



FINANCIAL STATEMENT ANALYSIS

Agenda

- ① Objectives of financial statement analysis
- ② Ratio analysis
- ③ Horizontal and vertical analysis
- ④ Illustrative examples: Good Group (International) Limited
- ⑤ Question and answer

1

Objectives of Financial Statement Analysis

The purpose and objectives of financial statement analysis
Key activities of financial statement analysis



The **purpose** and **objectives**
of financial statement
analysis



Key **activities** of
financial statement
analysis



The **purpose** and **objectives**
of financial statement
analysis

01

Review &
analysis of
historical
financial
performance

Quantitative
& qualitative
activities



Financial
statement
analysis

02

03

Developing
conclusions and
recommendations

Review & analysis of historical financial performance

01

Financial Statements



Balance Sheet



Income Statement



Statement of cash flow

02

03

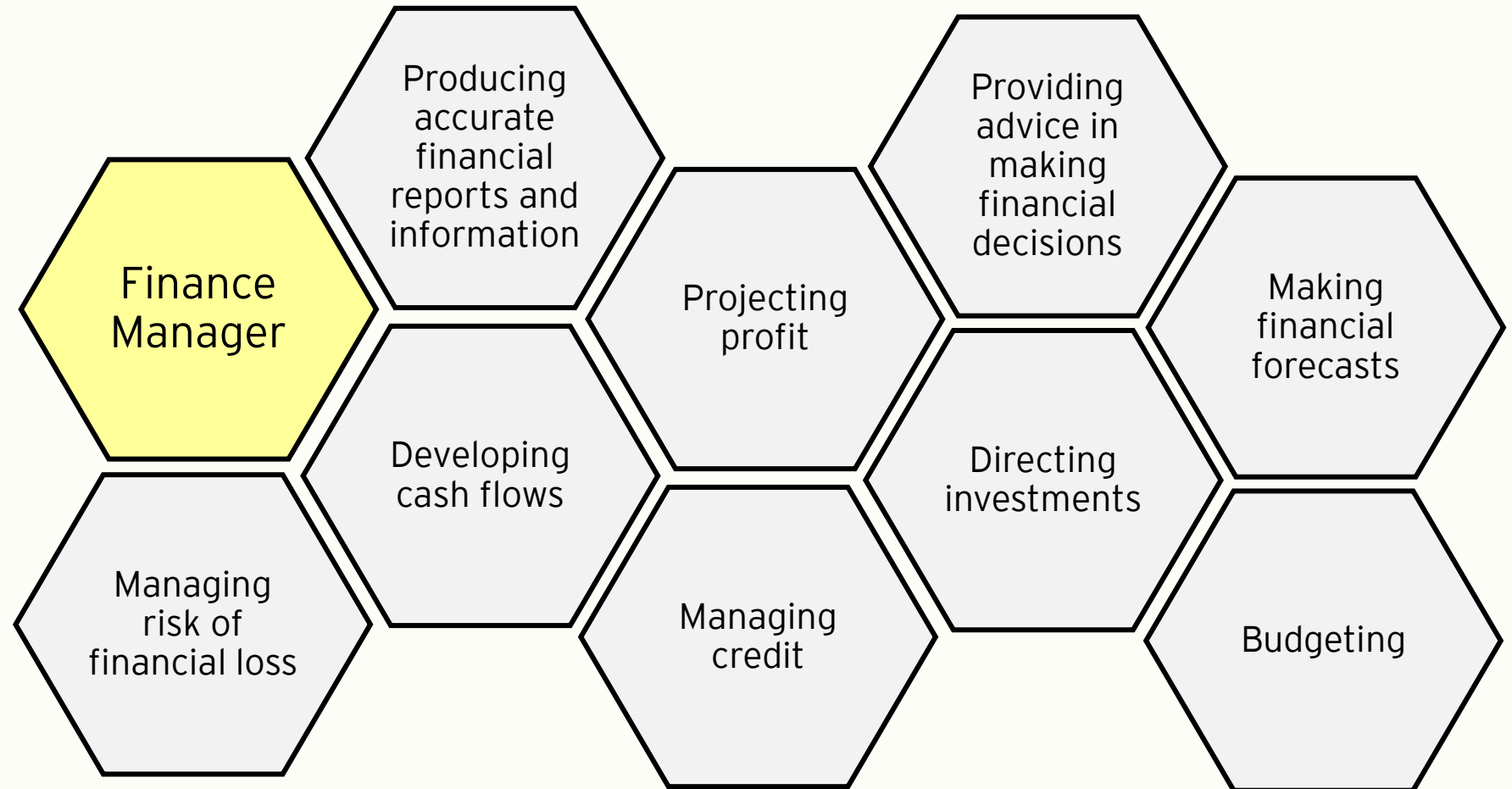
Review & analysis of historical financial performance

01

02

03

What are the roles of a finance manager?



