a company has free for interest payments, this metric gives an indication of the company's capability to pay interest and repay debts.*

- ***Cash* Flow (Funds flow): Net income + Depreciations and Non cash items.**

*Cash flow is a crucial metric to measure the company's financial strength.*
*Companies with ample cash on hand are able to invest the cash back into the business in order to generate more cash and profit.*

- ***Total Debt = Long term bank loans + Short term* bank loans + Notes Payables***

- ***Total Capital = Total Debt + Total Equity***



** Short term = <1 year*

# Ratings

| | Investment Grade | | | Speculative Grade | | |
|---|---|---|---|---|---|---|
| **Moody's Rating** | Aa or Aaa | A | Baa | Ba | B | Caa |
| **S&P Rating** | AA or AAA | A | BBB | BB | B | CCC |
| | Very strong | Strong | Good | Marginal | Weak | Very weak |
| **1. EBIT Int Cov. *(x)** | 8.8 + | 8.7 - 5.4 | 5.3 - 3.1 | 3.0 - 1.6 | 1.5 - 0.5 | < 0.5 |
| **2. Funds Flow/TD*(%)** | 51 + | 50.9 - 38 | 37.9 - 25 | 24.9 - 14.3 | 14.2 - 7.7 | < 7.6 |
| **3. TD / TC (%)** | < 38 | 37.9 - 43.8 | 43.9 - 54.3 | 54.4 - 67.9 | 68 - 82 | > 82 |
| **4. Debt / EBITDA (x)** | < 1 | 1 - 2 | 2 - 3 | 3 - 6 | 6 - 9 | > 9 |
| **5. 4-VARIABLE Z-SCORE** | > 7 | 6.9 - 6.4 | 6.3 - 5.6 | 5.5 - 4.7 | 4.6 - 3.7 | < 3.6 |

**When scores fall in more than one category, give more weight to the Coverage ratios.*