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Diploma thesis

Economic Evaluation of a Chosen Firm

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! ! !

Místo této strany vložíte zadání bakalářské práce.
(Do jedné vazby originál a do druhé kopii)

! ! !

Declaration on word of honour

I declare I have worked on the diploma thesis „Economic evaluation of a chosen firm“ on my own and I have used only the sources mentioned in the reference.

Prague, 6. 4. 2011 _____

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Ekonomické oceňování vybraného podniku

Economic evaluation of a chosen firm

Souhrn

Cílem mé diplomové práce je ocenění vybraného podniku. V mém případě se jedná o společnost AUDITOR Praha s.r.o., která se zabývá auditem a jinými auditorskými službami, kontrolami vedení účetnictví a daňovým, účetním a finančním poradenstvím. V oficiálním seznamu auditorů vedeném Komorou auditorů České republiky je zaregistrována od roku 1999. Sesterská společnost Auditor spol. s r. o. byla založena v roce 1991 jako 100 % dceřiná společnost rakouské hospodářsko-správní společnosti. Nejprve bylo nutné vypracovat strategickou a finanční analýzu a poté bylo možno provést samotné ocenění podniku. Ve strategické analýze je detailně prozkoumáno vnější prostředí ve vztahu k podniku. Je zde analyzován trh v ČR, dodavatelé, odběratelé a konkurenti dané firmy. Pro celkový přehled je vytvořena mapa strategických skupin a Porterův model pěti sil. Ve strategické analýze je také zhodnocení vnitřního prostředí a zdrojů podniku. Dále je prováděna finanční analýza firmy. Zde nalezneme analýzu absolutních ukazatelů, která se dělí na horizontální a vertikální analýzu, dále pak analýzu tokových a poměrových ukazatelů, jež zahrnují rentabilitu, aktivitu, platební schopnost a zadluženost. Na závěr finanční analýzy jsou vyhotoveny souhrnné modely, a to Altmanův model a pavučinový graf. Na celkové ocenění podniku jsou použita data za 6 let (2004 – 2009). Podnik je oceňován podle výnosových metod. Jsou zde aplikovány metody diskontovaných peněžních toků, kde hodnota podniku činí 15 781 000, - Kč a metoda kapitalizovaných výnosů, kde je hodnota vlastního kapitálu 5 300 000, - Kč.

Klíčová slova: oceňování podniku, strategická analýza, finanční analýza, horizontální analýza, vertikální analýza, ziskovost, aktivita, zadluženost, likvidita

Summary

The aim of my diploma thesis is to evaluate a chosen firm. My evaluated firm is AUDITOR Praha s.r.o. which offers auditing services, audit of bookkeeping and tax, accounting and financial advices. The company has been registered in the official list of auditors of the Czech Republic since 1999. The affiliated company Auditor spol. s r. o. was founded as a 100 percent subsidiary company of an Austrian consulting firm in May 1991 in Prague. Firstly it was needed to elaborate the strategic and financial analysis and then it was possible to make the company evaluation. In strategic analysis is in detail investigation of external environment towards the company. There is analyzed the Czech market, suppliers, customers and competitors of the certain enterprise. For an overview is created strategic map of groups and Porter model of five forces. In strategic analysis is also valuation of the internal environment and firm's resources. Furthermore is implemented the financial analysis of the firm. There we can find analysis of absolute indicators which is divided into horizontal and vertical analysis, then cash flow and ratio indicators which includes profitability, activity, payment ability and insolvency. At the end of the financial analysis are drawn summative models which are Altman model and spider graph. For the whole evaluation of the chosen firm is calculated with data for 6 years (2004 – 2009). The enterprise is evaluated according to yield methods. There are applied methods of discounted cash flow where the value is amounted to 15 781 000, - CZK and yield capitalized method where the value of equity is amounted to 5 300 000, - CZK.