Review & analysis of historical financial performance

01

Who are the users of financial statements?



Internal Users

- Business Owners
- Management

External Users

- Lenders
- Potential Investors
- Suppliers and customers
- Government bodies

02

03

Quantitative and qualitative activities

01

Financial statement analysis must include both:

- Quantitative
- Qualitative

02

The purpose is to gain insights into business's strategies, management decisions and position in market and industry.

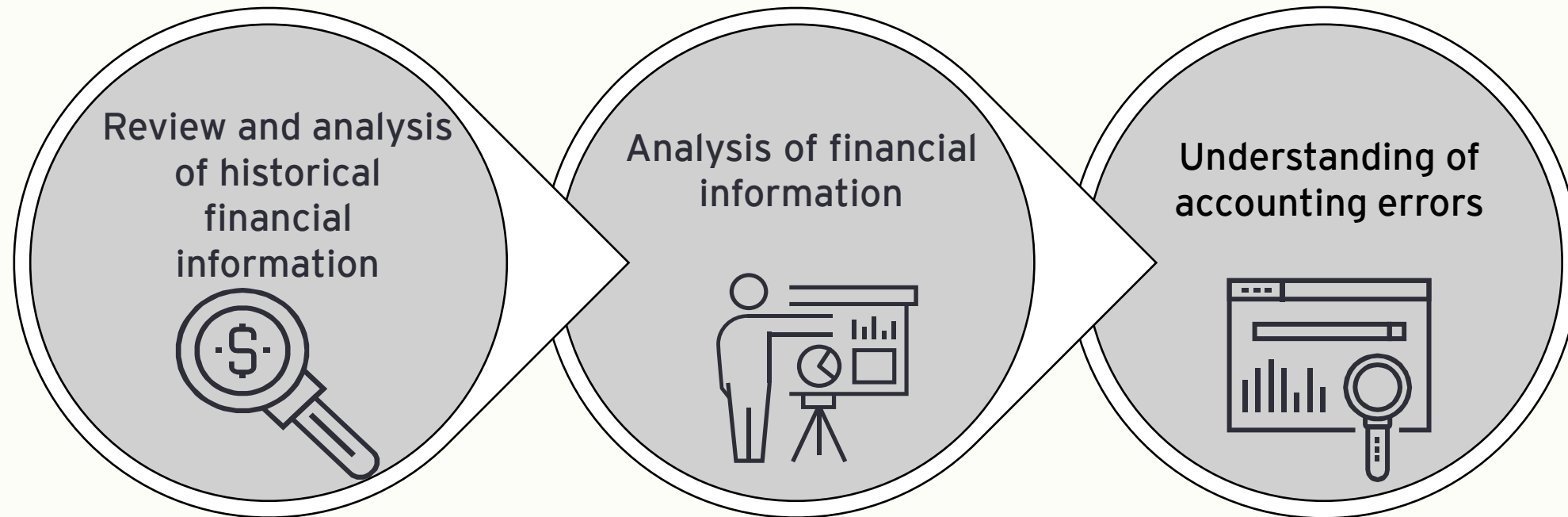
03





Key **activities** of
financial statement
analysis

A financial statement analysis includes completing the following activities:



Developing conclusions and recommendations

01

Review and analysis
of historical financial
information



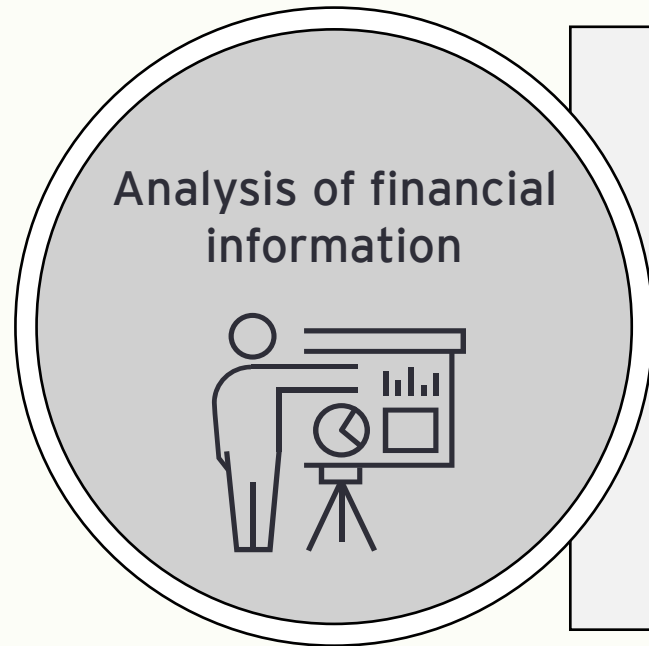
- To understand the historical financial information, underlying trends and key drivers of a business
- To use historical financial analysis to assess the reasonableness of estimates made by managements

