Financial analysis under IFRS

- **Risk & Return analysis**
  - **Strategy** relevance given the strengths and weaknesses of the firm and the attractivity of the markets addressed (Pestl, Porter, SWOT)
    - Competition and globalization effect
    - Technologies disruptions
    - Change in consumer's behaviors
    - Volatility in production factors costs/prices (wages, raw materials…)
    - Macro economics risks (growth rate in GDP, interest rates, FX rates,…)
    - Political, environmental, legal…. Risks
    - …

Financial analysis under IFRS

- **Risk & Return analysis**
  - **Strategy**
    - Revenues structure
      - By SBUs (strategic business units)
      - By Region (geographic markets)
      - By main subsidiairies eventually
    - Change in Revenues
      - Organic growth
      - Growth by acquisition (change in scope of consolidation)
    - Core questions :
      - Which SBUs is driving revenues growth ?
      - Which region is driving revenues growth ?

Financial analysis under IFRS

- **Risk & Return analysis**
  - **Performance**
    - Margin contribution (EBITDA or EBIT margin)
      - By SBUs
      - By Region (geographic markets)
      - By main subsidiairies eventually
    - Change in scope of consolidation
      - If so what is the impact on margin : increase or decrease ? Why ?
    - Change in Margin
      - Which SBUs is driving operating margin growth ?
      - Which region is driving operating margin growth ?

Financial analysis under IFRS

- **Risk & Return analysis**
  - **Operating risk**
    - Is the group well diversified ?
    - Is the group dependant on :
      - Resources (which one) ?
      - External parties ?
      - Regulations ?
      - Techs ?
    - What if there is a change in the operations ?
    - Are there risky assets ?
      - Brands
      - Goodwill
      - Patents
    - Are there a lot of fixed costs ?
    - What is the operating risk (low, medium, high) ?

Financial analysis under IFRS

- **Risk & Return analysis**
  - **Financial risk**
    - Is the group leveraged (Debt / Equity ratio) ?
    - What is the amount of equity ?
    - What is the dividends policy ?
      - What is the payout ratio ?
    - What is the solvency of the group ?
      - Debt / EBITDA ratio
    - What is the interest cover ratio ?
      - EBIT / Interests paid ratio
    - Is the financial risk (low, medium, high) ?

Financial analysis under IFRS

- **Risk & Return analysis**
  - **Free cash flows**
    - What is the capacity of the group to generate cash ?
      - WCR analysis
    - FCF are increasing ? Decreasing ? Why ?
    - What are the cash flow from financings (is debt repayment easy ?) ?
    - In the end how is the closing cash balance : increasing ? Decreasing ?

Financial analysis under IFRS

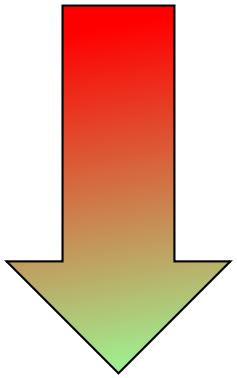
- **Risk & Return analysis**
  - **Value creation**
    - What is ROCE ?
      - Analyse the 2 ratios
    - Is the company attractive to the investors ? Already ?

Financial analysis under IFRS

- **What about the risk investors take by investing in a project/firm ?**
  - **How flexible or resilient is the business** to any change in its environment ?
    - What is the decision making process in the company ? The **governance** ?
    - What is the level of **operating risk** in the company ?
    - What is the level of **financial leverage** in the company ?
    - Is there any capacity or room for adaptation? For optimization ?
    - What is the reactivity of the company to competitors ?

THE INVESTMENT POLICY

- **What about the risk investors take by investing in a project/firm ?**
  - **What is the level of risk** on these different projects ?



New venture
New products
Expansion of current business
Cost reduction

THE INVESTMENT POLICY

- **Firm's risk is split into two types of risks**
  - **Operating risk (given the company and/or project)**
    - Volatility of revenues
    - Volatility of cost prices
    - Operating Sensitivity (cost structure)
  - **Financial risk & capital structure**
    - Financial expenses
    - Leverage (Debt/Equity ratio)

