

BASIC FINANCIAL ANALYSIS

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

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



How did the company finance its assets ?



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

- 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*

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

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		OTHER	6,941
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

- Return on sales = $\frac{\text{Net profit or loss}}{\text{total sales}} \times 100$ *
- 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

	Investment Grade			Speculative Grade		
	Aa or Aaa	A	Baa	Ba	B	Caa
Moody's Rating						
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.