Corporate finance MMIC

F. HAHNLEN

Course outline

- 1/ Review of financial statements : I/S; CF/S, B/S
- 2/ Introduction to Value creation & ROCE (return on capital employed)
  - Economic balance sheet
  - Setting up a business
  - ROCE
- 3/ Financial analysis & diagnosis
  - Case

- Review of financial statements

Financial statements under IFRS

French GAAPs vs IFRS

- Similarities
  - Fix accounting principles and rules so to harmonise the financial information delivered to sharelholders & third parties
- Differences

French GAAP	IFRS
Use : **nationally** by investors and Third parties	**Internationally** by financial markets for listed companies
They •determine the fiscal income according to local fiscal rules, •State the criminal penalty as regards •the distorsion in the books to the GAAPs •Or the computation of dividends served according to commercial code	•IFRS GAAPs are adopted and in force in Europe and considered as LAWs to any listed European ie French companies; •The compliance is the Auditor's duty under the control of the Regulator (AMF in France) •In case of non compliance AMF is entitled to take the representatives and the company to court

- Understand what is the **CORPORATION** and how can it be represented in terms of **FINANCIAL STATEMENTS**
- Understand **THREE** financial statements, i.e.
  - **the income statement,**
  - **the balance sheet,**
  - **the cash-flow statement**

Review of financial statements

- The **income statement** shows the components of **net income** in details.
- Revenues & Expenses (costs)
  - Operating revenues & exp
  - *Non operating revenues & exp*
  - Financial revenues & exp

Review of financial statements

- The income statement shows the components of net income in details
- Each section of the Income statement
  - **Operating** profit = Op. revenues – op. expenses
  - **Financial** result = Fin revenues – Fin expenses

- **Net income**

  Net income = sum of all results – corporate tax

Review of financial statements

The Income Statement (FRENCH GAAPS + KPIs)

	Sales	Goods, services sold
-	Cost of supplies (consumption)	RM, goods & change in inventories
=	**Gross profit**	
-	Staff costs	Wages & social charges
-	Selling General &Administrative expenses	Property costs, telecomms, travel, insurance, transportation, IT costs, maintenance, consulting, bank fees, marketing, subcontracting, stationery …
=	**EBITDA**	
-	**Depreciation on fixed assets**	**NON CASHABLE and FICTIVE expense**
=	**EBIT**	Profit on core **current/recurring** operations
+/-	Non current revenues or expenses	**Divestiture, unusual revenues and expenses**
=	**OPERATING PROFIT**	
-/+	Financial result	Financial revenues and expenses (interests paid)
=	**profit before tax**	
-	Income tax	Tax on taxable income
=	**Net income**	Net income (profits or losses)

Financial statements under IFRS

Financial statements under IFRS

- I/S

Beware of non current result !

PRESENTATION by NATURE		PRESENTATION by FUNCTION	
REVENUES	100	REVENUES	100
COST OF SUPPLIES	- 15	COST OF SALES*	- 31
CHANGE IN INVENTORIES	- 5	**GROSS PROFIT***	**69**
OVERHEADS	-19	R&D COSTS*	- 5
TAXES	- 3	DISTRIBUTION COSTS*	- 15
STAFF COSTS	-15	ADMINISTRATION COSTS*	- 10
DEPRECIATION OF FIXED ASSETS	- 3		
WRITE DOWN OF ALLOWANCES	- 1		
OPERATION INCOME *	**39**	**OPERATION INCOME ***	**39**
FINANCIAL RESULT	- 6	FINANCIAL RESULT	- 6
CORPORATE TAX	- 11	CORPORATE TAX	- 11
NET INCOME FROM CONTINUING OPERATIONS*	**22**	**NET INCOME FROM CONTINUING OPERATIONS***	**22**
NET INCOME FROM DISCONTINUED OPERATIONS*	**- 2**	**NET INCOME FROM DISCONTINUED OPERATIONS***	**- 2**
NET INCOME	**20**	**NET INCOME**	**20**

Review of financial statements

The Income Statement Format (BY FUNCTION)

	Sales	Goods, services sold
+	Other revenues from operation	Fees, write back of provisions
=	**Total operating revenues**	Revenues exclusively from operations
-	Cost of goods sold/cost of sales	**Direct costs to sales/products** : supplies, wages, overheads, depreciations (production costs)
=	**Gross profit**	
-	Administration/R&D/Distribution costs	**Indirect costs**
-	Non current result	divestiture, unusual revenues and expenses
=	**OPERATING PROFIT**	
-/+	Net cost of debt	Financial revenues and expenses (interests paid)
=	**profit before tax**	
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Financial statements under IFRS

Financial statements under IFRS

- I/S

PRESENTATION BY NATURE	
Operating income	Main differences between French GAAP and IFRS are to be identified here. Non recurring items (revenues and expenses) must be disclosed in the Income Statement but are included in the operating income and not in « exceptional result ».. Operating income is to breakdown as follows : Recurring operating income (which reflects the current performance of core activities and rather similar to the EBIT) Non recurring operating income consist on unusual items which can distort the assessment of the business performance like restructuring costs, capital gains on disposals, other income or expenses relating to claims and litigation in relation to third parties
Net income from continuing operations	Another characteristic of the IFRS principles is to segregate accounts between continuing operations on one hand and discontinued operations on the other hand. As regards the mergers, acquisitions, business divestitures dealt by listed companies this is invaluable to the financial markets to focus on continuing operations to see what portion of the current income can be replicate in the future.
Net income from discontinued operations	Discontinued operations are component of a company that has been disposed of or is classified as held for sale at closing date. Under IFRS net income from these operations must be disclosed separately in the Income Statement.
Net income	Difference between all revenues and expenses either from continuing or discontinued operations. Net income determines wether the company is profitable. In other words is the company delivering a return to the shareholders ?

