



Introduction to Analysing Financial Statements

CII CPD

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Introductions and admin

- Introductions
 - Presenter: Judith Craine
 - Lecturer at UCM
 - Director at Taxmann Limited
- Objectives
 - Key financial statements
 - User groups
 - Key ratios
- Housekeeping/ Health & Safety



Why analyse?

What do we want to know?

- Depends on relationship with the business:
 - Existing or potential investor
 - Lender
 - Supplier
 - Customer
 - Other?

Terminology

IFRS

- Income Statement
- Turnover, Revenue
- Statement of financial position
- Non-current Assets
- Inventory
- Receivables
- Payables

UK/IOM

- Profit & Loss Account
- Sales, income
- Balance Sheet
- Fixed Assets
- Stock
- Debtors
- Creditors

Profit (or Loss)

➤ **Income statement (Profit & Loss)**

- Operating result (continuing/discontinued)
 - Revenue
 - Cost of sales
 - Operating expenses
- Finance costs
- Taxation

➤ **Statement of comprehensive income**

- Recognised, but not realised

Financial position

➤ **Statement of financial position (Balance Sheet)**

- Assets, liabilities and capital (shareholders' funds)
- Sources of finance – long term, short term
- Working capital (current assets; current liabilities)

➤ **Statement of changes in shareholders' equity**

(Notes to the accounts – the detailed breakdown of totals in the other statements)

Initial analysis

- What does the business do?
 - Expectations, impact of wider environment
- Revenue and profitability year on year?
- Non-current assets – new purchases, depreciation?
- Financing – any change in sources of finance?

Ratio Analysis

Using figures from financial statements to:

- Assess performance
- Identify trends
- Assist risk decisions
- Prompt further questions and analysis
- Four main groups:
 - Profitability
 - Capital structure (Gearing)
 - Liquidity
 - Investors

Profitability Ratios

Gross profit	$\frac{\text{Gross profit}}{\text{Revenue (sales or turnover)}} \times 100$
Net (operating) profit	$\frac{\text{Net (operating) profit}}{\text{Revenue (sales or turnover)}} \times 100$
Return on Capital Employed (ROCE) (Capital Employed = Shareholders' funds + Long term borrowings)	$\frac{\text{Profit before interest \& tax (PBIT)}}{\text{Capital Employed}} \times 100$
Also EBIT (earnings before interest & tax); EBITDA (earnings before interest, tax, depreciation & amortisation)	

Capital Structure & Liquidity ratios

CAPITAL STRUCTURE	
Gearing	$\frac{\text{Long term borrowing}}{\text{Total capital employed}} \times 100$
Interest cover	$\frac{\text{Profit before interest \& tax}}{\text{Interest}}$
LIQUIDITY	
Current ratio	$\frac{\text{Current Assets}}{\text{Current liabilities}}$
Quick (acid test) ratio	$\frac{\text{Current Assets, less stock (inventory)}}{\text{Current liabilities}}$

Investor ratios

Earnings per share (EPS)	$\frac{\text{Profit after tax}}{\text{Number of shares in issue}}$
Dividend per share (available in notes to accounts)	$\frac{\text{Total dividend}}{\text{Number of shares in issue}}$
Price/earnings (P/E) (quoted in FT with share price)	$\frac{\text{Market price of share}}{\text{EPS}}$

Thank you for listening...

- Have we achieved the objectives?
- Any questions?