

Czech University of Life Sciences Prague

Faculty of Economics and Management



Bachelor Thesis

Topic:

Economic Analysis of Czech Construction Sector:

Case study of Selected Company

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CZECH UNIVERSITY OF LIFE SCIENCES PRAGUE

Department of Economics
Faculty of Economics and Management

BACHELOR THESIS ASSIGNMENT

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Economics and Management

Thesis title

Economic Analysis of Czech Construction Sector: Case study of a selected company

Objectives of thesis

Aim of the Bachelor thesis is to evaluate financial situation of the chosen company and its relative position among direct competitors in the industry. Theoretical explanation of the financial analysis methods. Evaluation of the structure of financial statements of the selected company. At the end attempt to compare the economic situation of the company during the period 2007 – 2011 with the industry averages and also with relevant selected competitors.

Methodology

The Bachelor Thesis is divided into two main sections titled Literature Review and Practical Part. Literature review is an important part of the research since contains necessary theoretical information which is essential for Thesis completion. Various literature resources have been used to explain definitions and theory which will contribute to clarify the basic purpose and nature of the economic analysis. The Practical Part contains description of the selected company and its brief history, evaluation of development in sample years with use of financial analysis methods (Vertical and Horizontal analysis, ratio indicators, bankruptcy index), at the end an attempt to generate prognosis of future development of the company.

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enterprise, financial statement, economic analysis, construction industry

Recommended information sources

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Czech statistical office - CZSO; <http://www.czso.cz/>

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Prague February 27. 2013

Declaration

I declare that the bachelor thesis on topic: "Economic Analysis of Czech Construction Sector: Case study of Selected Company " was written with utilization of literature and other sources which are all included in the List of used sources at the end of the Thesis, and also with the help of my supervisor Ing. Petr Procházka, Msc. Ph. D.

In Prague 15 May 2013

Cyril Pohl

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**Economic Analysis of Czech Construction Sector:
Case study of Selected Company**

(EKONOMICKÁ ANALÝZA ČESKÉHO STAVEBNÍHO
SEKTORU: PŘÍPADOVÁ STUDIE VYBRANÉ FIRMY)

SUMMARY

The topic of this Bachelor Thesis is an Economic analysis of Czech Construction Sector: Case study of a Selected Company. This work assesses economic situation of a selected company with use of a financial analysis. The business was established in 1990. Since then it has become medium-size construction company with 230 employees and 5 branches in big cities around Czech Republic.

Thesis contains two main parts Theoretical part and Practical part. First part covers knowledge and information necessary to formulate and explain financial analysis and used methods such as horizontal and vertical analysis of financial statements, ratio analysis of the statements and bankruptcy index. The practical part includes description of the selected company and the analysis itself. It evaluates the financial state of the selected company in perspective with recession on Czech construction sector.

Results of the financial analysis with Figures and tables were consulted with key company employees. Conclusion contains discussion and assessment of development of the companys financial situation.

Key Words: Enterprise, Financial Statements, Economic Analysis, Construction Sector

SOUHRN

Tématem této bakalářské práce je Ekonomická analýza stavebnictví v České Republice: Případová studie vybrané firmy. Tato práce hodnotí ekonomickou situaci vybraného podniku s využitím finanční analýzy. Společnost byla založena v roce 1990. Od té doby se z ní stala stavební společnost střední velikosti, s 230 zaměstnanci a pěti divizemi ve velkých městech v České republice.

Práce se skládá ze dvou hlavních částí, části teoretické a části praktické. První část se zabývá poznatky a informacemi nezbytné k vysvětlení a popsání použitých metod finanční analýzy jako jsou horizontální a vertikální analýza účetních výkazů, poměrová analýza výkazů popsání bankrotního indexu IN05. Praktická část obsahuje popis vybrané společnosti a vypracovanou finanční analýzu. Ta hodnotí finanční stav vybrané společnosti v časovém horizontu 4 let. Analýza se zabývá vývojem společnosti za časů finanční krize spojené s propadem stavební produkce v České republice.

Výsledky finanční analýzy s grafy a tabulkami byly konzultovány s klíčovými zaměstnanci společnosti. Závěr obsahuje diskusi a posouzení vývoje finanční situace společnosti.

Klíčová Slova: Podnik, Finanční výkazy, Ekonomická analýza, Stavební průmysl

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1. INTRODUCTION

A company is an economic subject established for various reasons. Main aims include maximization of profit, expansion to other markets or just to avoid bankruptcy during difficult times. Economic health of a company is important for many participants such as investors, business partners, employees etc. Financial analysis is a tool made for these users to assess and control how well is the enterprise being operated.

The aim of economic analysis is assessment of financial state of a company and its development with prediction for future. Financial analysis utilizes data from financial statements of selected company and translates numbers and data into consolidated understandable information. Analysis of company's financial development has during global financial recession become very important.

With use of financial analysis all interested groups are able to evaluate state of the company regularly. Users are able to make comparisons with previous years to observe development of the company, or make comparison of current values of analysis with competition. Management of the company is able to make necessary steps or precautions against any negative development based on results of the analysis.

2. THE AIM AND METHODOLOGY

2.1. Aim

The main Aim of the Bachelor thesis is to evaluate economic state of Czech construction industry through case study of the chosen company. Analysis is going to assess company's financial position and relative position among direct competitors in the Czech Construction industry. The Analysis is focused on the Construction Sector in years 2008 to 2011. According to Czech Statistical Office during this time period there is noticeable increase in vulnerability of the industry caused by financial recession and economic fluctuations causing decrease in production.

This main goal is further divided into sub aims. Bachelor Thesis begins with theoretical explanation of the financial analysis methods. Practical part is made up of assessment of the development of financial statements of the selected company. At the end the author compares economic situation of the selected company during years 2008 – 2011. Comparison with competitors is included when necessary.

2.2. Methodology

The Bachelor Thesis is divided into two main sections titled Literature Review and Practical Part. Literature review is an important part of the research since contains necessary theoretical information which is essential for Thesis completion. Various literature resources have been used to explain definitions and theory which will contribute to clarify the basic purpose and nature of the financial analysis. The Practical Part contains description of the selected company and its brief history, evaluation of development in sample years with use of financial analysis methods (Vertical and Horizontal analysis, ratio indicators, bankruptcy index), and at the end an attempt to generate prognosis of future development of the company.

3. LITERATURE REVIEW

“Financial analysis is necessary for evaluating internal operations and activities to optimize profit and efficiency, while at the same time reducing the risk. Analyzing the income statement, balance sheet and overall financial structure shows the company's financial strength and deficiencies and identifies problem areas for management attention.”[5] Also other definition of financial analysis claims that “The aim and sense of financial analysis is to make (with use of the special methodical measures) a diagnosis of financial management of the enterprise, to record all its sections, or eventually when making more detail analysis to appraise some of the sections of financial management.” [7] In conclusion about financial analysis it can be summarized that “Financial analysis based on the financial statements help to describe a company's financial performance and health.” [4] Therefore any decision concerned with the corporate finance should be based on the financial analysis for company management to be able to make effective and beneficial economic policies.

Financial statements are documents, providing information about the different economic activities of a company and provide basic information for completion of the Financial Analysis. The author of the Bachelor Thesis used two types of primary financial statements. The mentioned financial statements are balance sheet, income statement. "The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions. Financial statements are intended to be understandable by readers who have a reasonable knowledge of business and economic activities and accounting and who are willing to study the information cautiously and with care." [13]

3.1. Users of Financial Statements

There are different kinds of users of financial statements. These users are from inside or outside the corporation and utilize these documents for large variety of business related purposes. Users of financial statements are classified as follows:

3.1.1. Internal Users

Managers, Owners

Financial analysis is based on data from financial statements and is a tool used by managers and owners for more comprehensive view on company's financial position. In order to make qualified economic decisions concerning a business or corporation these users must have access to vital information included in these reports.

Employees

Employees are naturally interested in company prosperity and financial stability because they all want to keep their jobs and wage conditions. They watch economic indicators and influence management of the company usually through membership in trade unions.[6]

3.1.2. External Users

Investors – Investors use financial statements to assess and monitor the economic state and performance of the company. These statements are to help the users to make logical and profitable economic decision or investment.

Competitors – Companies use financial statements of their competitors to reconcile, compare and adjust their own financial policies in order to get an economic advantage.

Financial institutions – Banks and other financial or lending institutions use financial statements either to help company with working capital or to issue debt security to it.

Government – Government agencies use corporate financial reports to verify the tax to be paid and whether the amount corresponds with company financials.

Media and General Public

3.2. Financial statements

3.2.1. Income statement

The income statement is the one of the three major financial statements. It is a financial statement that measures a company's financial performance over a specific accounting period. Financial performance is assessed by giving a summary of how the business incurs its revenues and expenses through both operating and non-operating activities. It also shows the net profit or loss incurred over a specific accounting period, typically over a fiscal quarter or year. The income statement is divided into two parts: the operating and non-operating sections. The portion of the income statement that deals with operating items is interesting to investors and analysts alike because this section discloses information about revenues and expenses that are a direct result of the regular business operations. [16]

“The income statement represents the best effort of the firm's accountants to match the relevant items of revenue with the relevant items of cost and expense for the period, a process which involves accrual accounting and extensive use of allocation of prior and future revenues and costs.”[7]

The income statement is a financial document that offers more detailed overview of how the earnings were gained than for example balance sheet. The income statement is more dynamic because it reflects changes for the accounting period. It provides users with an overview of the firm's operations and profitability of the firm. Also in the balance sheet the data is only listed in one row. This way it does not give enough relevant information about the way how the possible profit or loss was gained.

3.2.2. Balance sheet

The balance sheet describes firms financial position at one specific point in time. It is a static representation of the firms financial composition of assets and liabilities. Balance sheet is a financial statement that summarizes a companys assets, liabilities and shareholders' equity at a specific point in time. These three balance sheet segments give investors an idea as to what the company owns and owes, as well as the amount invested by the shareholders. Each of the three segments of the balance sheet will have many accounts within it that document the value of each. Accounts such as cash, inventory and property are on the asset side of the balance sheet, while on the liability side there are accounts such as accounts payable or long-term debt.[16]

By definition “ the recorded value of the total assets invested in the business at any point in time must be matched precisely by the recorded liabilities and owners’ equity supporting these assets.”[7] This basically means that the value of assets always has to be equal to the value of invested capital on the other side of the balance sheet.

”The balance sheet indicates each individual items of assets, liabilities and shareholder’s equity and also shows the state of property and sources for its coverage on a particular date (usually end of the quarter or fiscal year), financially expressed.”[9]

Assets = Liabilities + Shareholders' Equity

Structure of the Balance Sheet

Total Liabilities

“The total amount of obligations of a company including creditor claims on company assets.”[13] Liabilities are a vital aspect of a companys operations because they are used to finance operations and pay for large expansions. Liabilities are settled over time through the transfer of economic benefits including money, goods or services. They can also make transactions between businesses more efficient. Short-term liabilities are typically liabilities which are due within one year or less. Long-term liabilities are those with a time horizon of maturity is past the one year point. [16]

- The equity

A stock or any other security representing an ownership interest. It is the amount of the funds contributed by the owners (the stockholders) plus the retained earnings (or losses).