Financial statements under IFRS

Financial statements under IFRS

- I/S

PRESENTATION PAR FONCTION	
Cost of sales	all the costs of a product sold, including manufacturing costs and the staff costs of the production department, before a general overhead is calculated
Gross profit	the difference between an firm's sales revenue and the cost of goods sold. Gross profit does not include distribution, administration, or finance costs
R&D expenses	They reflect the related development costs incurred by a company. They should be charged to expense. Development costs are capitalized only after technical and commercial feasability of the asset for sale or use have been established.
Distribution costs	They represent all costs related to the selling and distribution of the products, goods or services (they include staff costs, overheads, marketing expenses etc…)
Administration costs	All other costs which are not allocated to the other functions are considered as administration costs.

Financial statements under IFRS

Financial statements under IFRS

- I/S

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Review of financial statements

The Income Statement (second possible presentation : IFRS/US Gaap => bu function)

GLOBAL CONGLOMERATE CORPORATION

Income Statement
Year Ended December 31 (in $ million)

	2018	2017
Total sales	186.7	176.1
Cost of sales	(153.4)	(147.3)
Gross Profit	33.3	28.8
Selling, general, and administrative expenses	(13.5)	(13.0)
Research and development	(8.2)	(7.6)
Depreciation and amortization	(1.2)	(1.1)
Operating Income	10.4	7.1
Other income	—	—
Earnings Before Interest and Taxes (EBIT)	10.4	7.1
Interest income (expense)	(7.7)	(4.6)
Pretax Income	2.7	2.5
Taxes	(0.7)	(0.6)
Net Income	2.0	1.9

ACCOR

Review of financial statements

(€ in million)	Notes	2018 (*)	2019
Revenue	3	**3,282**	**4,049**
Operating expenses	3	(2,656)	(3,224)
EBITDA	3	**626**	**825**
Depreciation, amortization and provision expenses		(120)	(328)
EBIT		**505**	**497**
Share of net profit of associates and joint-ventures	5	80	3
EBIT including profit of associates and joint-ventures		**585**	**501**
Other income and expenses **Unusual income**	6	(432)	177
Operating profit		**153**	**678**
Financial result	10	(63)	(75)
Income tax	11	(109)	(138)
Profit from continuing operations		**(19)**	**465**
Profit from discontinued operations	2	2,303	20
Net profit of the year		**2,284**	**485**

Representing a firm as a **balance sheet**

- It is convenient to represent a firm in a two-pane view:
  - **Right**-hand side of the table : The **RESOURCES provided to the firm**, i.e. shareholders capital and liabilities (what the company **OWES)**
  - **Left**-hand side of the table : The uses of that resources, i.e. the **ASSETS** (what the company **OWNS)**
  - The sum of shareholders' capital + liabilities is used to purchase the assets, hence :

$$\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$$

Accounting equation

Financial statements under IFRS

Financial statements under IFRS

- B/S

Intangible assets	Represent goods or rights that have no material character (that we cannot touch). For instance : such as patents, software, purchased business assets, leasehold rights and trademarks or even Goodwill (in consolidated statements only).
Tangible assets	Are composed of the material properties used to serve the activity of the company in a lasting manner. For instance : lands, constructions, machines, technical installations, furnitures, office equipment, transportation material .
Financial assets	Are mainly held parts of the share capital of subsidiaries (called equity securities) or guarantee deposits paid to third parties, as well as loans given to subsidiaries or, on occasion given to employees
Derivative financial instruments	A derivative is a financial instrument recognized at market value in the non current assets whose value changes in response to the change in an underlying variable such as an interest rate, commodity or security price, or index; that requires no initial investment, or one that is smaller than would be required for a contract with similar response to changes in market factors; and that is settled at a future date. For instance : forward contracts, swaps, futures, options
Deferred tax	Deferred tax assets are the amounts of income taxes recoverable in future periods in respect of: •deductible temporary differences •the carryforward of unused tax losses, and •the carryforward of unused tax credits Deferred tax liabilities are The amounts of income taxes payable in future periods in respect of taxable temporary differences

Financial statements under IFRS

Financial statements under IFRS

- B/S

Inventories	Are the amount of all the goods and services that are intended to be sold or consumed within the financial year, but that are physically present in the company at the closing date. They can be inventories of raw materials, goods, work in progress products or services and finished goods
Trade receivables	Consist of the invoices that still have to be paid by the customers.
Other receivables	We can mention down payments to employees, social entities, State, and to suppliers.
Cash & Cash equivalents	Composed of two kinds of cash account : •**Bank and marketable securities :** correspond to the bank account and some types of short-term investments. Cash equivalents include certificates of deposit and term deposits with a maturity of less than three months. They are recorded at fair value. Any change in the market value will be written off the net income. •**Cash on hand** : corresponds to the liquid money the company has for its minor daily expenses .

Financial statements under IFRS

Financial statements under IFRS

- B/S

Share capital	Comprises a number of fully paid-up shares at par value. Share capital represents the contributions given to the company by the associates or the shareholders. It cannot be modified without a specific legal procedure, also called "the rule of capital fixity".
Reserves & Net income	Retained earnings consist of the previous profits generated by the company and not distributed as dividends. Net income corresponds to the profit or loss incurred during the financial year A distinction between net income from continuing operations and net income from discontinued operations must be done to allow the users of financial statements to make projections of an enterprise's cash flows, earnings-generating capacity and financial position.
Financial debt	The financial debts incorporate the loans contracted with the credit institutions or issued in financial markets like bonds or commercial paper including also financial leases. The whole can be named the Debt. This is a significant difference with the French GAAP which consider financial leases as off-balance sheet liabilities. Current portion of long term debt and short term facilities are shown in CURRENT LIABILITIES
Provisions	An entity must recognize a provision if, and only if: a present obligation (legal or constructive) has arisen as a result of a past event (the obligating event), payment is probable ('more likely than not'), and the amount can be estimated reliably For instance : provisions for claims and litigations, but also for pensions and post employment benefits Those latter are considered as off-balance sheet liabilities under French GAAP
Trade payables	Suppliers payables consist of what is due to trade suppliers or equipment suppliers, that are awaiting payment at the closing date.
Other current liabilities	Include in particular the tax and social debts but also salaries to be paid…

BALANCE SHEET
A snapshot at a point in time

USES OF RESOURCES !!