THE INVESTMENT POLICY

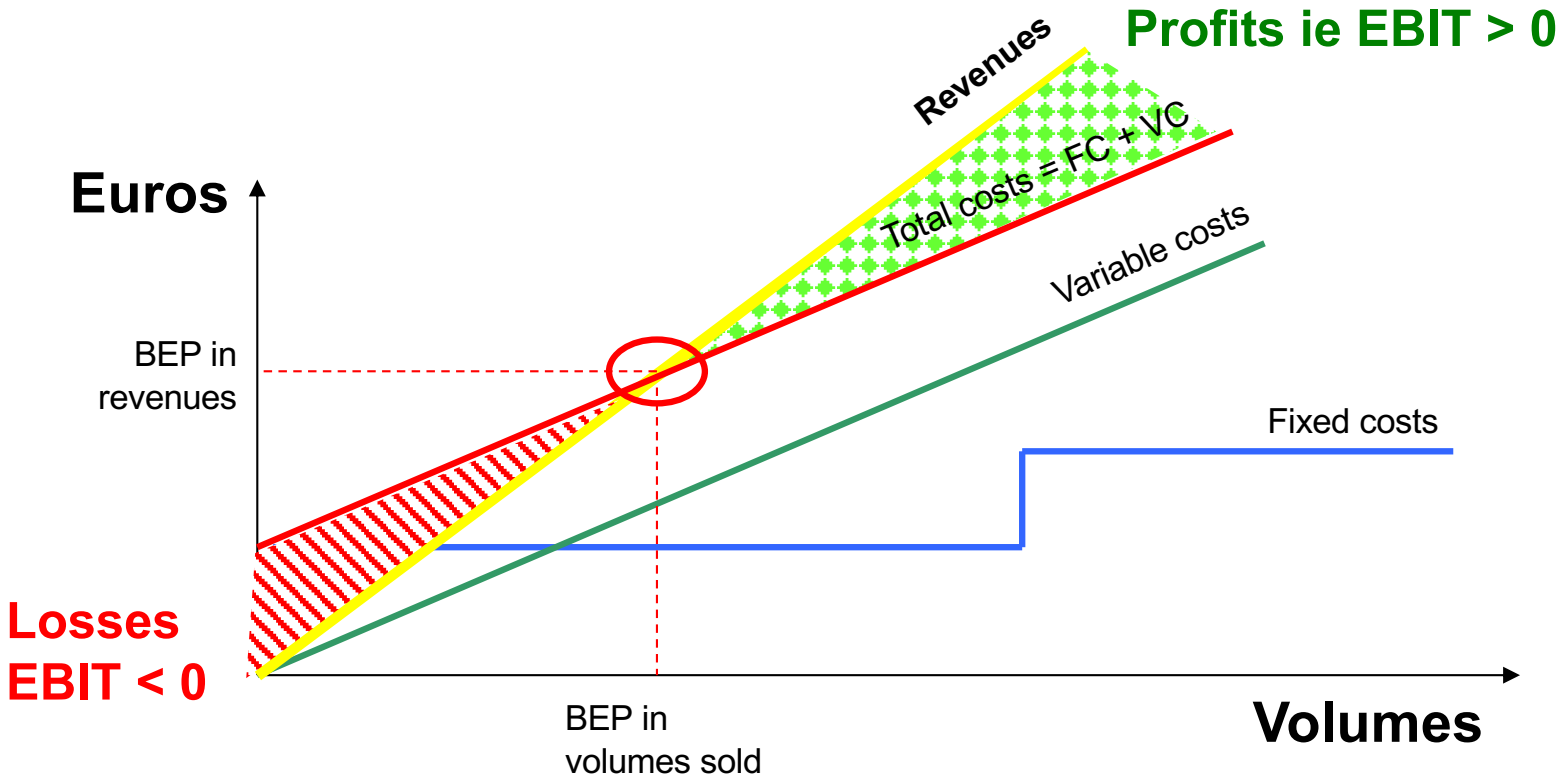
- **Operating risk in a Firm**
  - **Volatility of revenues**
    - Is the business cyclical ?
    - May other competitors come in (barriers to entry) ?
    - Are selling prices volatile (raw materials)?
    - Could there be a technological gap ?
    - Are there few customers (concentration of revenues among few)?
    - Are sales made of few large contracts ? When do they terminate ?

THE INVESTMENT POLICY

- **Operating risk in a Firm**
  - **Cost structure**
    - Fixed vs variable costs
    - Breakeven point
    - More or less flexibility, resilience, adaptability to any changes in the environment of the firm

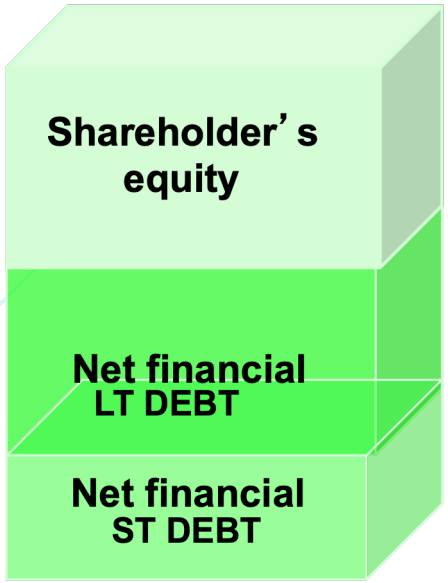
THE INVESTMENT POLICY

- **Operating risk in a Firm**
  - **Cost structure & BEP**



THE INVESTMENT POLICY

- **Financial risk of a Firm**
  - **Capital structure**
    - The higher the level of financial debt to equity the higher the financial risk in the firm
      - Risk of financial Distress
      - Risk of default



- **Leverage ratio** (gearing) : Financial Debt / Equity < 1
- *Financial Debt / EBITDA < 3,5*
- **Interest cover ratio** : EBIT / interest > 3

- *Long term debt / **Free cash Flow < 3 to 4***
- *Free Cash-Flow / Debt service (annuity : principle's repayment + interest) > 1,1*

THE INVESTMENT POLICY

- **Financial risk of a Firm**
  - **Shareholder's risk : Return uncertainty**
  - **Focus on business risk & cash flows**
    - Increases with sales uncertainty
    - Increases with operating sensitivity
    - Increases with the proportion of net fixed assets among Capital Employed (liquidity of assets)
    - **Increases with D/E ratio (financial risk)**
    - Decreases when operating income margin rate increases
    - Decreases when cash increases

THE INVESTMENT POLICY

- **Financial risk of a Firm**
  - **Lenders' risk : Default risk of the business**
  - Focus on **Financial** risk & Cash-flows
  - When financial risk is too high then part of business risk is transferred from shareholders to debt holders and default risk increases :
    - Increases with sales uncertainty
    - Increases with operating sensitivity (unflexible cost structure)
    - Increases with cash flows volatility
    - Decreases with the proportion of tangible fixed assets among Capital Employed
  - Increases with D/E ratio (financial risk)
  - Decreases when cash increases

THE INVESTMENT POLICY

- **Capital structure, return on capital invested**