- Registered capital
- Capital and Reserve funds
- Profit/loss from previous year
- Profit/loss from the current year
- External resources
 - reserves
 - long/short-term payables
 - bank loans
- Accruals

Total assets

- Fixed assets

“A long-term tangible piece of property that a firm owns and uses in the production of its income and is not expected to be consumed or converted into cash any sooner than at least one year’s time.” [16] Example: Buildings, real estate, equipment and furniture

- long-term intangible assets
- long-term tangible assets
- long-term financial assets
- Current assets

“It is a value of all assets that are reasonably expected to be converted into cash within one year in the normal course of business.” [16] including cash, accounts receivable, inventory, marketable securities, prepaid expenses and other liquid assets that can be readily converted to cash.

- inventories – (including material, unfinished production, products, animals, goods)
- long/short-term receivables
- financial assets
- *Accruals*

3.2.3. Cash Flow Statement

The cash flow statement reports the cash generated and used during specific time interval. It is the difference in amount of cash available at the beginning of a period (opening balance) and the amount at the end of that period (closing balance). The prime aim of this financial statement is to keep a track on where the financial sources are created and how they are being used by the enterprise. It can be defined as “Incoming and outgoing of cash, representing the operating activities of an organization.” [15]

Cash Flow statement is not a compulsory document required by law. It is optional for companies to make this financial statement. Unfortunately the selected company has started creating the cash flow statements after 2011, so cannot be used in this analysis.

3.2.4. Limitations of Financial Statements

- 1) **Variation in application of financial statements:** Even though financial statements are prepared in accordance with generally accepted accounting principles, the application of these rules vary because of the different methods that may be used in for example income measurement and determining the financial condition of a business. For example depreciation can be computed based on production volume instead of using the straight-line method. [7]
- 2) **Financial Statements do not contain all the significant information about a business:** They are prepared based on recorded transactions only so that other relevant information such as quality of organization, location, quality of and demand for its product are not included therein.[7]
- 3) **Financial statements are interim in nature although they give an impression of being accurate:** The statements are prepared only for an accounting period and not for the entire life of a business entity. As such they contain estimates of the results of operations and financial conditions of the business. [7]

3.3. Basic methods of financial analysis

In order to produce a good quality financial analysis it is necessary to adopt a suitable analysis method. The decision which methods to choose is an important factor that will influence the financial analysis as a whole. Another crucial factor influencing the analysis is acquiring sufficient amount of reliable input data. Most of the necessary data accumulated to write up this Bachelor Thesis has been supplied by the chosen company in form of financial statements and annual reports. „If we use only the items from accounting statements we talk about absolute (elemental) method, but if we use relation of two items and its numerical value we now talk about relative method(ratio analysis).“ [6]

There are also available more challenging analysis methods dealing with mathematical and statistical procedures such as discriminant, clustered, regression and correlation analysis etc. However due to their level of complexity and their demanding theoretical background understanding it was decided that the main focus and interest will be put into the basic analysis methods. Utilization of the mentioned methods connected together can create a balanced Economic analysis.

3.3.1. Absolute Method

It is a simple method that uses converting of indicators from absolute values into percentages. „The percentage decomposition is appropriate for comparing items of the enterprise in the long run, but the disadvantage is that it is not able to show causes of the changes, because the absolute base for the calculation changes, therefore information from the items could be incomparable.”[5]

Calculations in this procedure and their results are based on chain-base index numbers and connected with vertical and horizontal analysis of the financial statements. Due to simple and quick processing of the calculations this is considered to be a relatively friendly and common approach when making the financial analysis.

3.3.1.1. Horizontal analysis

Horizontal analysis is the comparison of historical financial information over a series of reporting periods. The analysis is most commonly a simple grouping of

information that is sorted by period, but the numbers in each succeeding period can also be expressed as a percentage of the amount in the baseline year, with the baseline amount being listed as 100%. [20] The horizontal analysis will be computed by the index numbers, where the results of selected items will be compared with each level in the time series to the one immediately preceding – in other words by the chain base series. With the help of this type of analysis, the performance of even a small business can be compared to that of a large business in the same industry.

3.3.1.2. Vertical analysis

“A method of financial statement analysis in which each entry for each of the three major categories of accounts (assets, liabilities and equities) in a balance sheet is represented as a proportion of the total account.” [16] Vertical (common-size) analysis focuses on one particular year and shows every item of a financial statement as a percentage of a summary amount. Vertical analysis shows the percentage relationship of each item on the financial statement to a total figure representing 100 percent.” Vertical analysis reveals the internal structure of the business. It also shows the mix of assets that generate the income as well as the sources of capital provided by either current or noncurrent liabilities, or by the sale of preferred and common stock.” [20] A company's vertical percentages should be compared to those of its competitors or/and to industry averages to determine the company's relative position in the market.

3.3.2. Ratio analysis

For successful accomplishment of the financial analysis it is necessary to use appropriate system of indicators, that have the ability to inform enough about the financial situation and the development of the enterprise. Financial ratio analysis utilizes ratios and relationships between various financial statement items as basic tools to compare operational, financial, and investing performance of companies over a specified time and against each other. These can be divided into two groups called primary and secondary ratios. Net sales to net worth ratio or net income to net sales ratio belong to primary ratios group because they indicate most important causes of company's strengths and weaknesses. Current assets to current liabilities ratio or current liabilities to net worth ratio belong to secondary group because they specify company's competitive position and financial structure. [7, 15]

Financial ratios are a valuable and relatively easy way to interpret the numbers found in statements. Examining these ratios over time provides some insight to how effectively the business is being operated. “It can help to answer critical questions such as whether the business is carrying excess debt or inventory, whether customers are paying according to terms and whether the company assets are being used properly to generate income.” [14] When computing financial relationships, a good indication of the company's financial strengths and weaknesses becomes clear.

Ratios are often classified according to these four categories: Liquidity, profitability, debt coverage, activity.

3.3.2.1. Liquidity Ratios

Common liquidity ratios are used to determine the debt-paying ability of the company and include the current ratio and the quick ratio. “Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid assets.” [16]

“The liquidity ratio measures the extent to which a corporation or other entity can quickly liquidate assets and cover short term liabilities, and therefore is of interest to short term creditors.” [17] In a very simple way the liquidity ratios offer the information of how well the company can pay its short-term debts.

Current ratio

“The current ratio is also called the working capital ratio. The current ratio should be high enough to show that current liabilities will be met but not too high that it signifies idle cash or too many resources tied up in current assets like inventory. A current ratio tells one how much in current assets is available to cover each dollar of liabilities.” [5]

“The ratio is mainly used to give an idea of the company's ability to pay back its short-term liabilities (debt and payables) with its short-term assets (cash, inventory, receivables). The higher the current ratio, the more capable the company is of paying its obligations. A ratio under 1 suggests that the company would be unable to pay off its obligations if they came due at that point.” [16] An optimal value of this ratio is considered 2:1, but generally it ranges from 1.5 : 1 and 2.5 :1 depending on different economical sectors in which the enterprise operates. In the current recessed state of economy, banks

and other institutions generally require a higher current ratio to provide a cushion to be able to withstand any unexpected conditions.

The Formula:
$$\frac{\text{Total Current Assets}}{\text{Total Current Liabilities}}$$

Quick Ratio

Quick Ratio also known as “acid–test ratio” is an indicator of a company's short-term liquidity. The quick ratio measures a company's ability to meet its short-term obligations with its most liquid assets. “Unlike the current ratio, the acid-test or quick ratio places emphasis on the relative convertibility of the current assets into cash. The ratio places greater emphasis on receivables than on inventory, since the inventory may not be readily convertible into cash. This method also assumes that prepaid expenses have minimal resale value.” [20,]

The Formula:
$$\frac{\text{Total Current Assets - Inventories}}{\text{Total Current Liabilities}}$$

Cash Ratio

The cash ratio is mostly utilized to measure of company liquidity by only using its cash and cash equivalents and nothing else. It is to determine how quickly can the company repay its short term debts. To obtain this ratio only cash and its equivalents are divided by the current liabilities. According to literature the optimal value for this ratio lies between 0.2 : 1 to 0.6 : 1.

The Formula:
$$\frac{\text{Cash+Cash Equivalents}}{\text{Current Liabilities}}$$

3.3.2.2. Activity ratios

These ratios measure how effectively the firm is using its assets and how quickly a company can convert certain of its assets into cash, or revenue. In general, the sooner management can convert assets into sales or cash, the more effectively the firm is being run. These ratios are used in fundamental analysis to determine the relative strength of a company compared to its competitors. Information used to calculate activity ratios can be found in company's balance sheet or income statement. [1]

Working capital turnover

“A company uses working capital (current assets - current liabilities) to fund operations and purchase inventory. The working capital turnover ratio is used to analyze the relationship between the money used to fund operations and the sales generated from these operations.” [8]

Working capital turnover ratio states how effectively the company utilizes the working capital that is available to the business to support the level of sales. Or simply how much of revenues are generated per dollar of working capital. Both too high and too low working capital turnover ratio is not good. “High turnover ratio can indicate that the management of the company is using working capital effectively and is being extremely efficient in using firm's short term assets and liabilities to support sales. A low ratio can indicate that a business is investing in too many accounts receivable and inventory assets to support its sales, which could eventually lead to an excessive amount of bad debts and obsolete inventory.” [4] A high or increasing Working Capital Turnover is usually a positive sign. It shows that the company is able to generate sales from its Working Capital. However despite that only an optimized working capital turnover ratio is the best for financial health of the business. Again it is necessary to compare company's turnover ratio with competition within the industry to reach optimization.

$$\text{The Formula: } \frac{\text{Net sales}}{\text{Average working capital}}$$

Inventory turnover

“Inventory turnover is a measure of the number of times a company sells its average level of inventory during the year. A high turnover indicates an ability to sell the inventory, while a low number indicates an inability. A low inventory turnover may lead to inventory obsolescence and high storage and insurance costs.”[20,pg. 70] The Inventory turnover ratio enables a company to properly manage its inventory levels and to determine how much of its cash should be tied up in inventory at any one time. Higher inventory turnover is considered to be desirable. However it is best to compare this ratio with companies within an industry because there are huge differences in this ratio across sectors.[6]

Cost of Goods sold

The Formula:

Average Inventory

Turnover of total assets

“Asset turnover is a ratio of a company's net sales to total assets. It measures how efficiently management is using the assets at its disposal to promote sales. It is the number of times by which the investment in assets turns over each year to generate sales. Calculating the total asset turnover is to generate the best results in net sales and at the same time making the best use of company assets all the way from the acquisition of raw materials to the completion of the sale.” [20, pg. 107]