RESOURCES !!

Assets of "Firm", in m$	2018	2017
Current assets		
Cash	21.2	19.5
Accounts receivable	18.5	13.2
Inventories	15.3	14.3
Other current assets	2.0	1.0
Total current assets	**57.0**	**48.0**
Long-term assets		
Land	22.2	20.7
Buildings	56.5	50.5
Equipment	49.7	43.2
Accumulated depreciation	18.7	17.5
Net property, plant, and equipment	*109.7*	*96.9*
Goodwill and intangible assets	20.0	20.0
Other long-term assets	21.0	14.0
Total long-term assets	**150.7**	**130.9**
Total assets	**207.7**	**178.9**

<1y

>1y

Liabilities of "firm", in m$	2018	2017
Current liabilities		
Short term debt	3.5	3.2
Accounts payable	29.2	24.5
Current maturities of long-term debt	13.3	12.3
Other current liabilities	2.0	4.0
Total current liabilities	**48.0**	**44.0**
Long term liabilities		
Long-term debt	99.9	76.3
Capital lease obligations	7.6	7.4
Total long-term liabilities	**107.5**	**83.7**
Total liabilities (ST+LT)	**155.5**	**127.7**
Stockholders' equity	**52.2**	**51.2**
Total resources	**207.7**	**178.9**

Review of financial statements

- **Assets** : resources to the company to generate future cash inflows and value, and are cash, **current** assets versus **non current** assets ie property, plant and equipment, long-term investments…

==========

- **Liabilities** : obligations of the company to third parties and are classified according to payment date (**current** liabilities, **long-term** liabilities)
- **Stockholders' equity** : the residual claims of the owners, and is classified based on source (contributed capital and retained earnings)

Review of financial statements

- **Current assets include (<1y)**
  - **Cash** ie checking and savings accounts, petty cash.
  - **Cash equivalents :** Deposits, short-term investments in monetary funds (non risky securities),
  - **Accounts receivables/Trade receivables/Trade debtors** : amounts owed to the firm by its customers,
  - **Inventories** : raw material, work in progress, semi-finished & finished products, goods, on hand designated for sale to customers,
  - **Other receivables** ie value-added tax, prepaid income tax,…

Review of financial statements

- **Non current assets (>1y) are commonly split into 3 main categories :**
  - Intangible, tangible or financial assets

- **Intangible assets (>1y) are :**
  Long-lived assets that have no physical substance such as :
  - **Patents** : legal claim to produce and sell a product,
  - R&D costs, etc…
  - Copyrights : legal claims to books, art, music and other created works,

  - *Goodwill in consolidated statements **only** (recognized when one company buys another company. It is the difference between the purchase price and the fair value of the identifiable assets of the target)*

Review of financial statements

- **Tangible assets (>1y) may be** :
- Physical Assets acquired/owned as :
  - Property, plant, and equipment are assets that are used in the **production of goods and services**.

  - These productive assets are long-term in nature, and include the following:
    - **Land** : property upon which the productive facilities are located
    - **Building** : the physical structure of the company's operations.
    - **Fittings & fixtures** : heating system, ceilings, carpets, paintings, integrated appliances, flooring, doors, windows…
    - **Machinery and equipment** : ie operating machinery, vehicles,
    - **Furniture** movable equipment (chairs, computers, electronic equipment, tables, bookcases, etc…)
    - **Hardware :** computers & associated software, copy machines, etc.

Review of financial statements

- **Financial assets (>1y) : Long-term investments**

  Assets acquired by the company to provide long-term benefits to the company ie :

  - **Investments in bonds or stocks of other companies** : held for expectation of dividends and/or stock price increase (subsidiaries)

Review of financial statements

- **Current liabilities (<1y) are**

  obligations expected to be paid within the next year/s

  - The elimination of the current liabilities requires the use of current assets (most commonly cash).
  - **Accounts/trade payables/Trade creditors** : from suppliers
  - **Other payables/Other current liabilities** : Wages payable (wages due at the given date to employees), social charges, deferred (unearned) revenues, tax payables, debt on fixed assets,…)
  - **Short-term notes payable** (interest bearing obligations, including bank and commercial paper)
  - **Current maturities** (<1y) of long-term debt : annual instalment of MLT debt

Review of financial statements

- **Long-term liabilities are**

  Medium long term debt ie obligations expected to be paid in the next years.

  - **Notes payable**: amounts owed to banks beyond the current year (long term / plain vanilla loans).
  - **Mortgage loans** : amounts owed to mortgage company beyond the current year.
  - **Bonds** : amounts owed to investors holding bond investments issued by the company, where payments of principal and interest are beyond the current year.
  - Loans

Review of financial statements

- **Shareholder's equity**
- Money invested by shareholders in the firm
  - **Contributed/Paid in capital is invested in the firm when owners** (shareholders) **of the company contribute cash** or other assets into the company.
  - **Common stock:** stock commonly issued with one voting right to owners to reflect ownership (shares)