02

03

Developing conclusions and recommendations

01



- To enable meaningful comparisons between that target company
- To interpret, understand and compare differences between companies related to its financial performance

02

03

Developing conclusions and recommendations

01

Understanding of
accounting errors



- To identify improperly recognized revenue
- To understand movement of expenses
- To recognize treatment of liabilities

03



Ratio Analysis

Overview of financial ratios

Financial ratios

- Liquidity
- Activity
- Profitability
- Solvency

Ratio Analysis | Overview of financial ratios

- Ratios are used to compare a company's past performance to its projected financial performance
- Ratios are used to compare a company's performance against other comparable companies or industry benchmarks
- Allows us to assess and analyze the strengths and weaknesses of a company



LIMITATIONS

- Limited comparability across firms
- The "industry norms" may be unavailable
- The "past" may not repeat in the future
- Ratio analysis does not consider non-financial factors

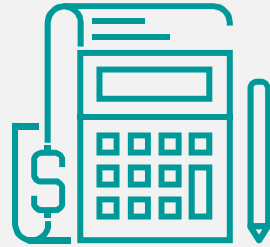
Ratio Analysis | Financial Ratios



Liquidity Ratios

Measure a company's ability to meet its **short-term** liabilities

- Current Ratio
- Quick Ratio



Activity Ratios

Measures efficiency of daily operations

- Receivables Turnover
- Inventory Turnover



Profitability ratios

Measure the financial performance of a company over a period of time

- Gross profit margin
- Operating profit margin
- Return on assets
- Return on equity



Solvency ratios

Measure the degree of protection for **long-term** creditors and investors

- Debt to total assets
- Time interest earned ratios

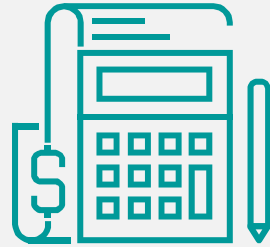
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Ratio Analysis | Liquidity Ratios

1

Current Ratio

measures a company's ability to pay short-term obligations



$$= \frac{\text{Current Assets} *}{\text{Current Liabilities}}$$

> 1 Has sufficient resources to pay its current liabilities
< 1 May suggest that the company has liquidity issues

Current Assets



Inventory

Less liquid



Marketable securities

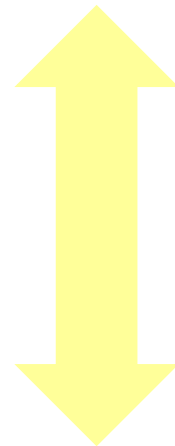


Trade Receivables



Cash and cash equivalents

Most liquid



Ratio Analysis | Liquidity Ratios

2

Quick Ratio

measures a company's ability to meet its short-term obligations with its most liquid assets.



$$= \frac{\text{Liquid Assets} *}{\text{Current Liabilities}}$$

> 1

Liquid assets can cover its current liabilities

< 1

May suggest that the company has liquidity issues

Liquid Assets

X	Inventory	Less liquid
✓	Marketable securities	
✓	Trade Receivables	
✓	Cash and cash equivalents	Most liquid

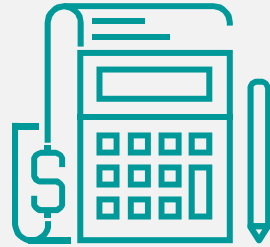
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Ratio Analysis | Activity Ratios

1

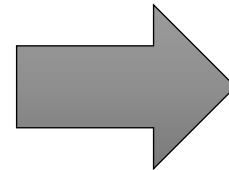
Receivables Turnover

provides an indication of how quickly a company collects its accounts receivables

Receivable Turnover



$$= \frac{\text{Net Sales}}{\text{Average Trade Receivables}}$$



"Days" Ratios

$$= \frac{365}{\text{Receivable turnover}}$$

HIGH

company's collection of accounts receivable is efficient and has a high proportion of quality customers that pay their debts quickly

LOW

could be the result of:

1. inefficient collection
2. inadequate credit policies
3. customers who are not financially viable or creditworthy.

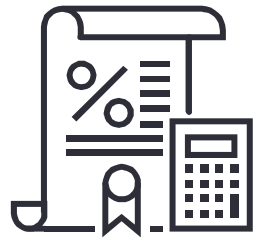
Ratio Analysis | Activity Ratios

2

Inventory Turnover

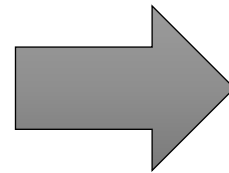
showing how many times a company has sold and replaced inventory during a given period.

