

**Czech University of Life Sciences Prague**

**Faculty of Economics and Management**

**Department of Economics**



# **FINANCIAL ANALYSIS OF A COMPANY**

**Abstract of Diploma Thesis**

**Bc. Alena RÁČKOVÁ**

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## **Souhrn**

Finanční analýza společnosti si klade za cíl posoudit a zhodnotit finanční situaci a vývoj společnosti za období minulé, ale také by měla být podkladem pro předvídání budoucího stavu firmy. Celý proces zahrnuje výběr vhodných ukazatelů a metod, výpočet indikátorů z vybraných finančních výkazů a také interpretaci výsledků, jež je nedílnou součástí celé analýzy. Takto získané závěry by měly sloužit vedení společnosti jako nástroj pro finanční řízení společnosti.

## **Klíčová slova:**

Finanční analýza, Technická elementární metoda finanční analýzy, Horizontální a vertikální analýza, Poměrové ukazatele, Systémové indikátory, Predikce

## **Summary**

The main aim of the financial analysis is to review and evaluate the financial situation and performance of the company in the past. This procedure should also provide the users the base for the prediction of possible future development. The procedure includes the choice of the indicators and methods, the calculation of chosen indexes, and the interpretation of returned results which can be considered as the most important part of the whole financial analysis. The findings should provide answers to many questions of the management of the company and should serve as a tool for financial management.

## **Keywords:**

Financial analysis, Technical elementary method of financial analysis, Horizontal and vertical analysis, Ratio analysis, System indicators, Prediction models

## **ABSTRACT**

The main aim of every company is to use its own and borrowed capital in the best way in order to increase its market value. With respect to this aim of companies, we need a review instrument such a financial analysis is.

This diploma thesis concentrates on the topic of financial analysis as a tool for evaluation of financial health, situation, and performance of a company.

The whole thesis is divided into two main parts. The first one is concerned with the theoretical part and provides a literature overview, explanation of basic terms and introduces the most often-used assessment indicators from the theoretical point of view.

In this part, the author focuses on the concepts of financial analysis, resources that are being used, users that are most concerned with the results of analysis, the steps that have to be done in order to finish the analysis and the methods used. Some of the methods are explained in more detail in order to be able to pursue the analysis itself in the second part of the thesis. The choice of the particular indicators is based on the best practice.

The second and the most important part is concerned with the practical pursuance of the financial analysis of particular company. For the analysis itself, author has chosen a manufacturing company. The value added should be provision of causes of past performance of the company. The company is not observed under its real name as to fulfill the wish of the company owner. For this diploma thesis the company is presented under the name: M&G, s.r.o. The data observed are from five year period. Methodology used is the technical elementary financial analysis method. The technical analysis is based on mathematical, statistical and econometric methods with utilization of quantitative data such as financial statements (balance sheet, profit and loss account, cash-flow statement).

The beginning of the practical part provides the introduction and background of the firm and the financial analysis follows. From the financial analysis, we can state that between years 2005 and 2006, the financial performance of the company was at very good level. The indicators of return on assets or return on equity returned results above standard. On the other hand, the situation was deteriorating afterwards. The Du Pont Analysis which decomposes the indicator of return on equity helped us to reveal the source of this deterioration. In the prosperous years 2005 and 2006, the company did not have too high profit margin but took advantage of high turnover of assets. When the turnover of assets decreased three times between 2006 and 2009, it influenced the overall return on equity (in 2006, the company was able to turn its total assets over 2.27 times but in 2009, the turn over ratio of total assets was only 0.7). Regarding the profit margin, it was quiet low but as it significantly decreased in

2008 and 2009, it can be considered another reason of the overall deterioration. The financial leverage did not affect the development of return on equity significantly and remained at comparatively same level.

These are only attributes of the situation of the company. In order to find the main causes, it is necessary to look deeper. The lead might be the development of the turnover ratio, therefore the structure and quantity of assets and sales.

The structure of assets remained very similar from 2005 to 2009. The main cause can be found in the decreasing sales. The sales changed from nearly 33 million CZK in 2005 to 9 million in 2009, this led to the bad result of turnover ratio. The year 2009 returned the worst results also due to high level of remaining inventory (almost twice as much as in all previous years).

In the first two observed years, the activity could be stated as strength of the company which has led to good result in its profitability. However, this has changed and the positive impact disappeared and the company lost one of its most influential strength sides. Deteriorating activity and profitability then would be assessed as a weakness of the company. In order to improve its position, the company should concentrate its activity which would result in improvement of profitability.

Another aspect that should be evaluated in the conclusion is the indebtedness of the company. The management decided to use most of its own resources to run the business which has led to overcapitalization in last two years. This means that the company financed some of its short-term assets through its own equity but this way of financing is considered to be the most expensive one. The company had in year 2009 high level of material left in the stock – therefore, there was no need to buy new inventory, no need to pay to its suppliers and the trade creditor amount significantly decreased.

Low financial leverage is closely connected with good level of liquidity ratio. Though, it can be perceived as a good result from one side, missing wider utilization of credit can be assessed as a weakness of M&G, s r.o..

According to the results of average collection period, I would also recommend to pay closer attention to management of receivables. The number of days M&G, s r.o. received its cash was quite high, especially in last year (2009).

To conclude the development of basic indicators from the profit and loss account such as sales, costs of goods sold and profit margin, we can observe negative development trend. Sales began at level of 32 million CZK and in 2009, it was about 9 million CZK (the overall negative change was 72%).

Cost of goods sold recorded similar decreasing trend as it was in sales. It started at 22 million CZK and ended at 4 million CZK. This was caused mainly due to deteriorating business activities of the company.

The profit margin development remained at almost the same level during the first three years (11 million CZK) but ended at 4.7 million CZK in 2009.

When we consider the prediction financial models such as Altman Z-score bankruptcy model, model IN 95 which is suited to the conditions of Czech market, or Kralicek's Quick test, we can sum up that the company was in overall good state in spite of deteriorating development. Neither of the prediction tests resulted in potential bankruptcy.

The goal of the thesis was also to confirm or reject suggested working hypotheses. There were three stated hypotheses:

With the decreasing sales, the profit margin decreases.

With the decreasing sales, the inventory turnover decreases.

The positive change of short-term receivables is connected with positive change of short-term liabilities and vice versa, the negative change of short-term receivables is connected with negative change of short-term liabilities.

All three of them were on the basis of gained knowledge confirmed.

The core business of this company is the production of marketing products, the stands and shelves that sell other companies products. Unfortunately, this field was hit the most by the financial crisis because the companies decided not to invest into marketing activities as it was in the past. As the enterprise is of a small size, it cannot push the prices lower in order to support the sale ability as the production costs are quite high. However, the vision of the end of the conjuncture might lead to improvement of the situation in the market, renewing of marketing activities and support the business pursuance of M&G, s.r.o.

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