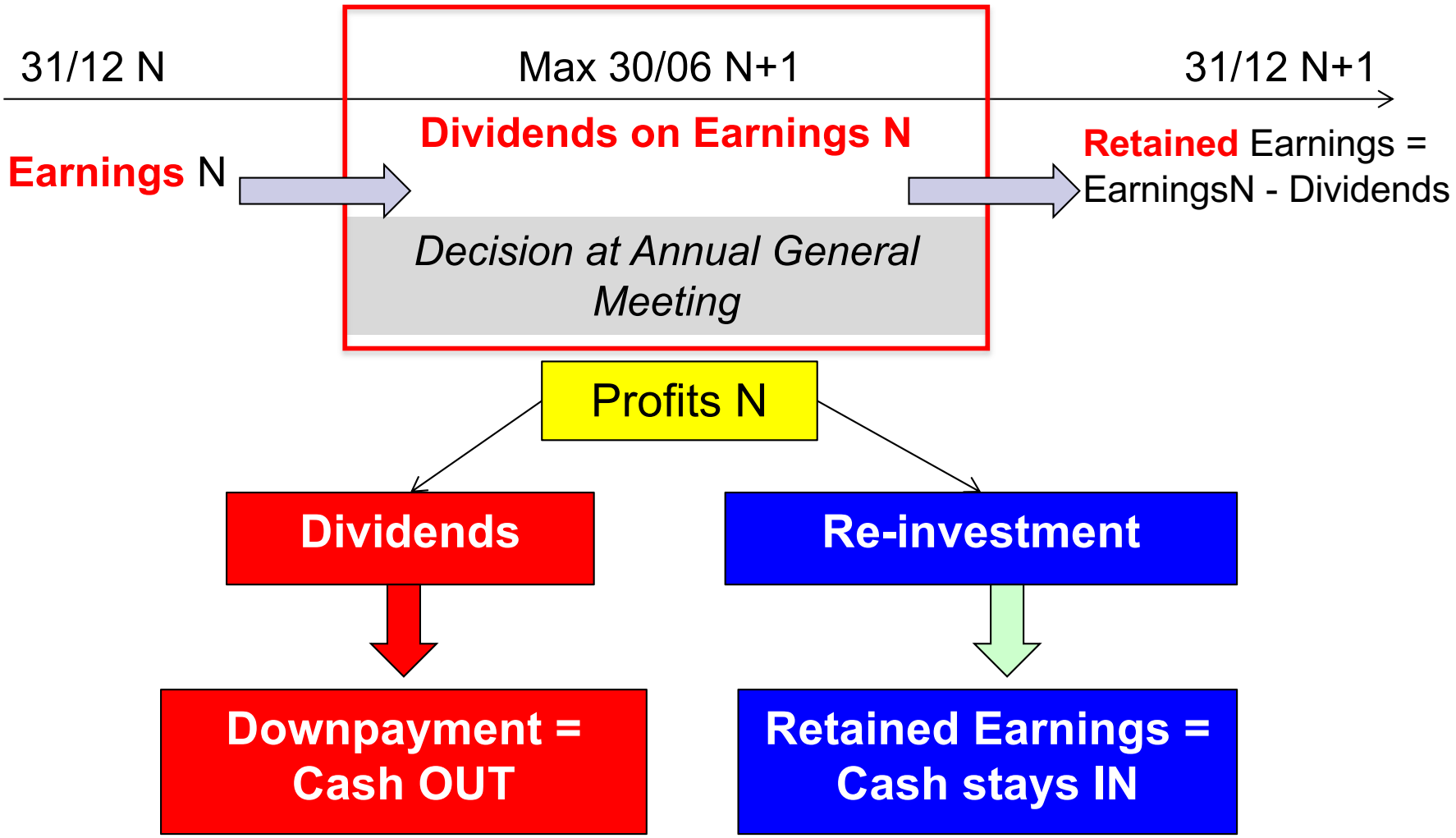
Review of financial statements

- **Shareholder's equity**
- Retained earnings represent past earnings reinvested in the firm
- The excess earnings retained in the company **after dividends** have been paid to shareholders.
- This represents the internal **equity generated** by the company (self financing).
- This is one of the key measures of performance of the Cy (return on equity)

Review of financial statements

- Basics about EARNINGS and DIVIDENDS
  - Earnings ie Net income are generated by the Firm
    - **Earnings >0 : profits => Dividends can be paid out**
    - **Earnings <0 : losses => Dividends can not be paid out**
  - Dividends are Part of Earnings (net income) paid out to shareholders as the Earnings are owned by shareholders (as they own the firm)
  - **Dividends can be paid in cash**, in stocks or in kind.
  - We will focus on the **cash payment of dividends**

Review of financial statements



Review of financial statements

The Shareholders' Equity

- This statement explains the changes in contributed capital and retained earnings in 2020.
- A basic version of the SSE is represented in the following table :

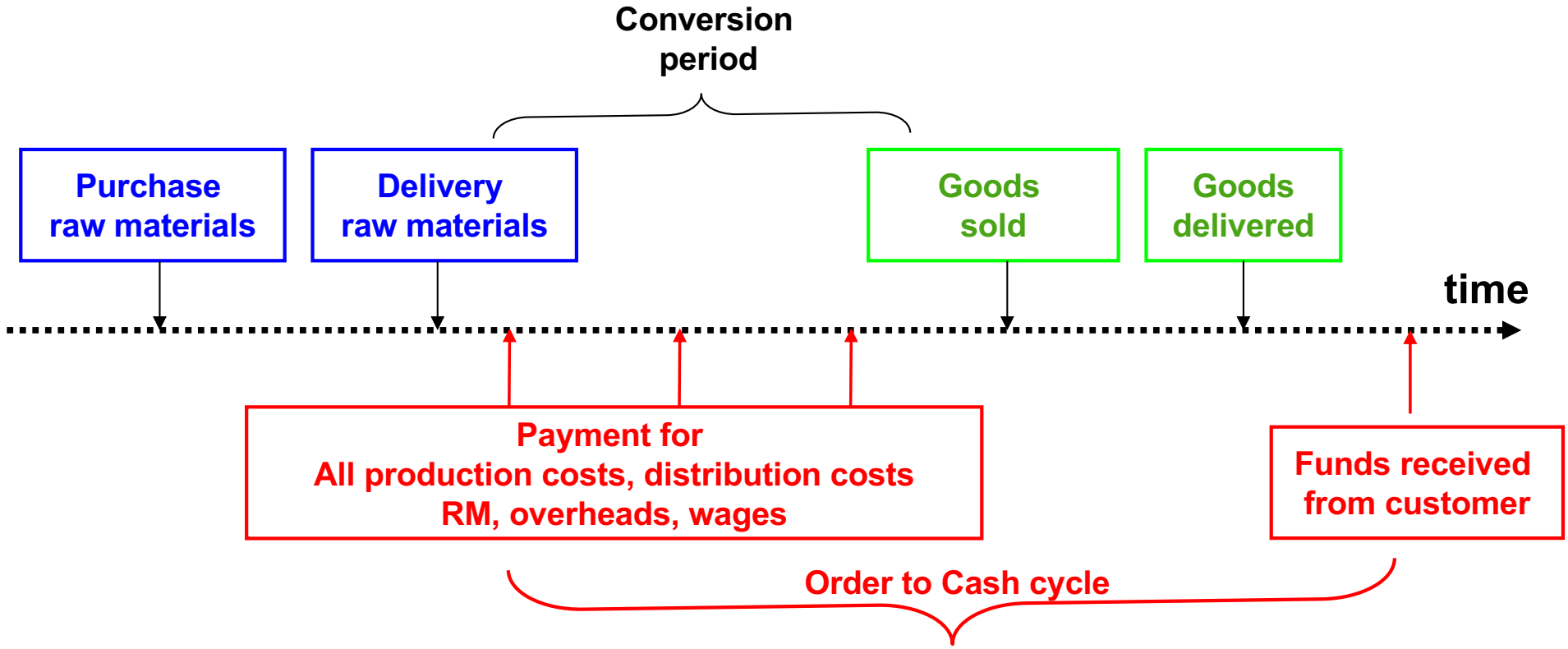
	Contributed Capital	Retained Earnings	Total
Dec. 31, 2024	**6,000**	**500**	**6,500**
- Dividends 2024		*(200)*	*(200)*
+ Issue of stock	*3,000*		*3,000*
+Net income 2025		*1,000*	*1,000*
Dec. 31, 2025	**9,000**	**1,300**	**10,300**