Inventory Turnover



=

$$\frac{\text{Cost of goods sold}}{\text{Average Inventory}}$$



"Days" Ratios



=

$$\frac{365}{\text{Inventory turnover}}$$

HIGH

means a company is selling goods quickly, and there is considerable demand for their products

LOW

indicate weaker sales and declining demand for a company's products

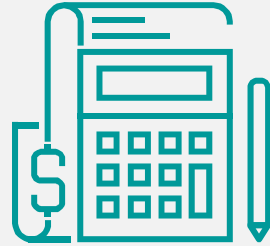
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Ratio Analysis | Profitability Ratios

Margin Ratios

1

Gross profit margin

percentage of sales revenue that a company is able to convert into gross profit



$$= \frac{\textit{Gross Profit}}{\textit{Revenue}}$$

2

Operating profit margin

reflects the percentage of profit a company produces from its operations before subtracting taxes and interest charge



$$= \frac{\textit{Operating income}}{\textit{Revenue}}$$

Ratio Analysis | Profitability Ratios

Return Ratios

3

Return on assets

how well a company is generating profits from its total assets



=

$$\frac{\text{Net income}}{\text{Average Total Assets}}$$

HIGH

company is more efficient and productive at managing its balance sheet to generate profits

LOW

company is not able to make maximum use of its assets for getting more profits

Ratio Analysis | Profitability Ratios

Return Ratios

4

Return on equity

measures the ability of a firm to generate profits from its shareholders investments in the company



$$= \frac{\text{Earnings before income tax}}{\text{Average total capital}}$$

HIGH

more efficient when it comes to utilizing investment financing to grow their business (and is more likely to provide better returns to investors)

LOW

indicates that a company may be mismanaged and could be reinvesting earnings into unproductive assets

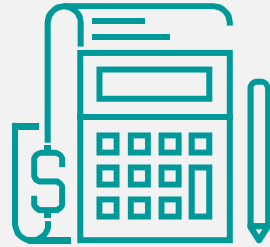
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Ratio Analysis | Solvency Ratios

1

Debt to total assets

quick indicator of a company's level of indebtedness


$$= \frac{\text{Debt}}{\text{Total Assets}}$$

Debt

- ✓ Short-term interest bearing debt
- ✓ Long-term debt



could mean that your company will have trouble borrowing more money, or that it may borrow money only at a higher interest rate




the company owns more assets than liabilities and can meet its obligations by selling its assets if needed

Ratio Analysis | Solvency Ratios

2

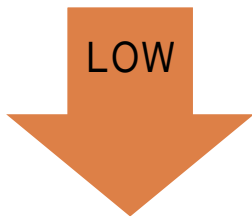
Time interest earned

measures long-term viability of business to pay off its debt.


$$= \frac{\text{Earnings before income tax}}{\text{Interest expense}}$$



lower probability of defaulting on its loans, making it a safer investment opportunity for debt providers.



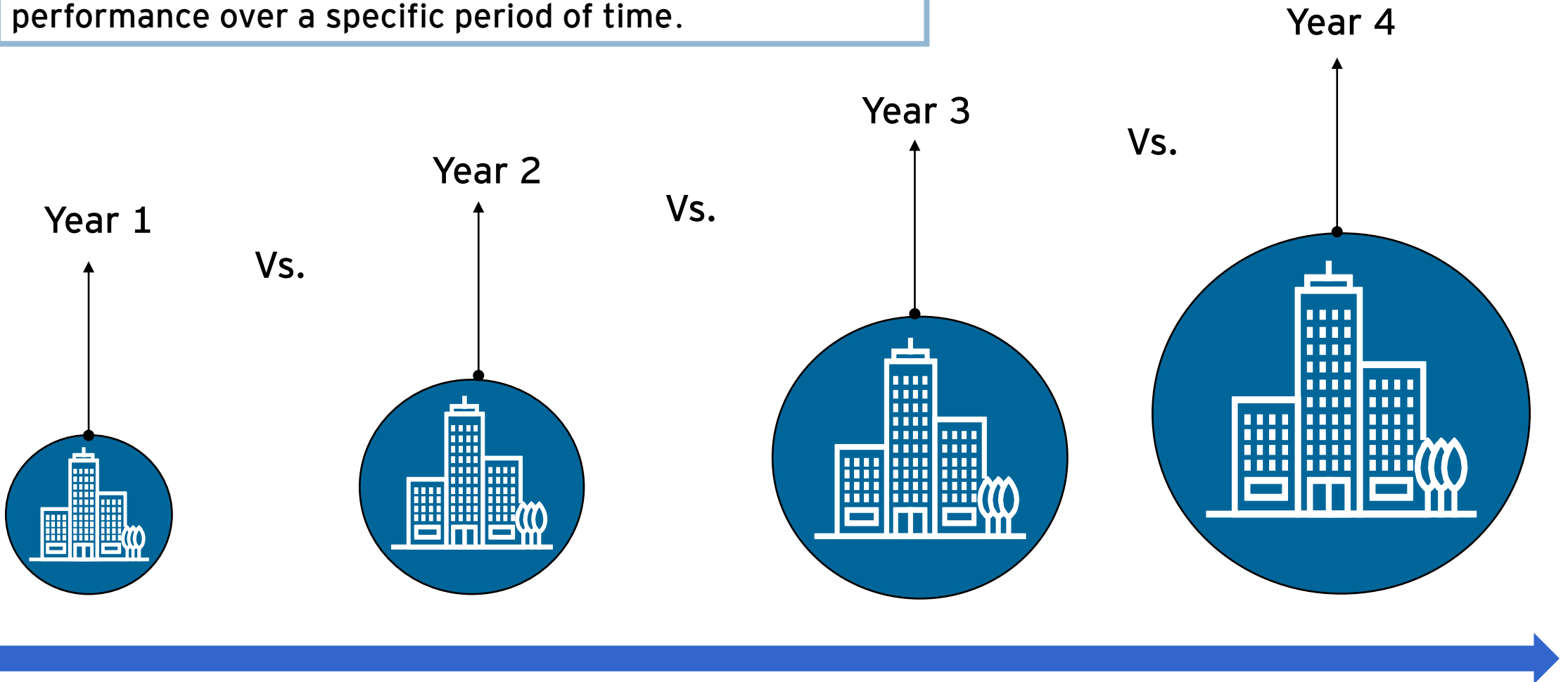
fewer earnings are available to meet interest payments