Asset turnover calculation makes it easy to track growth in net revenue from one period to the next, based on net sales. It will point the way to better utilization of assets that are not directly involved in the company production process. This ratio can also identify company's pricing strategy because “companies with low profit margins tend to have high asset turnover, while those with high profit margins have low asset turnover.”[4]

The Formula:

Revenue

Assets

Receivables turnover

Simply the average amount of time it takes for a business to collect on its accounts receivables. The receivables turnover ratio measures a company's efficiency to manage and to collect its accounts receivable and shows how quickly the receivables are transformed into financial resources. It is a way to state how a business' credit risk compares to that of its competitors and to determine the effectiveness of the company's cash collections during an accounting period. [5]”The higher the accounts-receivable turnover, the more successfully the business collects cash. However, an excessively high ratio may signal an excessively stringent credit policy, with management not taking advantage of the potential profit by selling to customers with greater risk.” [20, pg.69]

$$\text{The Formula: } \frac{\text{Net Credit Sales}}{\text{Average Net Accounts Receivable}}$$

3.3.2.3. Profitability ratios

Profitability ratios focus on how well a firm is performing. These ratios are useful in fundamental analysis which investigates the financial health of companies. They show how effectively the profitability of a company is being managed. “Ratios that show margins represent the firm's ability to translate sales dollars into profits at various stages of measurement. Ratios that show returns represent the firm's ability to measure the overall efficiency of the firm in generating returns for its shareholders.”[4]

Profitability ratios measure the company's ability to generate earnings as compared to its expenses and other relevant costs incurred during a specific period of time. For most of these ratios, having a higher value relative to a competitor's ratio or the same ratio from a previous period is indicative that the company is doing well. [3]

Return on assets

Return on assets (ROA) measures the efficiency with which a company is managing and allocating its assets to generate net income. It is the key indicator of the profitability of a company. This ratio indicates how profitable a company is relative to its total assets. The higher the return, the more efficient management is in utilizing its asset base, because the company is earning more money on less investment. The ROA ratio is calculated by comparing net income to average total assets. The solution is then expressed as a percentage. The ROA percentage gives investors an idea of how effectively the company is converting the money it has to invest into net income. [4]

$$\text{The Formula: ROA} = \frac{\text{Net Income}}{\text{Total Assets}}$$

Return on equity (return on net worth)

ROE ratio measures the ability of a company's management to find out and adopt appropriate return on the capital invested by the owners in the firm. This ratio determines a corporation's profitability by showing how much profit a company earns with the money invested from shareholders. [7] The return on equity figure takes into account the retained earnings from previous years, and tells owners how effectively their capital is being reinvested.

$$\text{The Formula: ROE} = \frac{\text{Net Income}}{\text{Shareholder's equity}}$$

Profit Margin

Profit margin shows to be very useful when comparing companies within similar industries. Basically, it is the amount of profit (at the gross, operating, net income level) generated by the company as a percent of the sales generated. A higher profit margin indicates high company profitability and better control over its costs compared to its competition. Positive profit margin translates into positive investment quality.[8]

Gross profit margin

This ratio indicates the efficiency of a company's trading activities. The gross profit margin is used to analyze how efficiently a company is using its raw materials, labor and manufacturing-related fixed assets to generate profits. A higher margin percentage is a favorable profit indicator. Industry characteristics of raw material costs, have a major effect on a company's gross margin.[2] Generally it is better to compare the results over time to look for development or to compare it to other companies in the industry.

$$\text{The formula: GPM} = \frac{\text{Revenue} - \text{Cost of Goods Sold}}{\text{Revenue}}$$

Operating Profit Margin

“By subtracting selling, general or operating expenses from a company's gross profit number, we get operating income.” [7] Operating Profit Margin (OPM) indicates how effective a business is at controlling the costs and expenses associated with normal company activities. By doing so it eliminates influences of financial expenditures, mainly interests, which do not belong to operating sphere. OPM reveals the extent to which a company is earning a profit from standard operations. This way has management much more control over operating expenses than its cost of sales outlays. [6]

$$\text{The formula: OPM} = \frac{\text{EBIT}}{\text{Sales Revenue}}$$

Net Profit Margin

So called net margin is what remains for the owners from an each dollar of sales after all expenses and taxes have been paid. “The relationship of net income to sales indicates managements ability to operate the business with sufficient success and essentially expresses the overall cost effectiveness of the operation.” [9] Profit margins vary significantly in companies from different industries, but again it can be said that the higher a companys profit margin compared to its competitors within sector, the better.

$$\text{The Formula: NPM} = \frac{\text{Net Income}}{\text{Net Sales}}$$

3.3.3. IN05 index

This index is able to determine the level of threat of the enterprise against going into the bankruptcy. Bankruptcy index uses ratio analysis indicators to measure the financial health of a business and derives the financial problems. Such indexes are made especially for creditors since they are mostly interested in the ability of the enterprise to fulfill its debts. [6]

The necessity of measuring business financial health drove development of bankruptcy indexes further and in 1960s was created *Altman's Z-score index*. This index was considered very universal using some significant indicators of ratio analysis. However its unreliability and inaccuracy in calculations for Czech Industry conditions resulted in creation of new index suited especially for Czech Republic. New adjusted index IN95 was derived and composed by Mr. And Mrs Neumaier in 1995.

The same authors later refined and merged the indexes IN95 and IN99 and created IN01. This new index combined ability of both previous indexes. IN01 assesses the ability owner. In 2004 the new index IN05 was created as a substitute for the old IN01 witch suits better for Czech Construction Sector.

IN05 Formula

$$\begin{aligned} &= 0.13 * (\text{Total Assets} / \text{External Investments}) \\ &+ 0.04 * (\text{EBIT} / \text{Interest Expense}) \\ &+ 3.97 * (\text{EBIT} / \text{Total Assets}) \\ &+ 0.21 * (\text{Net Income} / \text{Total Assets}) \\ &+ 0.1 * (\text{Current Assets} / (\text{Current Liabilities} + \text{Current Bank Credit})) \end{aligned}$$

If the calculated result of the IN05 is higher than 1.6 the company generates additional value and finds itself in satisfactory financial situation. On the other hand if the calculation of IN05 is less than 0.9 the company is decreasing in value and there is danger of financial complications. If IN05 ranges between values 1.6 to 0.9 then it is called “grey zone”. [7]

3.3.3. Analysis of development of the Czech Construction Sector 2008-2011

3.3.3.1. Introduction

This part of the bachelor thesis attempts to assess the state of Czech construction sector from 2008 to 2011. The aims are to find what are the limiting factors for growth and how they affected companies in construction sector. Information necessary for completion of this part was collected through study of various construction sector analysis, interviews of key construction company managers, and collection of data from the Czech Statistical Office. The study also utilizes data from annual and financial reports of selected companies in order to ensure quality analysis.

3.3.3.2. Economic Importance of Construction Industry for Czech Republic

Promotion and support of construction industry benefits domestic economy. Available studies show multiplier effect of constructions on employment. This states that one million CZK invested in the industry generates the need for 3.5 workers in

constructions and related activities. It has also been stated that government investments of 100 million CZK into the sector bring roughly 55 million CZK as tax and other benefits to the public budgets. This way the state is able, through public construction tenders, directly stimulate the domestic economy. On the other hand reduction of government investments in constructions has a negative impact on employment and other economic indicators. For example if the investments were to be decreased by 10 billion CZK, it would lead to loss of 32,000 to 35,000 jobs and decrease of 5.5 billion of income directly into public budget. [15]

3.3.3.3. Development of the Construction Sector in 1990's

It took approximately 18 years before the Czech construction caught up the growth of Western European construction companies. While the development of the Western construction went forward relatively smoothly, the Czech construction industry had to deal in the 1990's with fluctuations and two phases of recession. The first decline in constructions occurred in the first two years of transition to a market economy (1990-1992). The decline was reported throughout whole sector. During years 1992 – 1996 there was reported a phase of 20% growth, followed by second crisis (1996 - 1999) of 16% decline in construction output. At the same time Western European construction has experienced modest growth in all directions. After year 2000 Czech Republic, along with Slovakia experienced boom in constructions and showed the most significant growth among 19 members of Euroconstruct the European construction research group.[10]

3.3.3.4. Czech Construction Sector 2008 – 2011

As well as throughout the world, the economic situation in Europe changed dramatically at the end of 2008. The recession hit almost all 19 Member States of Euroconstruct. To cope with the economic crisis, some states have introduced financial support packages and policies. Some of these measures have been focused on the construction sector.

While until the year 2007, majority of 19 countries of the group continued to grow Czech Republic with Slovakia lost at the end of 2007 the highest economic growth rates in Europe, including construction production. However the slowdown in 2008, following a

change in the development has pulled the European construction sector down into “red numbers“

Following years 2009 to 2011 are not optimistic. Czech construction sector showed in 2011 decrease in construction production index by 15% in comparison with the year 2009. This drop was caused both by increasing effects of financial recession which limited significantly contracts financed by public budgets. Other factor was extremely unfavorable weather conditions, which play an important role in construction production. Additionally it analysts expect further slight decline caused by changes in legislation. These negative changes include usually taxation, pensions and health reforms and announced change in value-added tax. Another negative impact on the development of construction may also have worsening payment behavior and distrust of the banking sector in the construction industry. [15]

In order to deal with decrease of granting public contracts companies were forced to optimize their capacities. This was has been managed either or both by firing employees or by accepting under priced contracts. Higher competition causes situation in which companies have no other choice but to construct buildings with negative margin. This fact does not bring any reasons to be optimistic towards future. Only positive moment is expected as a slight growth in production volume. This is indicating further future increase in production due to massive numbers of bankrupted competitors.

4. DESCRIPTION OF THE SELECTED COMPANY

The author of this work is required by the founder not to state the name of the selected company. The name is not mentioned in the Bachelor Thesis.

The company was established in 1990. The enterprise has gone through many changes during its lifetime. It transformed from limited liability company to stock company. The business acquired several companies strategically situated around Czech Republic. 23 years from its establishment it has become medium-size contractor in Czech construction sector.

In beginning the enterprise focused mainly on implementation and reconstruction of underground structures in Prague and local area. As a part of its development the company expanded both their services and geographically. Thanks to that it is now able to operate in all regions of Czech Republic.

The scope of the business is purchase of merchandize with the aim of further sale, engineering activities in construction; construction of buildings, modification, maintenance works and removal; mining activities etc. Mainly company puts focus on underground constructions and engineering nets. Customers include both private and public sector investors (towns and cities).

The structure of the company is divided geographically in branches located in cities Praha, Opava, Brno, Plzen. Each division has its own CEO (Chief Executive Officer). CEOs are directed by the sole shareholder and at the same time founder of the company.

The enterprise currently employs 234 employees that include 65% construction workers, 35% technical & economic personnel and management. Due to the masculine nature of most of the jobs in construction industry the ratio of men to women is 10 to 1. The number of employees have not changed significantly in observed years 2008 to 2011.