Shareholders equity 2024 is **increased** by the profits made in 2025 + a capital increase of 3,000 et **reduced** by 200 dividends paid out of the net income 2024

Review of financial statements

- **Cash cycle management & WCR**
  - Cash cycle exposure arises as a result of the timing difference between purchases settlements and their ultimate sales processing (collections).

“THE LONGER THE WORST !!!”



Review of financial statements

OPERATING WORKING CAPITAL REQUIREMENT

Inventories	Raw materials, goods for resale, products & work in progress, finished products
+Trade receivables	Amounts owed by customers
+Other receivables	Prepayments to suppliers, other trade receivables
-Trade payables	Amounts owed to suppliers
-Other payables	Wages payables, social security, tax payables, prepayment received from customers…
= **Operating** WCR	

Review of financial statements

- **WCR management**
  - A measure of both a company's efficiency and its short-term financial health…
  - The operating cash cycle requires on one hand to
    - **"freeze" capital in** :
      - inventories of raw material, production costs (semi & finished products…),
      - Customer receivables ie sales that have not been paid yet,
    - **"Borrow" capital from :**
      - Suppliers and other creditors (administration tax, etc…) as you have not paid them yet
  - **So it is the difference between operating inflows and outflows**

Review of financial accounting

- **Working capital management**
  - Working capital is part of the capital employed by a business.
  - As such capital employed is financed by two main types of funds
    - Shareholder's equity and/or debt
  - Two main principles of Working Capital
    - **Working capital is Permanent**
    - **Working capital is Liquid**
- **Most businesses absorb cash !! (ie WC>0)**

Review of financial accounting

- **Working capital management**
  - Looking at the working capital position is being able to **foresee any financial difficulties that may arise**.
  - *Even a business that has billions of dollars in fixed assets will quickly find itself in bankruptcy court if it can't pay its monthly bills.*
  - **Poor working capital leads to financial pressure on a company**, increased borrowing, and late payments to creditor - all of which result in a lower credit rating.
  - *A lower credit rating means banks charge a higher interest rate, which can cost a corporation a lot of money over time*.

Exercise 1 –Understanding Retained earnings & WCR

- Assume an opening balance sheet as follows……

Assets	E	Liabilities+SE	E
Cash	1000	Paid in Capital	1000

- Purchase inventories for 800 E cash. Prepare a B/S.
- Sell the entire inventory for 950 E cash. Prepare a B/S.
- Buy an equipment for 800 E cash.
  - What does RE represent ?

Exercise 2 – Understanding RE & WCR

- Assume an opening balance sheet as follows……

Assets	E	Liabilities+SE	E
Cash	1000	Paid in Capital	1000

- Purchase inventory for 800 E paid in 30 days. Prepare a B/S.

- Sell the entire inventory for 950 E paid in 45 days. Prepare a B/S.

- Pay inventory for 800 E and buy an equipment for 800 E cash. Prepare a B/S

  - What does WCR represent ?

BALANCE SHEET
A snapshot at a point in time

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RESOURCES !!

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Exercise : WCR computing

- Given the data provided in the balance sheet, Compute the WCR in 2018

Exercise : WCR computing

- The company achieved 186.7 million $ Sales and 10.4 million $ EBIT.
- Given the data provided in the balance sheet, **Compute the WCR ratios in 2018 :**
  - the WCR days

  WCR / Sales x 360
  - The DIO => days inventories ratio

  Inventories / sales x 360
  - The DSO => days sales ratio

  A/R / (sales+VAT) x 360
  - The DPO => days payables ratio

  A/P / (sales + VAT) x 360

Review of financial statements

- **Cash flow statement**
- In conceptual terms the **strength of the free cash flow within a company is a better indicator of the health of that company** than the value of its balance sheet or its reported income statement.

- **What is generating cash in a company ?**
  - Profitability
  - WCR (optimisation)
  - Disposal of assets
  - Equity
  - Debt

Internal re/sources

External re/sources

Financial statements under IFRS

Financial statements under IFRS

- CF/S

Statement of Cash Flows
Cash flows from operating activities (1)
Cash flows from investing activities (2)
Cash flows from financing activities (3)
Net increase (decrease) in cash & cash equivalents (1)+(2)+(3)
Opening cash balance
Closing cash balance

Review of financial statements

Cash flow statement

Where the cash is from ?
Where the cash goes to ?