3

Horizontal and vertical analysis

Horizontal Analysis

Horizontal analysis, or trend analysis, is a method where financial statements are compared to reveal financial performance over a specific period of time.



Vertical Analysis

proportional analysis of a financial statement, where each line item on a financial statement is listed as a percentage of another item.

$$\textcircled{1} \text{ Balance Sheet} = \frac{\text{Balance Sheet item}}{\text{Total Asset or Total liabilities and equity}} \times 100$$

$$\textcircled{2} \text{ Income Statement} = \frac{\text{Income statement item}}{\text{Total Sales}} \times 100$$

4

Illustrative examples


Good Group (International) Limited

Illustrative example | Liquidity Ratios

Current assets		
Inventories	26,027	23,830
Right of return assets	1,124	929
Trade receivables	25,672	22,290
Contract assets	4,541	5,180
Prepayments	244	165
Other current financial assets	551	153
IAS 1.54(d), IFRS 7.8 Cash and short-ter	17,528	14,916
Total current assets	75,687	67,463
Assets held for sale	13,554	–
	89,241	67,463
Total assets	147,371	110,665

Current liabilities		
Trade and other payables	16,969	20,023
Contract liabilities	2,880	2,486
Refund liabilities	6,242	5,844
Interest-bearing loans and borrowings	2,832	3,142
Government grants	149	151
Other current financial liabilities	2,953	254
Income tax payable	3,511	3,563
Provisions	902	156
Dividends payable	410	–
Total current liabilities	36,848	35,619

① Current Ratio



$$= \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

	2021		2020
=	$\frac{75,687}{36,848}$	=	$\frac{67,463}{35,619}$
=	2.05	=	1.89

Illustrative example | Liquidity Ratios

Current assets		
Inventories	26,027	23,830
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2

Quick Ratio



$$= \frac{\text{Liquid Assets}}{\text{Current Liabilities}}$$

2021

2020

$$= \frac{75,687 - 26,027}{36,848}$$

$$= \frac{67,463 - 23,830}{35,619}$$

$$= 1.35$$

$$= 1.22$$

Illustrative example | Activity Ratios

Current assets		
Inventories	26,027	23,830
Right of return assets	1,124	929
Trade receivables	25,672	22,290

Continuing operations	2021	2020
Revenue from contracts with customers	179,058.0	159,088.0
Rental income	1,404.0	1,377.0
Revenue	180,462.0	160,465.0
Cost of sales	(136,549.0)	(128,386.0)
Gross profit	43,913.0	32,079.0