Membership in professional organizations:

- Czech Tunneling Association ITA / AITES
- PPP Association
- SOVAK - Association of Water Supply and Sewerage CR
- HKP - Chamber of Commerce City. Prague
- CSS - Czech Road Society
- ČKAIT - Czech Chamber of Authorized Engineers and Technicians

All company management systems are certified according to the applicable standards.

The company is certified:

- Quality Management System according to ISO 9001:2009
- Environmental management system according to ISO 14001:2005 and EMAS
- Safety Management System Occupational Health OHSAS 18001:2008
- System of corporate social responsibility by SA 8000:2008

5. FINANCIAL ANALYSIS OF THE SELECTED COMPANY

5.1. Vertical and Horizontal analysis of assets

Vertical analysis of assets compares individual items in the balance sheet with total amount of assets. Horizontal analysis of assets compares percentile or absolute difference of individual items between this year and last year. It makes it therefore easier to see relative yearly changes within a business. The analysis was computed using financial calculators and software in order to avoid miscalculations and other mistakes.

For better readability the all tables were reduced to include only the major values of the Balance Sheet. These items were summarized into group Total Assets which include Fixed Assets, Current Assets and Accruals. For more detailed observations see the full scale vertical and horizontal analysis of assets included in the appendix of this Bachelor Thesis.

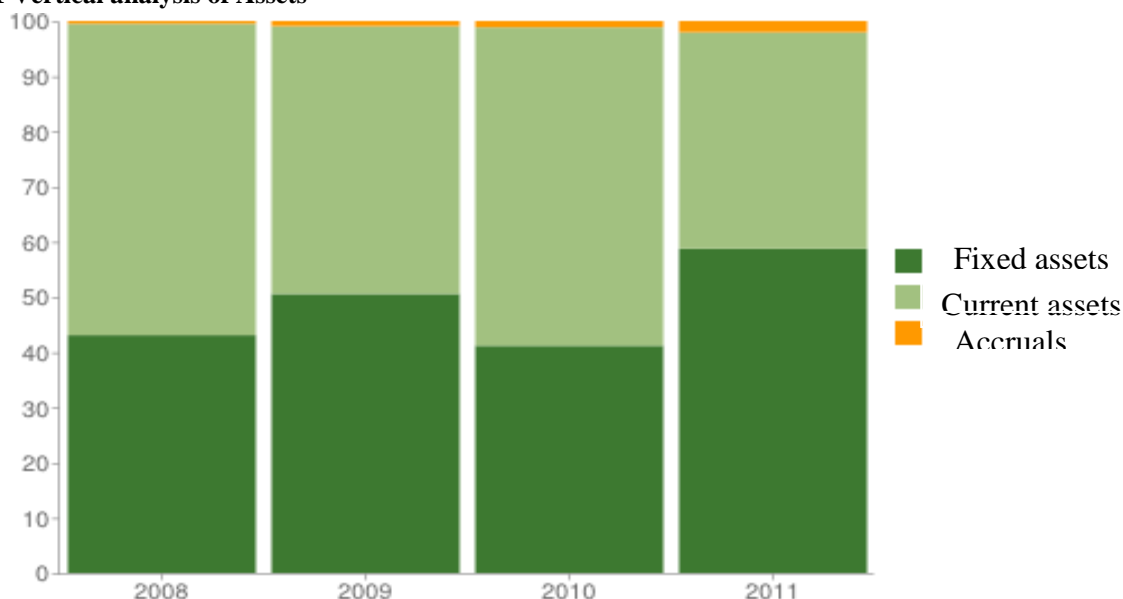
In order to evaluate the selected enterprise it is necessary to make comparison with adequate competitor. For this reason it was decided to include other construction company in the analysis. The selected data of competing enterprise EDIKT a.s. are located in two right shaded column in a table when appropriate.

Table 1 Vertical Analysis of assets

Total assets	2008	2009	2010	2011	Competitor	2010	2011
	100%	100%	100%	100%		100.00 %	100.00 %
Fixed assets	24.96 %	32.93 %	21.25 %	20.11 %		25.93 %	26.41 %
Current assets	73.82 %	66.16 %	78.13 %	79.21 %		71.41 %	71.88 %
Accruals	1.21 %	0.92 %	0.62 %	0.67 %		2.66 %	1.70 %

Source: Financial software and own calculations from Annual Reports

Figure 1 Vertical analysis of Assets



Source: Financial software and own calculations from Annual Reports

The major part of the total assets of the selected company in years 2008 to 2011 accounts for the Current Assets. According to calculations the value of Current assets grew over the recent years from 73.8% in 2008 up to 79.2% in 2011. The growth of Current assets appear to be steady except in year 2009 we can observe significant decrease from 73.8% to 66.2%. This drop was caused by decrease of short-term receivables and was only temporal since the volume of Current assets increased back again next year as it is visible in both tables 1 and 2.

Table 2 Horizontal analysis of assets

Item	2009/2008		2010/2009		2011/2010		2011/2010	
	Absolute change (In 1000 CZK)	Relative change (%)	Absolute change (In 1000 CZK)	Relative change (%)	Absolute change (In 1000 CZK)	Relative change (%)	Competitor Absolute change (In 1000 CZK)	Competitor Relative change (%)
Total Assets	-12041	-6.65%	60976	36.09%	-5551	-2.41%	79807	20.65%

Fixed assets	10453	23.13%	-6776	-12.18%	-3731	-7.64%	22924	22.88%
Current assets	-21845	-16.35%	67863	60.71%	-1894	-1.05%	59207	21.46%
Accruals	-646	-29.40%	-114	-7.35%	74	5.15%	-2324	-22.63%

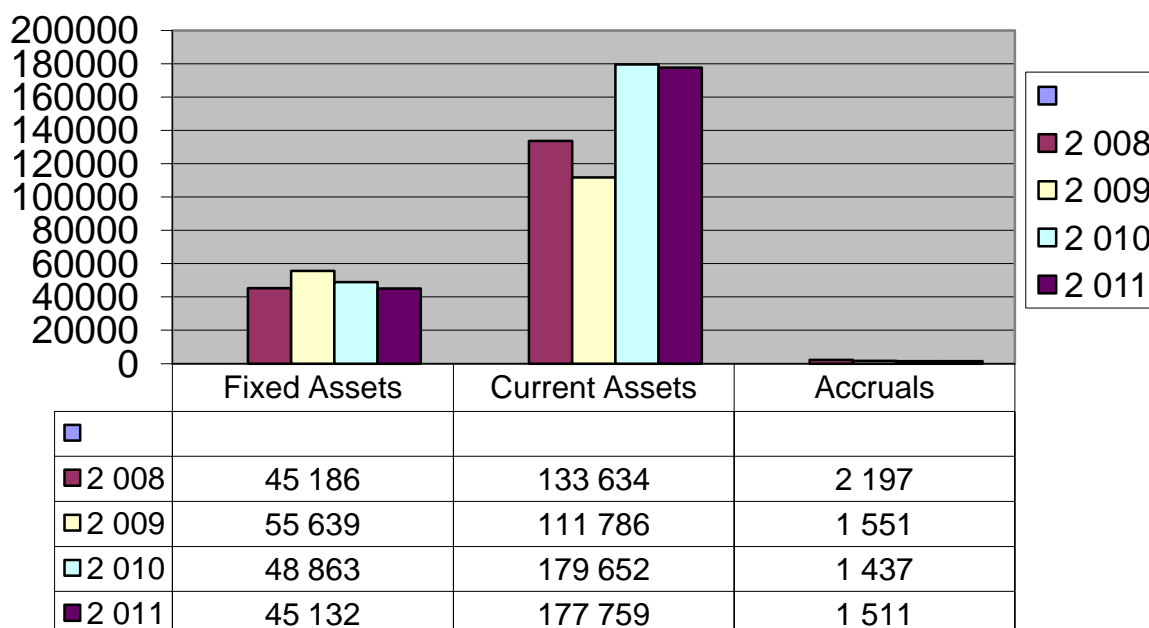
Source: Financial software and own calculations from Annual Reports

The drop in short-term receivables was mainly caused by an attempt of company management to shorten contract maturities, even if it caused cut in prices of their constructions. Simply the company wanted to get paid by an investor in shorter period of time. In return the company agreed to cut price of the building. Generally if the shorter maturity is agreed, the company is able to increase production with the same amount of working capital, because the capital circulates quicker within the system.

Figure 2 Volume of Assets from 2008 to 2011

State of assets during 2008 - 2011

All values are in thousands of CZK



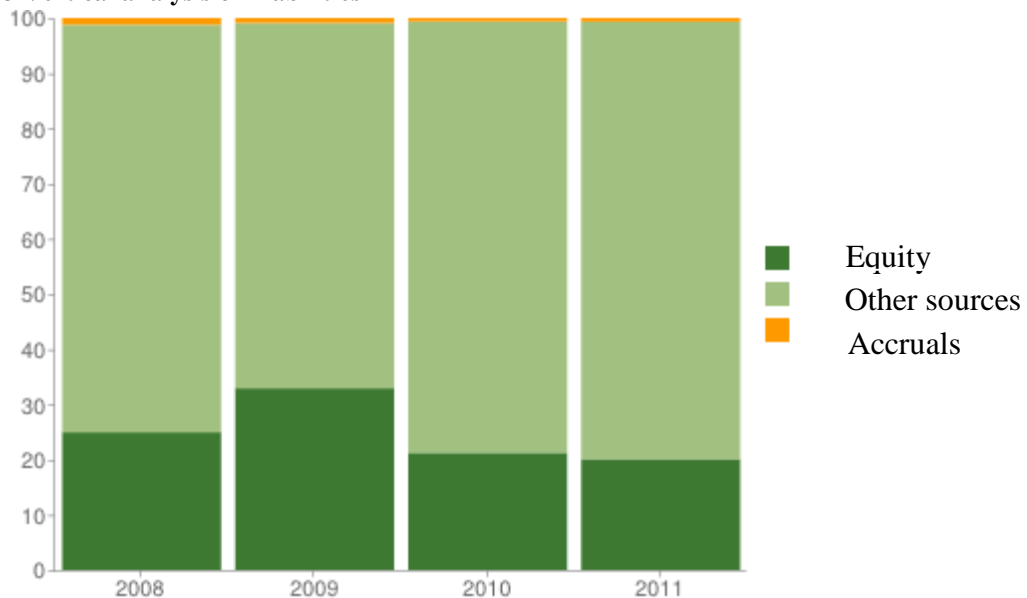
Source: Financial software and own calculations from Annual Reports

5.2. Vertical and Horizontal analysis of Liabilities

Vertical analysis of liabilities compares individual items in the balance sheet with total amount of liabilities. Horizontal analysis of liabilities compares percentile or absolute difference of individual items between this year and last year. It makes it easier to see relative yearly changes within a business. For more detailed observations the full scale vertical and horizontal analysis of liabilities are included in the appendix of this Bachelor Thesis.