	CASH FLOW *(cash from earnings)*
-	**Change in WCR**
=	**Cash flow from operations (1)**
-	Capital expenditures *(buying non current assets)*
+	Disposal *(sale)* of non current assets
=	**Cash flow from investments (2)**
∑	**Free cash flow (1+2)**
-	Dividends paid
+	Capital raising, issuance of stocks
-	Loan repayment (instalment : P+I)
+	New bank loan or Bonds issues
=	**Cash flow from financings (3)**
∑	**Change in cash over the period (1+2+3)**
+	**Opening Cash balance**
=	**Closing Cash Balance**

from P&L

from B/S

Cash generated by the company from its operating & investing activities

Financing policy of the company

Financial statements under IFRS

Financial statements under IFRS

- CF/S

- **Cash flows from operating activities are comprised of :**
  - Net income adjusted for
    - all non cash revenues and expenses such as depreciation, amortization, and allowances
    - Any capital gains or losses as a result of the difference between revenues generated by the disposal of fixed assets and the net book value of the assets sold as expenses
  - The increase (decrease) of the net book value of inventories, trade receivables, other receivables, trade payables, other current liabilities including social debt to employees (so to say the working capital requirement)
- This cash flow reflects the capacity of the company to generate cash on its core activities. It must be positive.

Financial statements under IFRS

Financial statements under IFRS

- CF/S

- **Cash flows from investing activities are :**
  - Purchases of property, plant, equipment and any other kind of tangible or intangible assets
  - Purchases of subsidiaries (financial assets)
  - Proceeds from the sale of fixed assets

- Mostly these cash flows are cash outflows so the total amount of cash flows from investing activities are negative. Actually a firm is more likely to invest to sustain its growth than divest.

Financial statements under IFRS

Financial statements under IFRS

- CF/S

- **Cash flows from financing usually consist of :**
  - Cash inflows from capital raising (capital increase)
  - Dividends paid to shareholders
  - New loans or debts provided by banks or investors when debt is issued in financial markets for instance
  - Repayment of the existing debt

- So then cash flows from financing activities are of significance as they present the financial policy dictated by shareholders to the managers so to say the decisions made how to fund the business needs. Therefore does the company rather use rather retained earnings or bank debt or equity ?

Financial statements under IFRS

Financial statements under IFRS

- CF/S

- **Net increase (decrease) in cash & cash equivalent** is the sum of all these cash flows from operating, investing & financing activities
- Should it be a net increase then the closing cash balance has increased over the fiscal period
- Should it be a net decrease then the closing cash balance has decreased over the fiscal period. So the cash position of the firm under these circumstances has worsened.

Financial statements under IFRS

Financial statements under IFRS

- CF/S

- **The closing cash balance reflects :**
  - The opening cash position as a result of the difference between the cash & cash equivalents and bank overdraft
  - The net increase (decrease) in cash over the fiscal period
- So then **closing cash balance** consists of the net cash position of the company at closing date.

Review of financial statements

Cash flow statement

	2018	Comments
Operating activities		
Net income	**2,0**	
Depreciation and amortization	**1,2**	**CASH FLOW**
Other non-cash items	**0,2**	
Changes in working capital		Final WCR - Initial WCR
(+) Δ Accounts receivable	5,3	
(+) Δ Inventory	1,0	
(+) Δ Other current assets	1,0	
(−) Δ Accounts payable	(4,7)	
(−) Δ Other current liabilities	2,0	
Net change in working capital	*4,6*	
Cash from operating activities	***(1,2)***	
Investment activities		
Capital expenditures	(14,0)	
Acquisitions and other investing activity	(7,0)	
Proceeds from the sale of non current assets	-	
Cash from investing activities	***(21,0)***	
FREE CASH FLOWS or ECONOMIC CASH FLOWS		
Financing activities		
Capital increase		
Dividends paid	(1,0)	
Sale (or purchase of stock)	-	
Increase in borrowing	24,9	
Bonds issues		
Bonds redemption		
Cash from financing activities	***23,9***	
Change in cash and equivalents	**1,7**	
Opening cash balance		
Closing cash balance		

Review of financial statements

- **With Free Cash Flow (if >0)**, a company has to:
  - **Pay interest**
  - **Repay its financial debts**
  - *Face extraordinary expenses*
  - *Pay out dividends*

- **Free cash flows** are used in
  - **The investment valuation method**
  - The firm valuation method (DCF)

Financial statements under IFRS

- **Financial statements under IFRS**
  - Conclusion
    - I/S : How the company is profitable
    - B/S : capital structure and creditworthiness
    - CF/S : impact of activities on the cash balance