① Receivables Turnover

Receivable Turnover

$$\text{Icon} = \frac{\text{Net Sales}}{\text{Average Trade Receivables}}$$

2021
2020

$$= \frac{180,462}{(25,672 + 22,290)/2} = \frac{160,465}{22,290}$$

$$= 7.56 = 7.20$$

"Days" Ratios

$$\text{Icon} = \frac{365}{\text{Receivable turnover}}$$

2021
2020

$$= \frac{365}{7.56} = \frac{365}{7.20}$$

$$= 48.28 \text{ days} = 50.69 \text{ days}$$

Illustrative example | Activity Ratios

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② Inventory Turnover

Inventory Turnover



$$= \frac{\text{Cost of Sales}}{\text{Average Inventory}}$$

2021

2020

$$= \frac{136,549}{(26,027 + 23,830)/2}$$

$$= \frac{128,386}{23,830}$$

$$= 5.48$$

$$= 5.39$$

"Days" Ratios



$$= \frac{365}{\text{Receivable turnover}}$$

2021

2020

$$= \frac{365}{5.48}$$

$$= \frac{365}{5.39}$$

$$= 66.6 \text{ days}$$

$$= 67.7 \text{ days}$$

Illustrative examples | Profitability Ratios

①

Gross profit margin



$$= \frac{\text{Gross Profit}}{\text{Revenue}}$$

2021

2020

$$= \frac{43,913}{179,058} = \frac{32,089}{159,088}$$

$$= 24.52\% = 20.17\%$$

Continuing operations	2021	2020
Revenue from contracts with customers	179,058.0	159,088.0
Rental income	1,404.0	1,377.0
Revenue	180,462.0	160,465.0
Cost of sales	(136,549.0)	(128,386.0)
Gross profit	43,913.0	32,079.0
Other operating income	2,435.0	2,548.0
Selling and distribution expenses	(14,001.0)	(12,964.0)
Administrative expenses	(18,290.0)	(12,011.0)
Other operating expenses	(2,554.0)	(353.0)
Operating profit	11,503.0	9,299.0
Finance costs	(1,366.0)	(1,268.0)
Finance income	202.0	145.0
Other income	98.0	66.0
Share of profit of an associate and a joint venture	671.0	638.0
Profit before tax from continuing operations	11,108.0	8,880.0
Income tax expense	(3,098.0)	(2,233.0)
Profit for the year from continuing operations	8,010.0	6,647.0
Discontinued operations		
Profit/(loss) after tax for the year from discontinued operations	220.0	(188.0)

Illustrative examples | Profitability Ratios

2

Operating profit margin



$$= \frac{\text{Operating income}}{\text{Revenue}}$$

2021

2020

$$= \frac{11,503}{180,462} = \frac{9,299}{160,465}$$

$$= 6.37\% = 5.80\%$$

Continuing operations	2021	2020
Revenue from contracts with customers	179,058.0	159,088.0
Rental income	1,404.0	1,377.0
Revenue	180,462.0	160,465.0
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Illustrative example | Return Ratios

	<u>2021</u>	<u>2020</u>
Assets		
Non-current assets		
Property, plant and equipment	32,979	24,329
Investment properties	8,893	7,983
Intangible assets and goodwill	6,019	2,461
Right-of-use assets	2,908	2,732
Investment in an associate and a joint v	3,187	2,516
Deferred tax assets	383	365
Non-current financial assets	3,761	2,816
Total non-current assets	58,130	43,202
Current assets		
Inventories	26,027	23,830
Right of return assets	1,124	929
Trade receivables	25,672	22,290
Contract assets	4,541	5,180
Prepayments	244	165
Other current financial assets	551	153
IAS 1.54(d), IFRS 7.8 Cash and short-ter	17,528	14,916
Total current assets	75,687	67,463
Assets held for sale	13,554	—
	89,241	67,463
Total assets	147,371	110,665

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Profit for the year from continuing operations	8,010.0	6,647.0

Return of assets



$$= \frac{\text{Net income}}{\text{Average Total Assets}}$$

2021

2020

$$= \frac{8,010}{(147,371 + 110,665)/2} = \frac{6,647}{110,665}$$

$$= 6.20\% = 6\%$$

Illustrative example | Return Ratios

Equity and liabilities	2021	2020
Equity		
Issued capital	21,888	19,388
Share premium	4,780	80
Treasury shares	(508)	(654)
Other capital reserves	1,171	864
Retained earnings	31,636	25,929
Other components of equity	(642)	(505)
Reserves of a disposal group held for sale	46	
Equity attributable to equity holders of the	58,371	45,102
Non-controlling interests	2,410	740
Total equity	60,781	45,842

Finance costs	(1,366.0)	(1,268.0)
Finance income	202.0	145.0
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Profit for the year from continuing operations	8,010.0	6,647.0

Return on Equity




$$= \frac{\text{Earnings before income tax}}{\text{Average total capital}}$$

$$= \frac{11,108}{(60,781 + 45,842)/2} = \frac{8,880}{45,842}$$

$$= 20.83\% = 19.37\%$$

Ratio Analysis | Solvency Ratios

① Debt to total assets



$$= \frac{\text{Debt}}{\text{Total Assets}}$$

$$= \frac{2,832 + 22,147}{147,371} \quad = \frac{3,142 + 23,313}{110,665}$$

$$= 16.95\% \quad = 23.91\%$$

Non-current liabilities		
Interest-bearing loans and borrowings	22,147	23,313
Other non-current financial liabilities	806	
Provisions	1,898	19
Government grants	3,300	1,400
Contract liabilities	2,962	888
Net employee defined benefit liabilities	3,050	2,977
Deferred tax liabilities	2,454	
	<hr/>	<hr/>
	36,617	29,204
Current liabilities		
Trade and other payables	16,969	20,023
Contract liabilities	2,880	2,486
Refund liabilities	6,242	5,844
Interest-bearing loans and borrowings	2,832	3,142
Government grants	149	151
Other current financial liabilities	2,953	254
Income tax payable	3,511	3,563
Provisions	902	156
Dividends payable	410	-
Total current liabilities	<hr/>	<hr/>
	36,848	35,619