Between years 2008 to 2011 the company used relatively the same portion of Other Sources as was its Equity. According to the Annual Reports from previous years it is important to mention that the utilization of companys External Sources to own Equity was much higher than in present. This trend of decreasing utilization of external sources specifically the short-term payables continues in present and in 2011 equals only to 39.2%.

Figure 3 Vertical analysis of Liabilities



Source: Financial software and own calculations from Annual Reports

In comparison the utilization of external sources between 2003 to 2005 was about 70%. From 2008 the enterprise adopted policies that led to stabilization of financial situation in order to be ready when the recession hits the construction sector without reduction of number of employees. Such steps included limiting investments and continual increase of equity from 43% to 58.8% in four observed years and decrease in volume of other sources. These steps led to slower increase of return on equity which was in case of many other construction companies negative. However at the same time this did not reduce volume of total production which saved many jobs during recession.

The major portion of the Other Sources account for short-term payables. In case of Equity the majority includes Registered Capital and Profit from Previous Year. Due to unchanging value of Capital Registered it can be claimed, also the analysis confirms the facts, that the profit from previous years has an increasing trend.

Table 3 Vertical analysis of Liabilities

Total Liabilities	2008	2009	2010	2011	Competitor	2010	2011
	100%	100%	100%	100%		100%	100%
Equity	43.08 %	50.56%	41.19%	58.75%		39.96 %	27.76 %
Other Sources	56.43 %	48.51%	57.66%	39.21%		58.33 %	70.45 %
Accruals	0.49 %	0.93 %	1.15 %	2.04 %		1.70 %	1.80 %

Source: Financial software and own calculations from Annual Reports

According to annual reports the competitor used its external sources in similar manner as the selected company in previous years. However in 2010 and 2011 set a pace of increasing utilization of external sources. Due to increasing effects of the Construction Sector Crisis companies tend adopt new economic rescue packages and policies which in this case include for example acquiring new bank loans. Such steps are vital when attempting to survive through times of economic recession.

Table 4 Horizontal analysis of Liabilities

Item	2009/2008		2010/2009		2011/2010		2011/2010	
	Absolute chnge (In 1000 CZK)	Relative change (%)	Absolute chnge (In 1000 CZK)	Relative change (%)	Absolute chnge (In 1000 CZK)	Relative change (%)	Absolute chnge (In 1000 CZK)	Relative change (%)
total Liabilities	-12041	-6.65%	60976	36.09%	-5551	-2.41%	79807	20.65%
equity	7450	9.55%	9284	10.87%	37125	39.19%	-25002	-16.19%
Other Sources	-20173	-19.75%	50608	61.74%	-44599	-33.64%	103056	45.73%
Accruals	682	77.06%	1084	69.18%	1923	72.54%	1783	27.07%

Source: Financial software and own calculations from Annual Reports

5.3. Vertical and Horizontal analysis of Profit/Loss Account

Vertical analysis of profit/loss account compares individual items with total amount of profit or loss. Horizontal analysis of profit/loss account compares percentile or absolute difference of individual items between this year and last year. It makes it therefore easier to see relative yearly changes within a business. The analysis was computed using financial calculators and software in order to avoid miscalculations and other mistakes.

Table 5 Vertical analysis of Profit/Loss Account

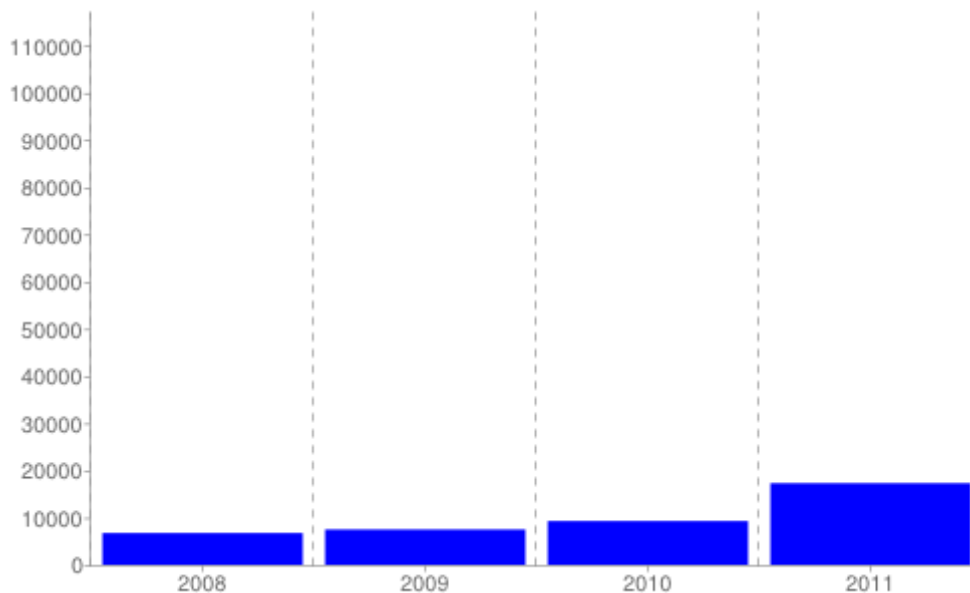
Item	2008	2009	2010	2011
Production	100.00 %	100.00 %	100.00 %	100.00 %
Revenues from own production and services	97.34 %	99.76 %	100.85 %	99.92 %
Change in inventory	2.66 %	0.24 %	-0.85 %	0.08 %

Production consumption	76.39 %	79.32 %	82.14 %	80.48 %
Consumption of material and energy	19.15 %	16.92 %	17.25 %	13.07 %
Service	57.23 %	62.40 %	64.90 %	67.41 %
Wages and salaries	13.28 %	13.16 %	12.33 %	11.16 %
Transfer of operating expenses	53.26 %	16.91 %	19.93 %	21.23 %
Operating Profit/loss	2.18 %	1.98 %	2.07 %	3.26 %

Source: Financial software and own calculations from Annual Reports

Before the outbreak of the economic recession the company management decided to make changes in personal structures of employees. Specifically increased numbers of employees in management of the company by the end of booming year 2008. The increase can be observed as jump in wages and salaries by 21.2%.

Figure 4 Operating Profit/loss from ordinary activities



Source: Financial software and own calculations from Annual Reports

After year 2008 it is possible to observe an increase in production without increase of wages and salaries or without letting any employees off. In simple way this means that the employees increased their effectiveness which resulted in higher production. This is very unique phenomenon among competitors in construction sector during the recession, because most of the companies had to let go of some employees because of lack of total production in whole sector.

According to Magazine Stavilel this decrease of volume in total constructions was 19.7%. However the increase in management allowed the selected company to increase its volume of production by 22.7% between 2008 and 2009, by 12.3% between 2009 and 2010 and by 13.3% between 2010 and 2011.

Table 6 Horizontal analysis of Profit/Loss Account

Item	2009/2008		2010/2009		2011/2010	
	Absolute chnge (In 1000 CZK)	Relative change (%)	Absolute chnge (In 1000 CZK)	Relative change (%)	Absolute chnge (In 1000 CZK)	Relative change (%)
Production	100420	22.70%	66771	12.30%	81345	13.35%
Wages and salaries	12671	21.56%	3710	5.19%	1943	2.59%
Depreciation of intangible and tangible fixed assets	989	14.62%	722	9.31%	-1118	-13.19%
Revenues from disposals of fixed assets	-8910	-99.64%	9080	28375%	-9009	-98.87%
Change in reserves and provisions to operating activities and complex deferred expenses	-13191	-156.53%	-6750	-141.69%	12171	105.71%
Other operating income	-968	-29.17%	3219	136.98%	-2266	-40.69%
Operating Profit/loss	1104	11.43%	1874	17.41%	9910	78.43%
Profit/loss from ordinary activities	750	11.12%	1790	23.89%	8017	86.35%

Profit/loss before tax	580	6.74%	2045	22.27%	10069	89.69%
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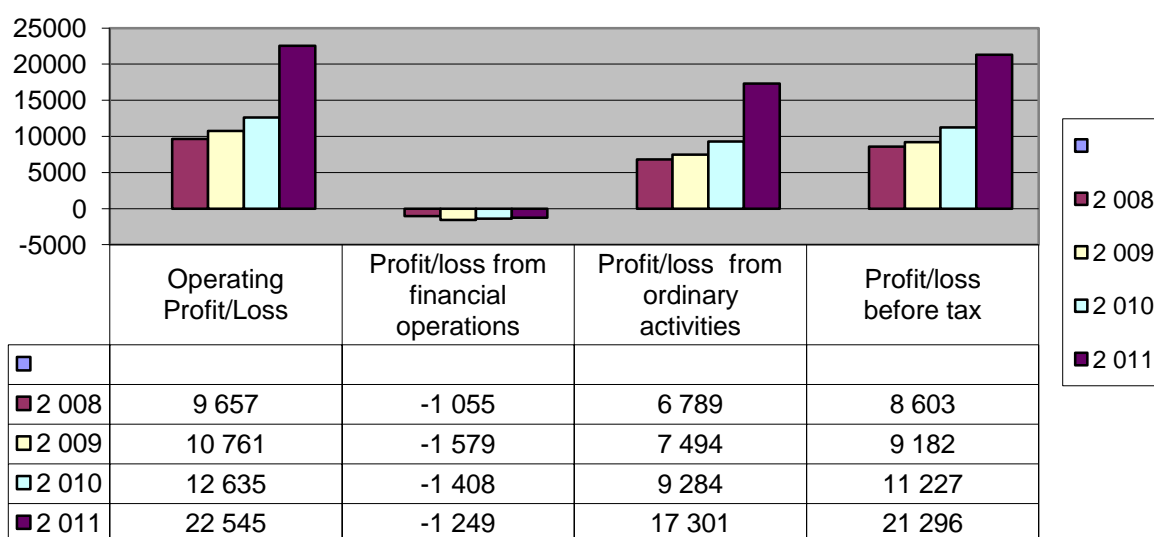
Source: Financial software and own calculations from Annual Reports

From observation of interest expenses it is deducible that the company decreased its indebtedness with banks while having the same credit line. Credit line is an amount of capital the bank is willing to invest, specifically for the selected company up to 100 million crowns. Utilization of the credit line(which now works as a buffer against further unexpected negative development in the construction sector) by the company decreased rapidly. From psychological point of view the buffer ensures employees or investors that the company is not going to be affected negatively by the recession.

Figure 5 Economic Results 2008 to 2011

Economic Results 2008 - 2011

All values are in thousands of CZK



Source: Financial software and own calculations from Annual Reports

Change in reserves and provisions to operating activities and complex deferred expenses show decreasing tendency between 2008 to 2010. That is mainly caused by fear of effects of economic recession. These reserves were abnormally high in period of time before recession. The reserves were being released in 2008 when the crisis hit the industry in order to maintain operating profit.