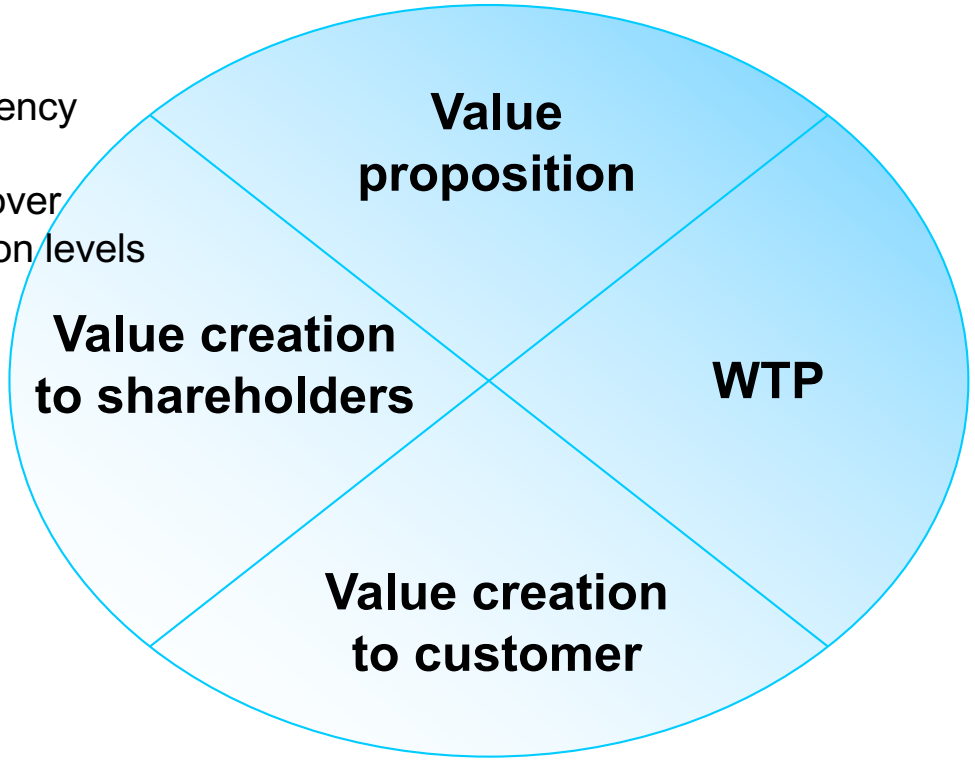
Financial analysis

- **Lecture 2 : Introduction to Value creation & ROCE (return on capital employed)**

Financial analysis under IFRS

What is Value creation ?

Strong value propositions
deliver **tangible results** like :
Increased revenues
Faster time to market
Decreased costs
Improved operational efficiency
Increased market share
Decreased employee turnover
Improved customer retention levels



Financial analysis under IFRS

- **What is value creation ?**
  - How to create value for Shareholders?
    - **The VOICE OF CUSTOMERS**
      - Understanding customers is the cornerstone of effective long term strategy engendering real value creation in the end
        - From revenue to profit (size vs customer selection …)
        - From market shares to increased value share…

Financial analysis under IFRS

- **What is value creation ?**
  - What kind of “operational strategies” are implemented to create value ?
    - The past decade has been a time of cost leadership strategy
      - **Cost cutting,**
      - **Supply chain rationalization**,
      - Activity based costing model (ABC method)
      - Etc…

Financial analysis under IFRS

- **What is Value creation ?**
  - What kind of “operational strategies” are implemented to create value ?
    - “When everybody cuts costs to the bone, the playing field is re-levelled and new sources of competitive advantage must be sought.”
    - Back from cost leadership to **differentiation & innovation**…

Financial analysis under IFRS

- **Companies need "operating" means to run/operate the business**
  - Operating means are
    - **Non current assets** (equipment, intangible assets, acquisitions) ie Long term investment of capital (>1year)
    - **working capital requirement** ie Short term investment of capital (<1year)

- *These needs vary significantly from one industry to another and within an industry, according to management choices ie :*
  - *Business model (manufacturing, distribution, services…)*
  - *Nature of investments ie strategy (make or buy)*
  - *Performance of operating activities*
  - *Efficiency of WCR management…*

Financial analysis under IFRS

- **Companies need "capital" to fund the operating means :**
  - Equity
  - Financial Debt

- Raising funds suppose to attract investors :
  - Equity sponsors (private equity funds, pension funds, investors in the stock market)
  - Debt holders (banks, investors in monetary or bonds markets…)