Total current assets	75,687	67,463
Assets held for sale	13,554	-
	<hr/>	<hr/>
	89,241	67,463
Total assets	<hr/>	<hr/>
	147,371	110,665

Ratio Analysis | Solvency Ratios

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Profit for the year from continuing operations	8,010.0	6,647.0

② Time interest earned

$$\begin{aligned}
 \text{Icon} &= \frac{\text{Earnings before income tax}}{\text{Interest expense}} = \frac{\overset{2021}{11,108}}{1,366} = \frac{\overset{2020}{8,880}}{1,268} \\
 &= 8.13 = 7.01
 \end{aligned}$$

Horizontal Analysis – Balance Sheet

	<u>2021</u>	<u>2020</u>	Movement	% Change
Assets				
Non-current assets				
Property, plant and equipment	32,979	24,329	8,650	36%
Investment properties	8,893	7,983	910	11%
Intangible assets and goodwill	6,019	2,461	3,558	145%
Right-of-use assets	2,908	2,732	176	6%
Investment in an associate and a joint venture	3,187	2,516	671	27%
Non-current financial assets	3,761	2,816	945	34%
Deferred tax assets	383	365	18	5%
	58,130	43,202	14,928	35%
Current assets				
Inventories	26,027	23,830	2,197	9%
Right of return assets	1,124	929	195	21%
Trade receivables	25,672	22,290	3,382	15%
Contract assets	4,541	5,180	(639)	-12%
Prepayments	244	165	79	48%
Other current financial assets	551	153	398	260%
Cash and short-term deposits	17,528	14,916	2,612	18%
	75,687	67,463	8,224	12%
Assets held for sale	13,554	-		
	89,241	67,463	21,778	32%
Total assets	147,371	110,665	36,706	33%



Horizontal Analysis – Balance Sheet

	<u>2021</u>	<u>2020</u>	Movement	% Change
Non-current liabilities				
Interest-bearing loans and borrowings	22,147	23,313	(1,166)	-5%
Other non-current financial liabilities	806	-		
Provisions	1,898	19	1,879	9889%
Government grants	3,300	1,400	1,900	136%
Contract liabilities	2,962	888	2,074	234%
Net employee defined benefit liabilities	3,050	2,977	73	2%
Deferred tax liabilities	2,454			
	<hr/> 36,617	<hr/> 29,204	<hr/> 7,413	<hr/> 25%
Current liabilities				
Trade and other payables	16,969	20,023	(3,054)	-15%
Contract liabilities	2,880	2,486	394	16%
Refund liabilities	6,242	5,844	398	7%
Interest-bearing loans and borrowings	2,832	3,142	(310)	-10%
Other current financial liabilities	2,953	254	2,699	1063%
Government grants	149	151	(2)	-1%
Income tax payable	3,511	3,563	(52)	-1%
Provisions	902	156	746	478%
Dividends payable	410	-		
	<hr/> 36,848	<hr/> 35,619	<hr/> 1,229	<hr/> 3%
Liabilities directly associated with the assets held for sale	13,125	-		
	<hr/> 49,973	<hr/> 35,619	<hr/> 14,354	<hr/> 40%
Total liabilities	<hr/> 86,590	<hr/> 64,823	<hr/> 21,767	<hr/> 34%
Total equity and liabilities	<hr/> <hr/> 147,371	<hr/> <hr/> 110,665	<hr/> <hr/> 36,706	<hr/> <hr/> 33%

Horizontal Analysis – Balance Sheet

Equity	<u>2021</u>	<u>2020</u>	Movement	% Change
Issued capital	21,888	19,388	2,500	13%
Share premium	4,780	80	4,700	5875%
Treasury shares	(508)	(654)	146	-22%
Other capital reserves	1,171	864	307	36%
Retained earnings	31,636	25,929	5,707	22%
Other components of equity	(642)	(505)	(137)	27%
Reserves of a disposal group held for sale	46			
Equity attributable to equity holders of the par	58,371	45,102	13,269	29%
Non-controlling interests	2,410	740	1,670	226%
Total equity	60,781	45,842	14,939	33%