5.4. Ratio analysis

5.4.1 Profitability

From 2008 to 2011 it is possible to observe growing trend of all indicators. These figures describe rate of return. According to the owner of the selected company the most monitored and reliable indicator is Return on Sales which dropped slightly in 2009 however in 2011 not only grew but even doubled compared to other years.

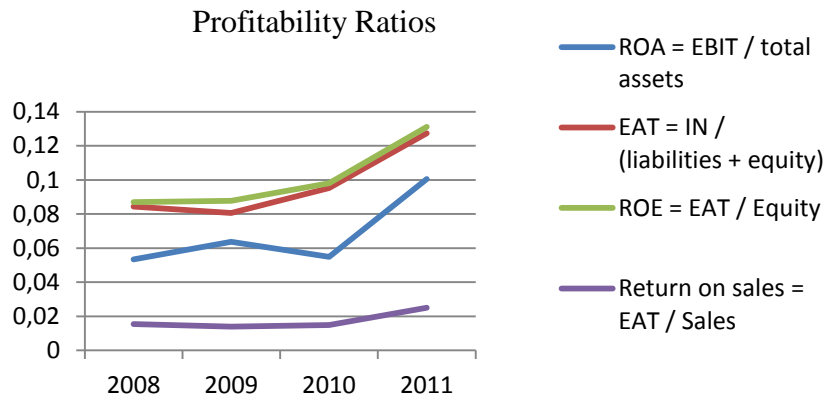
Table 7 Profitability Ratios

Profitability Indicator	2008	2009	2010	2011
ROA = EBIT / total assets	0.053349	0.063684	0.054946	0.100467
EAT = IN / (liabilities + equity)	0.084441	0.080557	0.095274	0.127445
ROE = EAT / Equity	0.087054	0.087715	0.098015	0.131222
Return on sales = EAT / Sales	0.01544	0.01384	0.014881	0.02506

Source: Financial software and own calculations from Annual Reports

Also it is important to mention that these indicators seem to have very small values in comparison with other industries. Generally it can be said that the construction industry has very small profitability. According to businessmen operating in the sector this is caused by and long-term rate of competition in this very traditional industry. Construction Industry in its essence can comparable with automotive industry. The company buys material, fuel and machinery and its own work is to “assemble” some building almost like a car.

Figure 6 Profitability Ratios



Source: Financial software and own calculations from Annual Reports

Usually it is very difficult to generate new innovations with which the company would gain significant advantage against competition. If so these advances are usually made in new materials and machinery, not in construction itself. Such competition advantage can be gained only by better and more quality constructions.

For every entrepreneur it is important to optimize these indicators based on company strategy. In case of the selected company the long term strategy is dynamic growth. This aim is going to be reached also by limiting the amount dividends paid to zero during the recession times. That means that all the profit generated will be reinvested in the company.

5.4.1. Liquidity

Liquidity describes ability of the company to convert its assets into cash in certain period of time. When inspecting **Table 8** it is noticeable that all the indicators increase steadily in time except for year 2010 where there is slight drop in values. Still based on literature all of the ratios stay and develop within range of their optimal book values. For example current ratio should range within values 1.5 – 2.5, quick ratio should range from 1.0 – 1.5. Based on authors own calculations and the **Table 8** below it is clear that the company finds itself within the optimal values for each of the indicators.

Table 8 Liquidity Ratios

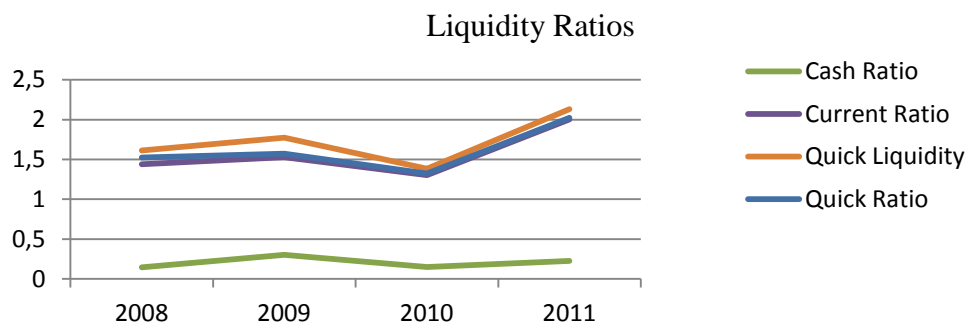
Liquidity Indicator	2008	2009	2010	2011
Cash Ratio	0.135828	0.289924	0.145526	0.224972
Quick liquidity = (OA-inventory) / current liabilities	1.441691	1.527192	1.304233	2.002507
Current ratio = current assets / current liabilities	1.612438	1.771878	1.383279	2.132272
Working capital = current assets - current liabilities	50 757	48 697	49 778	94 393
Quick Ratio	1.5248462	1.572147	1.323659	2.02214

Source: Financial software and own calculations from Annual Reports

A construction company in its purest form should not own any tangible fixed assets. Tangible assets are not as profitable and are blocking the rest of total assets according to the owner of the selected company. Therefore it is necessary to attempt to limit amount of tangible assets so the larger portion of the total assets can circulate within the business.

However ownership of tangible asset is necessary for banking institutions to allow loans and overall credit line. Banks approve credit line to be about two thirds of company total assets. Usual experience is that 20% of the credit line must be guaranteed and covered by tangible assets. That means that in order to have 100 million Crowns of credit line which is the case of the selected company it is necessary to own tangible assets of value 20 million Crowns.

Figure 7 Liquidity Ratios



Source: Financial software and own calculations from Annual Reports

5.4.2. Activity

Activity ratios indicate and quantify how efficiently and quickly can the company utilize its assets. All activity indicators show increasing trend from 2008 to 2011 according to the Table 9 below. Only exceptions are Working capital Turnover which dropped in 2011 and Receivables turnover rate which showed rapid increase in 2009.

Table 9 Activity Ratios

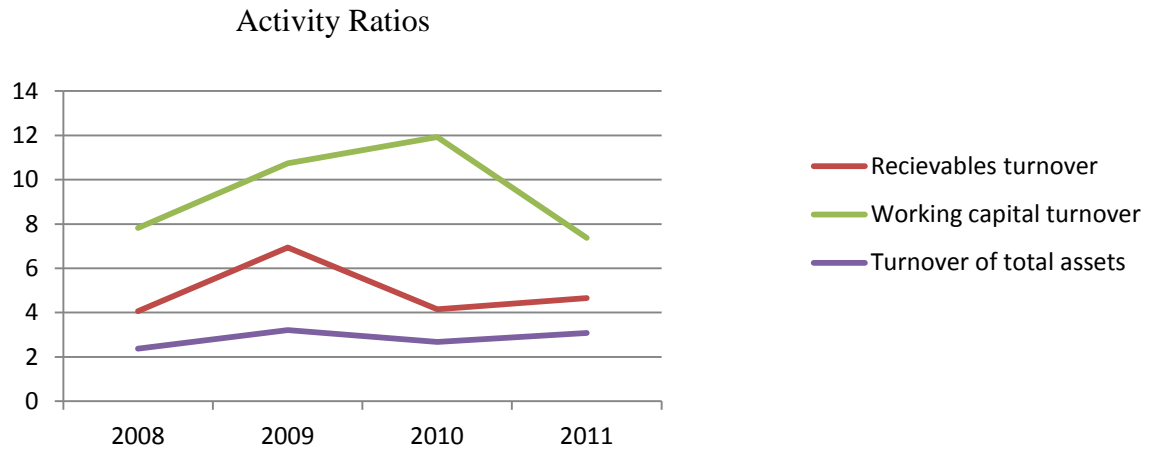
Activity Indicators	2008	2009	2010	2011
Inventory turnover rate = cost of goods sold/ average inventory	31.0647 3	35.0764 4	60.7723 6	63.8191 9
Receivables turnover rate = sales / accounts receivable	4.06184 3	6.93594	4.14582 8	4.65901 4
Working Capital Turnover = sales/working capital	7.82689 6	10.7365 2	11.9214 5	7.36958
Turnover of total assets = revenue/assets	2.37652 3	3.21569	2.67235 9	3.07896 5

Source: Financial software and own calculations from Annual Reports

Until year 2008 volumes of construction production grew significantly and reached its all time top. At this time the demand for construction capacities also reached its maximum and therefore contracts agreed this year were favorable (friendly prices and payment terms with short maturities) for suppliers (construction companies). Usual duration of construction contract for selected company is about 18 months, except for example highways or larger construction. These favorable conditions took shape as significant increase in receivables turnover rate in 2009 due to the duration time of the contracts.

Working capital turnover showed noticeable decrease in 2011. That is caused by drop in volume of current liabilities. The connection between working capital, bank credit line and the company policy to shorten contract maturities was already explained above. For illustration in simple way it can be said that the selected company is willing not to use external sources, consequently to have smaller working capital turnover ratio in order to have guaranteed credit line as a buffer against effects of the recession.

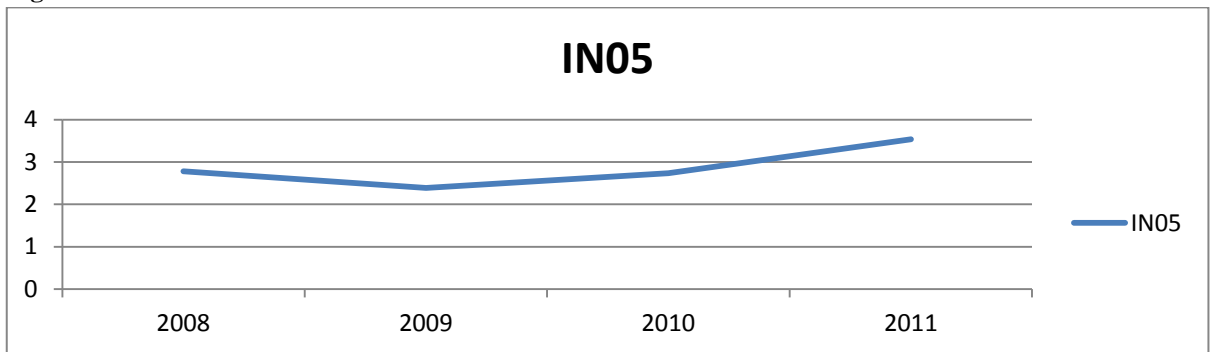
Figure 8 Activity Ratios



Source: Financial software and own calculations from Annual Report

5.5. IN05 Bankruptcy Index

Figure 9 Index IN05



Source: Financial software and own calculations from Annual Reports

Bankruptcy Index IN05 was calculated for years 2008 to 2011. Data from table and Figure suggest that the selected company went through fluctuating development regarding the index. From 2008 we can observe slight decrease followed by growth which even increased in 2010 and 2011. Based on IN05 values the index divides companies into three categories. The boundaries of the index are set as follow.