Financial analysis under IFRS

A. Group	Jun N-1	Jun N
EPS (cents)	46.5	52.3
PBIT/CE	14.1%	15.9%

RETURN

LIQUIDITY

STRATEGIC MARKET

CAPITAL INVESTED In Business

FINANCIAL MARKET & BANKS



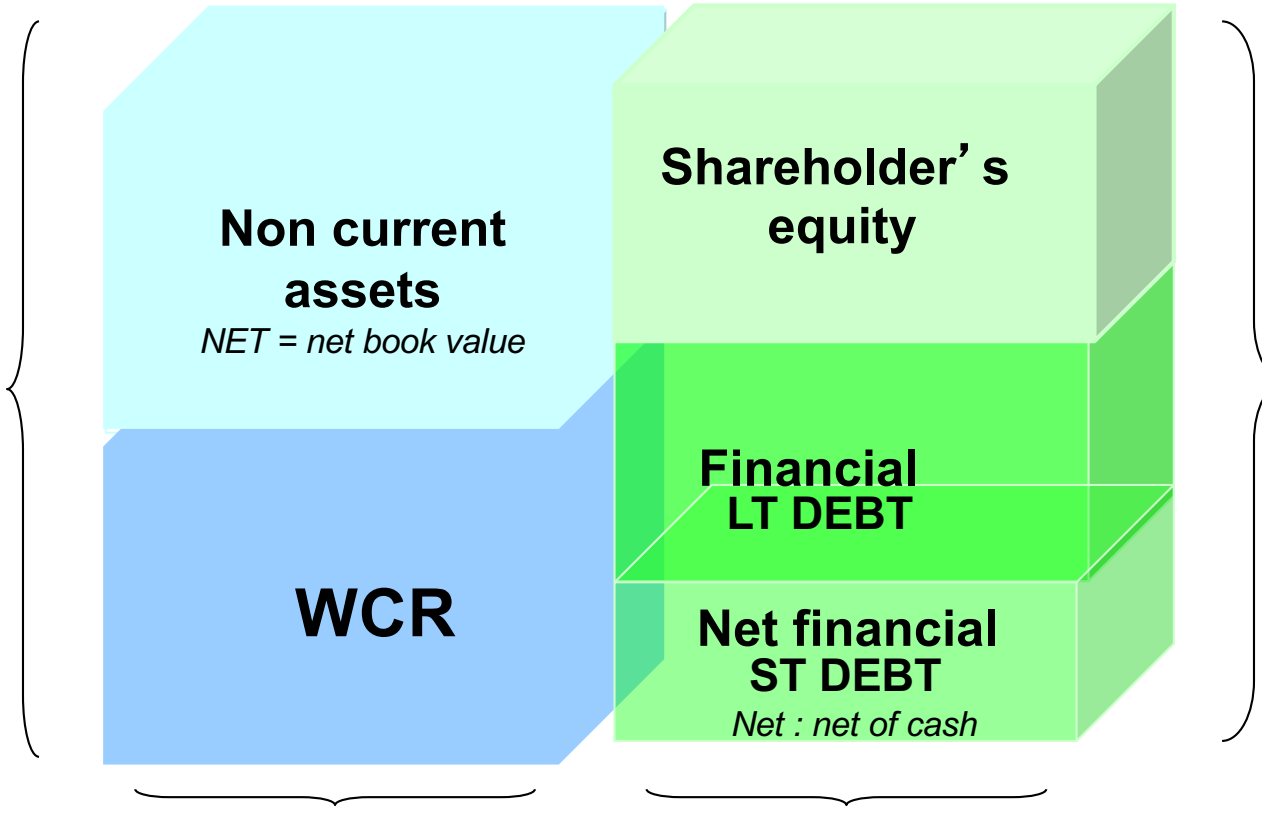


RISK

Operating assets

Financial analysis under IFRS

- **TRANSLATED IN Economic balance sheet**



Financial analysis under IFRS

- **Methodology to build up an economic balance sheet**

- **STEP 1 : Separate Operating and Financial items**
- **STEP 2 : Compute capital employed**
- **STEP 3 : Compute financial resources**

Financial analysis under IFRS

- **STEP 1 : Separate !!!!....**
- **OPERATING** ASSETS or RESOURCES
  - Assets and resources involved in /generated by /related to the conduct of the **ongoing operations of a business**
    - *Example : LT assets, Inventories, Account Receivables (A/R), other current assets, and Account payables (A/P), other current liabilities*
- **FINANCIAL** ASSETS or RESOURCES
  - All resources provided by **BANKS, Financial Markets (investors), or SHAREHOLDERS**
    - *ST & LT debt ie loans, bonds, leases,… & Equity*
  - **Cash & Cash equivalents** *(extra unused resources)*

Financial analysis under IFRS

- **STEP 2 : Compute CAPITAL EMPLOYED**

1/ Identify NON CURRENT OPERATING assets ONLY

Intangible non current assets
+Tangible non current assets
+Financial non current assets
=> Non current operating assets

2/ Identify CURRENT OPERATING assets AND resources (liabilities) => WCR

CAPITAL EMPLOYED = NON CURRENT ASSETS + WCR

Financial analysis under IFRS

- **STEP 3 : Compute FINANCIAL RESOURCES**

1/ Identify EQUITY

2/ Identify FINANCIAL DEBT (long term and short term)

3/ Identify CASH (financial assets)

FINANCIAL RESOURCES =
EQUITY + FINANCIAL DEBT - CASH

Exercise 3 : WCR computing

USES OF RESOURCES !!

RESOURCES !!

Assets of "Firm", in m$	2018	2017
Current assets		
Cash	21.2	19.5
Accounts receivable	18.5	13.2
Inventories	15.3	14.3
Other current assets	2.0	1.0
Total current assets	**57.0**	**48.0**
Long-term assets		
Land	22.2	20.7
Buildings	56.5	50.5
Equipment	49.7	43.2
Accumulated depreciation	18.7	17.5
Net property, plant, and equipment	*109.7*	*96.9*
Goodwill and intangible assets	20.0	20.0
Other long-term assets	21.0	14.0
Total long-term assets	**150.7**	**130.9**
Total assets	**207.7**	**178.9**

<1y

>1y

Liabilities of "firm", in m$	2018	2017
Current liabilities		
Accounts payable	29.2	24.5
Short term debt	3.5	3.2
Current maturities of long-term debt	13.3	12.3
Other current liabilities	2.0	4.0
Total current liabilities	**48.0**	**44.0**
Long term liabilities		
Long-term debt	99.9	76.3
Capital lease obligations	7.6	7.4
Total long-term liabilities	**107.5**	**83.7**
Total liabilities	**155.5**	**127.7**
Stockholders' equity	**52.2**	**51.2**
Total resources	**207.7**	**178.9**

Exercise 4 : Economic BS

- Based on the balance sheet provided, present an economic balance sheet

Financial analysis

- **Exercise : Setting up a business**
  - I/S, CF/S & B/S

Financial analysis under IFRS

- **HOW MUCH Return is completed by the Firm when it uses the money (financial resources) to fund the operating means needed to run the business.**

- The traditional measure of the performance of a company is **the expected return on economic assets**.
  - ROCE (or ROIC) ie **Return on Capital Employed** (Return on Invested Capital) is one of key measure of performance of a given company and as such may rely on the efficiency of the **management**

THE INVESTMENT POLICY

- **Return on capital employed**
  - **Accounting approach (pretax)**

ROCEpretax = EBIT / Sales x Sales / CE

  - EBIT/Sales : Operating margin ratio
  - Sales/CE : Asset turnover ratio
  - ***CE = Economic*** *Assets => ie operating assets (net fixed assets, WCR)*

  - ***After tax ROCE = NOPAT / CE***
  - ***NOPAT = EBIT x (1- Tax rate)***

*For 1euro **sales** how much profit done ?*

HOW MUCH **PROFIT** MADE ON OPERATIONS !!!

TWO OPERATIONAL LEVERS

ROCE
=
EBIT / CE

Operating margin rate
=
EBIT / Sales

✖

Productivity rate
=
Sales / CE

HOW MUCH **EFFICIENCY** FROM OPERATIONS !!!

*For 1euro **invested** how many sales done ?*

CE = WCR + Non current assets or Equity + Net financial debt

EXAMPLE : CE & ROCE

- The company achieved 186.7 million $ Sales and 10.4 million $ EBIT.
- Based on the economic balance sheet provided in exercise 4, compute the ROCE

ROCE

- Exercises
- CE & ROCE
- ROCE & Real estate