Horizontal Analysis – Income Statement

	<u>2021</u>	<u>2020</u>	Movement	% Change
Continuing operations				
Revenue from contracts with customers	179,058	159,088	19,970	13%
Rental income	<u>1,404</u>	<u>1,377</u>	27	2%
Revenue	180,462	160,465	19,997	12%
Cost of sales	<u>(136,549)</u>	<u>(128,386)</u>	(8,163)	6%
Gross profit	43,913	32,079	11,834	37%
Other operating income	2,435	2,548	(113)	-4%
Selling and distribution expenses	(14,001)	(12,964)	(1,037)	8%
Administrative expenses	(18,290)	(12,011)	(6,279)	52%
Other operating expenses	<u>(2,554)</u>	<u>(353)</u>	(2,201)	624%
Operating profit	11,503	9,299	2,204	24%
Finance costs	(1,366)	(1,268)	(98)	8%
Finance income	202	145	57	39%
Other income	98	66	32	48%
Share of profit of an associate and a joint venture	<u>671</u>	<u>638</u>	33	5%
Profit before tax from continuing operations	11,108	8,880	2,228	25%
Income tax expense	<u>(3,098)</u>	<u>(2,233)</u>	(865)	39%
Profit for the year from continuing operations	8,010	6,647	1,363	21%

Vertical Analysis – Balance Sheet

	<u>2021</u>	<u>% per item</u>
Assets		
Non-current assets		
Property, plant and equipment	32,979	22%
Investment properties	8,893	6%
Intangible assets and goodwill	6,019	4%
Right-of-use assets	2,908	2%
Investment in an associate and a joint venture	3,187	2%
Non-current financial assets	3,761	3%
Deferred tax assets	383	0%
	<hr/>	
	58,130	
Current assets		
Inventories	26,027	18%
Right of return assets	1,124	1%
Trade receivables	25,672	17%
Contract assets	4,541	3%
Prepayments	244	0%
Other current financial assets	551	0%
Cash and short-term deposits	17,528	12%
	<hr/>	
	75,687	
Assets held for sale	13,554	9%
	<hr/>	
	89,241	
Total assets	<hr/> <hr/>	<hr/> <hr/>
	147,371	100%



Vertical Analysis – Balance Sheet

	<u>2021</u>	<u>% per item</u>
Non-current liabilities		
Interest-bearing loans and borrowings	22,147	15%
Other non-current financial liabilities	806	1%
Provisions	1,898	1%
Government grants	3,300	2%
Contract liabilities	2,962	2%
Net employee defined benefit liabilities	3,050	2%
Deferred tax liabilities	2,454	2%
	<hr/>	
	36,617	
Current liabilities		
Trade and other payables	16,969	12%
Contract liabilities	2,880	2%
Refund liabilities	6,242	4%
Interest-bearing loans and borrowings	2,832	2%
Other current financial liabilities	2,953	2%
Government grants	149	0%
Income tax payable	3,511	2%
Provisions	902	1%
Dividends payable	410	0%
	<hr/>	
	36,848	
Liabilities directly associated with the assets held for sale	13,125	9%
	<hr/>	
	49,973	
Total liabilities	<hr/>	
	86,590	
Total equity and liabilities	<hr/>	
	147,371	100%

	<u>2021</u>	<u>% per item</u>
Equity and liabilities		
Equity		
Issued capital	21,888	15%
Share premium	4,780	3%
Treasury shares	(508)	0%
Other capital reserves	1,171	1%
Retained earnings	31,636	21%
Other components of equity	(642)	0%
Reserves of a disposal group held for sale	46	0%
Equity attributable to equity holders of the par	<hr/>	
	58,371	
Non-controlling interests	2,410	2%
Total equity	<hr/>	
	60,781	

Vertical Analysis – Income Statement

	<u>2021</u>	<u>2021</u>
Continuing operations		
Revenue from contracts with customers	179,058	99.2%
Rental income	<u>1,404</u>	0.8%
Revenue	180,462	100.0%
Cost of sales	<u>(136,549)</u>	-75.7%
Gross profit	43,913	
Other operating income	2,435	1.3%
Selling and distribution expenses	(14,001)	-7.8%
Administrative expenses	(18,290)	-10.1%
Other operating expenses	<u>(2,554)</u>	-1.4%
Operating profit	11,503	
Finance costs	(1,366)	-0.8%
Finance income	202	0.1%
Other income	98	0.1%
Share of profit of an associate and a joint venture	<u>671</u>	0.4%
Profit before tax from continuing operations	11,108	6.2%
Income tax expense	<u>(3,098)</u>	-1.7%
Profit for the year from continuing operations	8,010	4.4%
Discontinued operations		
Profit/(loss) after tax for the year from discontinued operations	<u>220</u>	0.1%
Profit for the year	8,230	4.6%



5

Question and answer

A person with long dark hair, wearing a light-colored jacket and a shoulder bag, stands in a library aisle. The shelves are filled with books. The text 'Thank you!' is overlaid in large black font. On the left, a sign reads '防犯カメラ設置' (Security camera installation). In the center, a sign titled '金額の見方' (How to see the amount) lists '800円', '500円', and '200円'.

Thank you!

防犯カメラ設置

金額の見方

800円
500円
200円