Table 10 Index IN05

Year	2008	2009	2010	2011
IN05	2.778	2.386	2.736	3.534

Source: Financial software and own calculations from Annual Reports

Values less than 0.9 indicate that the company has 97% probability of going bankrupt and 76% probability of not making any additional value. Companies with index values between 0.9 and 1.6 are in so called “grey zone” and have 50% probability to go bankrupt. In case of companies with index values above 1.6 there is probability 4% to go bankrupt and 95% to make additional value. [20] The selected company has got values of the bankruptcy index above 1.6 therefore we can say that the company is not going bankrupt. The selected company is able to generate value during times of recession.

6. CONCLUSION

The aim of this Bachelor Thesis is to evaluate financial situation of a chosen company and its relative position among its competitors in Czech Construction Industry. Material and information necessary to complete this work were obtained from various sources such as interviews with key company employees, company annual reports, various construction sector analysis etc. Utilization of these material helped the author to assess financial situation of the selected company. Unfortunately author of this work had faced obstacles that disabled him from writing more detailed and deeper analysis. These include limited knowledge of both theoretical and practical aspects of company economics and finance, lack of even basic experience in construction industry and also limited extend of the Bachelor Thesis.

Despite the limiting factors author was able to assess economic state of the selected company. This Bachelor Thesis contains two main bodies Theoretical part and Practical part. The Literature review in Practical part is an important part of the research since contains theoretical information and procedures necessary to make financial analysis. Various literature sources were used to explain definitions and theory.

Practical part of the Bachelor thesis contains chapters that include introduction of the selected company, horizontal and vertical analysis of financial statements, ratio analysis, and assessment of bankruptcy index.

Analysis of assets showed that the drop in short-term receivables was mainly caused by an attempt of company management to shorten contract maturities, to make the capital circulate quicker within the system. The result of this policy was increase of production with the same amount of working capital at the times when most of the construction companies have decreasing volumes of production.

Analysis of liabilities show that the enterprise adopted policies that led to stabilization of financial situation in order to be ready when the recession hits the construction sector. Such steps included limiting investments and continual increase of equity in four observed years and decrease in volume of other sources such utilization of bank credit line. These policies enabled company to keep all the employees.

Results of the ratio analysis indicate continual growth at all levels except few ratios. Those include decrease of working capital turnover in 2011. According to founder the selected company has been willingly not using external sources at the moment which resulted in smaller working capital turnover ratio. This policy guarantees credit line as a buffer against effects of the recession.

Bankruptcy Index IN05 proved that the economic situation of the selected enterprise is during difficult times of recession relatively good. The selected company generates value and shows growing trend in the future according to the index. Overall economic state of the selected company is good with promising future development. This claim is supported by the financial analysis, bankruptcy index and even by the founder himself.

Despite the positive results and outcome of the analysis, the selected company can still face difficult situations on the market, due to continuing effects of recession in construction industry. The founder of the company is aware of this fact and therefore has begun with company transformation of the medium-size into an larger enterprise. The company now finds itself in such good state that is ready to expand and acquire other construction companies, according to the owner. This way it is going to become one of 5 largest construction companies in next ten years.

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Appendix

Vertical analysis of assets

	Item	2008	2009	2010	2011
	total Assets	100.00 %	100.00 %	100.00 %	100.00 %
B.	Fixed assets	24.96 %	32.93 %	21.25 %	20.11 %
B. I.	Intangible fixed assets	0.35 %	0.19 %	0.18 %	0.11 %
	3. software	0.35 %	0.19 %	0.18 %	0.11 %
B. II.	Tangible fixed assets	24.61 %	32.74 %	21.07 %	20.00 %
B. II. 1.	Lands	3.23 %	7.27 %	6.10 %	6.39 %
	2. Constructions	10.08 %	14.08 %	8.31 %	8.20 %
	3. Independently movable assets and sets of movable things	10.26 %	11.39 %	6.60 %	5.41 %
	7. Tangible fixed assets under construction	1.04 %	0.00 %	0.05 %	0.00 %
C.	Current assets	73.82 %	66.16 %	78.13 %	79.21 %
C. I.	Inventory	7.82 %	9.14 %	4.46 %	4.82 %
C. I.	material	0.00 %	0.00 %	0.00 %	0.00 %

1.					
2.	Work in progress and semi-finished products	7.82 %	9.14 %	4.46 %	4.82 %
C. II.	Long-term receivables	2.27 %	2.51 %	3.05 %	2.45 %
C. II. 1.	Trade receivables	2.27 %	2.51 %	3.05 %	2.45 %
C. III.	short-term receivables	57.51 %	43.69 %	62.39 %	63.58 %
C. III. 1.	Trade receivables	56.73 %	40.67 %	59.66 %	61.41 %
7.	Short-term advances	0.72 %	1.88 %	0.35 %	0.47 %
9.	other receivables	0.06 %	0.03 %	2.37 %	1.70 %
C. IV.	Short-term financial assets	6.22 %	10.82 %	8.22 %	8.36 %
C. IV. 1.	Cash	0.22 %	0.33 %	0.18 %	0.22 %
2.	Bank accounts	6.00 %	10.49 %	8.04 %	8.14 %
D. I.	Accruals	1.21 %	0.92 %	0.62 %	0.67 %
D. I. 1.	Deferred expenses	1.19 %	0.89 %	0.62 %	0.64 %

3.	Deferred income	0.02 %	0.03 %	0.00 %	0.03 %
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Horizontal analysis of Assets

Označ.	Položka	2009/2008		2010/2009		2011/2010	
		Abs.	Rela. (%)	Abs.	Rela. (%)	Abs.	Rela. (%)
	total Assets	12041	-6.65	60976	36.09	5551	-2.41
B.	Fixed assets	10453	23.13	-6776	-12.18	3731	-7.64
B. I.	Intangible fixed assets	-319	-49.84	85	26.48	-154	-37.93
	3. software	-319	-49.84	85	26.48	-154	-37.93
B. II.	Tangible fixed assets	10772	24.18	-6861	-12.40	3577	-7.38
B. II. 1.	Lands	6438	110.11	1751	14.25	300	2.14
	2. Constructions	5542	30.38	-4670	-19.63	-709	-3.71
	3. Independently movable assets and sets of movable things	669	3.60	-4060	-21.09	3050	-20.08

7.	Tangible fixed assets under construction	-1877	-	118	0.00	-118	-
		100.00				100.00	
C.	Current assets	21845	-16.35	67863	60.71	1894	-1.05
C. I.	Inventory	1286	9.09	-5171	-33.50	552	5.38
2.	material	1286	9.09	-5171	-33.50	552	5.38
C. II.	Work in progress and semi-finished products	128	3.11	2773	65.31	-	-21.57
		1514					
C. II.	Long-term receivables	128	3.11	2773	65.31	-	-21.57
1.		1514					
C. III.	Trade receivables	30286	-29.09	69645	94.34	-787	-0.55
C. III.	short-term receivables	33975	-33.08	68480	99.65	604	0.44
1.							
6.	Trade receivables	1866	0.00	-1866	-100.00	0	0.00
7.	Short-term advances	1868	142.49	-2368	-74.49	244	30.09
9.	other receivables	-45	-43.69	5399	9308.62	-	-29.96
		1635					
C. IV.	Short-term financial assets	7024	62.40	619	3.39	-145	-0.77
C. IV.	Cash	152	37.72	-135	-24.32	70	16.67
1.							

2.	Bank accounts	6872	63.31	754	4.25	-215	-1.16
D. I.	Accruals	-646	-29.40	-114	-7.35	74	5.15
D. I. 1.	Deferred expenses	-652	-30.20	-70	-4.64	5	0.35
3.	Deferred income	6	15.79	-44	-100.00	69	0.00

Horizontal analysis of liabilities

Označ.	Položka	2009/2008		2010/2009		2011/2010	
		Abs.	Rela. (%)	Abs.	Rela. (%)	Abs.	Rela. (%)
	total Liabilities	-12041	-6.65	60976	36.09	-5551	-2.41
A.	equity	7450	9.55	9284	10.87	37125	39.19
A. III.	Reserve funds, Statutory reserve accounts fo cooperatives other retained earnings	341	7.97	375	8.12	465	9.31
A. III. 1.	Statutory reserve fund / indivisible fund	340	8.11	375	8.27	465	9.47
2.	Statutory and other funds	1	1.16	0	0.00	0	0.00

A. IV.	Profit/loss previous year	6404	86.33	7119	51.50	8543	40.80
A. IV. 1.	Retained earnings from previous year	6404	86.33	7119	51.50	8543	40.80
A. V.	Profit / loss current year	705	10.38	1790	23.89	8017	86.35
B.	Other Sources	20173	-19.75	50608	61.74	44599	-33.64
B. I.	reserves	-5563	-33.00	11293	100.00	708	0.00
B. I. 1.	Reserves under the special laws and regulations	-5563	-33.00	11293	100.00	708	0.00
B. II.	Long-term lpayables	5178	214.59	-4866	-64.10	1183	43.41
B. II. 1.	Trade payables	-57	-6.76	249	31.68	1108	107.05
8.	Estimated payables	-155	100.00	0	0.00	0	0.00
9.	other payables	0	0.00	-5000	100.00	0	0.00
10.	Deferred tax liability	390	27.56	-115	-6.37	75	4.44
B. III.	short-term payables	17302	-22.07	66917	109.53	45590	-35.61

B. III. 1.	Trade payables	- 14602	-23.37	64966	135.69	- 39647	-35.13
5.	Payroll	695	14.33	440	7.93	-360	-6.01
6.	Payables to social security and health Insurance	310	13.80	33	1.29	31	1.20
7.	Due from state - tax liabilities and subsidies	302	34.63	-895	-76.24	-17	-6.09
8.	Short-term deposits recieved	-2056	-82.24	-402	-90.54	-42	- 100.00
10.	Estimated payables	146	0.00	366	250.68	-22	-4.30
11.	Other payables	-2095	-38.48	2407	71.85	-5533	-96.11
B. IV.	Bank loans and financial accomodations	-2486	-55.47	-150	-7.52	-900	-48.75
3.	Short term accomodations	-2486	-55.47	-150	-7.52	-900	-48.75
C. I.	Accruals	682	77.06	1084	69.18	1923	72.54
C. I. 1.	Accrued expenses	682	77.06	1084	69.18	1923	72.54

Vertical analysis of liabilities

Označ.	item	2008	2009	2010	2011
	total Liabilities	100.00 %	100.00 %	100.00 %	100.00 %
A.	equity	43.08 %	50.56 %	41.19 %	58.75 %
A. I.	Registered capital	32.87 %	35.21 %	25.87 %	26.52 %
A. I. 1.	Registered capital	32.87 %	35.21 %	25.87 %	26.52 %
A. III.	Reserve funds, Statutory reserve accounts fo cooperatives other retained earnings	2.36 %	2.73 %	2.17 %	2.43 %
A. III. 1.	Statutory reserve fund / indivisible fund	2.32 %	2.68 %	2.13 %	2.39 %
	2. Statutory and other funds	0.05 %	0.05 %	0.04 %	0.04 %
A. IV.	Profit/loss previous year	4.10 %	8.18 %	9.11 %	13.14 %
A. IV. 1.	Retained earnings from previous year	4.10 %	8.18 %	9.11 %	13.14 %
	2. Accumulated losses from previous year	0.00 %	0.00 %	0.00 %	0.00 %
A. V.	Profit / loss current year	3.75 %	4.43 %	4.04 %	7.71 %

B.	Other Sources	56.43 %	48.51 %	57.66 %	39.21 %
B. I.	reserves	9.31 %	6.68 %	0.00 %	0.32 %
B. I. 1.	Reserves under the special laws and regulations	9.31 %	6.68 %	0.00 %	0.32 %
B. II.	Long-term lpayables	1.33 %	4.49 %	1.19 %	1.74 %
B. II. 1.	Trade payables	0.47 %	0.47 %	0.45 %	0.95 %
	9. other payables	2.76 %	2.96 %	0.00 %	0.00 %
	10. Deferred tax liability	0.78 %	1.07 %	0.73 %	0.79 %
B. III.	short-term payables	43.31 %	36.15 %	55.67 %	36.73 %
B. III. 1.	Trade payables	34.52 %	28.33 %	49.07 %	32.62 %
	5. Payroll	2.68 %	3.28 %	2.60 %	2.51 %
	6. Payables to social security and health Insurance	1.24 %	1.51 %	1.13 %	1.17 %
	7. Due from state - tax liabilities and subsidies	0.48 %	0.69 %	0.12 %	0.12 %
	8. Short-term deposits recieved	1.38 %	0.26 %	0.02 %	0.00 %

10.	Estimated payables	0.00 %	0.09 %	0.22 %	0.22 %
11.	Other payables	3.01 %	1.98 %	2.50 %	0.10 %
B. IV.	Bank loans and financial accomodations	2.48 %	1.18 %	0.80 %	0.42 %
3.	Short term accomodations	2.48 %	1.18 %	0.80 %	0.42 %
C. I.	Accruals	0.49 %	0.93 %	1.15 %	2.04 %
C. I. 1.	Accrued expenses	0.49 %	0.93 %	1.15 %	2.04 %

Profit/Loss account

Horizontal analysis of profit/loss account

	Item	2009/2008		2010/2009		2011/2010	
		Abs.	Rela. (%)	Abs.	Rela. (%)	Abs.	Rela. (%)
I.	Revenues for goods sold	0	0.00	0	0.00	0	0.00
A.	Cost of goods sold	0	0.00	0	0.00	0	0.00
+	Sale margin	0	0.00	0	0.00	0	0.00
II.	Production	100420	22.70	66771	12.30	81345	13.35
II.	Revenues from own	110884	25.75	73228	13.52	75622	12.30

1.	production and services						
II. 2.	Change in inventory	-10464	-89.06	-6457	-502.10	5723	110.67
II. 3.	Capitalization	0	0.00	0	0.00	0	0.00
B.	Production consumption	92616	27.41	70191	16.31	55305	11.05
B. 1.	Consumption of material and energy	7089	8.37	13314	14.50	14831	-14.11
B. 2.	Service	85527	33.78	56877	16.79	70136	17.73
+	Added value	7804	7.47	-3420	-3.05	26040	23.93
C.	Personal expenses	16362	20.60	4884	5.10	1978	1.96
C. 1.	Wages and salaries	12671	21.56	3710	5.19	1943	2.59
C. 2.	Remuneration of board members	80	200.00	0	0.00	0	0.00
C. 3.	social security expenses and health insurance	4171	21.30	1157	4.87	49	0.20
C. 4.	Social costs	-548	-51.46	5	0.97	-14	-2.68
D.	Taxes and fees	691	92.13	-546	-37.89	-14	-1.56
E.	Depreciation of intangible and tangible fixed assets	989	14.62	722	9.31	-1118	-13.19

III.	Revenues from disposals of fixed assets and materials	-9006	-99.65	9186	28706.25	-9115	-98.88
III. 1.	Revenues from disposals of fixed assets	-8910	-99.64	9080	28375.00	-9009	-98.87
III. 2.	Revenues from disposals of materials	-96	-100.00	106	0.00	-106	-100.00
F.	Net book value of disposed fixed assets and material	-6565	-98.96	7663	11105.80	-7658	-99.04
F. 1.	Net book value of disposed fixed assets	-6565	-98.96	7663	11105.80	-7658	-99.04
F. 2.	Net book value of Material sold	0	0.00	0	0.00	0	0.00
G.	Change in reserves and provisions to operating activities and complex deferred expenses	-13191	-156.53	-6750	-141.69	12171	105.71
IV.	Other operating income	-968	-29.17	3219	136.98	-2266	-40.69
H.	Other operating expenses	-1560	-30.46	1138	31.95	-791	-16.83
V.	Transfer of operating revenues	143801	-61.04	29661	32.31	25203	20.75
I.	Transfer of operating expenses	143801	-61.04	29661	32.31	25203	20.75
*	Operating Profit/loss	1104	11.43	1874	17.41	9910	78.43

VI.	Revenues from the sale of securities and investments	-100	- 100.00	0	0.00	0	0.00
J.	Revenues from bonds and shares sold	-100	- 100.00	0	0.00	0	0.00
VII.	Revenues from long term financial assets	0	0.00	0	0.00	0	0.00
VII. 1.		0	0.00	0	0.00	0	0.00
VII. 2.	Income from investments in subsidiaries and	0	0.00	0	0.00	0	0.00
VII. 3.	in accounting units with substantial influence	0	0.00	0	0.00	0	0.00
VIII.	Income from other securities and investments	0	0.00	0	0.00	0	0.00
K.	Income from other financial investments	0	0.00	0	0.00	0	0.00
IX.	Income from financial assets	0	0.00	0	0.00	0	0.00
L.	Cost of investments	0	0.00	0	0.00	0	0.00
M.	Income from revaluation of securities and derivatives	0	0.00	0	0.00	0	0.00
X.	Interest revenues	-36	-72.00	-4	-28.57	0	0.00
N.	Interest expenses	-307	- 100.00	228	0.00	-131	-57.46

XI.	Other financial revenue	-5	-100.00	1	0.00	1	100.00
O.	Other financial expenses	151	13.25	-100	-7.75	-27	-2.27
XII.	Transfer of financial revenues	0	0.00	0	0.00	0	0.00
P.	Transfer of financial expenses	0	0.00	0	0.00	0	0.00
*	Profit/loss from financial operations	-524	-49.67	171	10.83	159	11.29
Q.	Income tax on ordinary income	-170	-9.15	255	15.11	2052	105.61
Q. 1.	- Due tax	473	57.33	760	58.55	1862	90.48
Q. 2.	- Deferred tax	-643	-62.25	-505	-129.49	190	165.22
**	Profit/loss from ordinary activities	750	11.12	1790	23.89	8017	86.35
***	Profit loss current accounting period	750	11.12	1790	23.89	8017	86.35
****	Profit/loss before tax	580	6.74	2045	22.27	10069	89.69

Vertical analysis of profit/loss account

Označ.	2008	2009	2010	2011
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II.	Production	100.00 %	100.00 %	100.00 %	100.00 %
II. 1.	Revenues from own production and services	97.34 %	99.76 %	100.85 %	99.92 %
II. 2.	Change in inventory	2.66 %	0.24 %	-0.85 %	0.08 %
II. 3.	Capitalization	0.00 %	0.00 %	0.00 %	0.00 %
B.	Production consumption	76.39 %	79.32 %	82.14 %	80.48 %
B. 1.	Consumption of material and energy	19.15 %	16.92 %	17.25 %	13.07 %
B. 2.	Service	57.23 %	62.40 %	64.90 %	67.41 %
+	Added value	23.61 %	20.68 %	17.86 %	19.52 %
C.	Personal expenses	17.96 %	17.65 %	16.52 %	14.86 %
C. 1.	Wages and salaries	13.28 %	13.16 %	12.33 %	11.16 %
C. 2.	Remuneration of board members	0.01 %	0.02 %	0.02 %	0.02 %
C. 3.	social security expenses and health insurance	4.43 %	4.38 %	4.09 %	3.61 %

C. 4.	Other social expenses	0.24 %	0.10 %	0.09 %	0.07 %
D.	Taxes and fees	0.17 %	0.27 %	0.15 %	0.13 %
E.	Depreciation of intangible and tangible fixed assets	1.53 %	1.43 %	1.39 %	1.06 %
III.	Revenues from disposals of fixed assets and materials	2.04 %	0.01 %	1.51 %	0.01 %
III. 1.	Revenues from disposals of fixed assets	2.02 %	0.01 %	1.49 %	0.01 %
III. 2.	Revenues from disposals of materials	0.02 %	0.00 %	0.02 %	0.00 %
F.	Net book value of disposed fixed assets and material	1.50 %	0.01 %	1.27 %	0.01 %
F. 1.	Net book value of disposed fixed assets	1.50 %	0.01 %	1.27 %	0.01 %
F. 2.	Net book value of Material sold	0.00 %	0.00 %	0.00 %	0.00 %
G.	Change in reserves and provisions to operating activities and complex deferred expenses	1.91 %	-0.88 %	-1.89 %	0.10 %
IV.	Other operating revenues	0.75 %	0.43 %	0.91 %	0.48 %
H.	Other operating expenses	1.16 %	0.66 %	0.77 %	0.57 %
V.	Transfer of operating revenues	53.26 %	16.91 %	19.93 %	21.23 %
I.	Transfer of operating expenses	53.26	16.91	19.93	21.23

		%	%	%	%
*	Operating Profit/loss	2.18 %	1.98 %	2.07 %	3.26 %
VI.	Revenues from the sale of securities and investments	0.02 %	0.00 %	0.00 %	0.00 %
J.	Revenues from bonds and shares sold	0.02 %	0.00 %	0.00 %	0.00 %
X.	Interest revenues	0.01 %	0.00 %	0.00 %	0.00 %
N.	Interest expenses	0.07 %	0.00 %	0.04 %	0.01 %
O.	Other financial expenses	0.26 %	0.24 %	0.20 %	0.17 %
*	Profit/loss from financial operations	-0.24 %	-0.29 %	-0.23 %	-0.18 %
Q.	Income tax on ordinary income	0.42 %	0.31 %	0.32 %	0.58 %
Q. 1.	- Due tax	0.19 %	0.24 %	0.34 %	0.57 %
Q. 2.	- Deferred tax	0.23 %	0.07 %	-0.02 %	0.01 %
**	Operating Profit/loss from ordinary activities	1.52 %	1.38 %	1.52 %	2.50 %
***	Profit loss current accounting period	1.52 %	1.38 %	1.52 %	2.50 %
****	Profit/loss before tax	1.94 %	1.69 %	1.84 %	3.08 %