Keywords: evaluation of enterprise, strategic analysis, financial analysis, horizontal analysis, vertical analysis, profitability, activity, insolvency, liquidity

Content

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1 Introduction

This thesis is engaged in evaluation of firm problems which is one of the most substantial areas of firm's financial management and decision making in market economy. There exist so many reasons for the evaluation of a firm. The most important ones are company purchasing and selling, merger or separation of company, share issue, advanced credit, expropriation compensation or evaluating of partner capital participation. It is not possible to do without evaluation. Nowadays certain progress from accounting concepts to market accesses and ways out in company's evaluation is obvious. When evaluating firm we can get together especially with strategic analysis, financial analysis and financial future plan. Their elaboration degree, in the sense of availability and data sources usage, and reason why the company should be evaluated offers valuer information about certain accessions and methods which should be chosen for the certain evaluation. The selected enterprise for my evaluation is AUDITOR Praha s.r.o. company. I have chosen this firm mostly because of their goodwill to provide me data and documents which are necessary for the elaboration of separate parts of my thesis.

2.1 Aim of my thesis and methodology

2.1 Aim of my thesis

The aim of my diploma thesis is possible to differ into several partial goals. These are adherent mostly to work divisions and correlation to certain chapters. The main aim is to make complex evaluation of a chosen firm according to pertinent methods and progresses which are set by technical literature. Between the partial aims we can include namely strategic analysis elaboration where the conditions and factors of external and internal environment of the certain firm are elicited. The strategic analysis shows internal sources and capabilities, respectively the external environment of the company. Other partial aim is to achieve financial analysis and uncover the company financial health. In the field of financial analysis is the fulfilment of vertical and horizontal analyses of accounting data. There is also ratio analysis and last but not least the total models of evaluating financial

levels. Financial analysis measures complexly up the evaluation of financial situation of a certain firm. Strategic and financial analysis is necessary namely for location of survival in competitive environment and for election of the right evaluating method.

2.2 Methodology

The elaboration of this diploma thesis was progressed in the following ways. Firstly, here was a technical literature studying and identification of the progresses and methods commonly used in enterprise evaluation. Indispensable for the practical part was selection of a company which would be kind to afford their data necessary for the individual analyses elaboration. Next according to realized processes was here elaboration of the strategic and financial analysis. Financial analysis is elaborated from six accounting period that is from 2004 to 2009. The marketing season in AUDITOR Praha s.r.o. is harmonized with the calendar year. Finally was compiled the particular evaluation of the enterprise by selected yield methods.

Strategic analysis

Strategic maps

This method creating strategic maps including companies placing into the strategic groups is possible to summarize in following points:

1) Finding main characteristics which differentiate companies in certain branch from one another.
2) Illustration of companies by two variables in the use of these different characteristics on the map.
3) Enlistment of firms which fall within approximately same strategic space and same strategic group.
4) Retrace circle around every strategic group; every circle has to have a size in the proportion to the part of certain group on the total revenues of branches.

Financial analysis

Relative indicator changes against previous season is formulate as following:

$$\Delta = \frac{\text{indicator}_{t+1} - \text{indicator}_{t}}{\text{indicator}_{t}} \times 100$$

where: Δ is indicator change expressed in %

In vertical analysis of income statement was as the main item, for which the others are related, chosen the sum of return on sales in own product items and services together with return on sale in merchandize.

Profitability

$$\text{ROA} = \frac{\text{EBIT}}{\text{assets}}$$

$$\text{ROE} = \frac{\text{EAT}}{\text{equity}}$$

$$\text{ROS} = \frac{\text{EBIT}}{\text{sales}}$$

$$\text{Return on costs:} \frac{\text{EAT}}{\text{total costs}}$$

Liquidity

$$\text{Liquidity of the 3.level} = \frac{\text{current assets}}{\text{Short time period commitment}}$$

$$\text{Liquidity of the 2.level} = \frac{\text{Financial assets + short time claims}}{\text{Short time period commitment}}$$

$$\text{Liquidity of the 1.level} = \frac{\text{Financial assets}}{\text{Short time period commitment}}$$

$$\text{Proportion of claims on short term assets} = \frac{\text{claims}}{\text{short term assets}}$$

Net working capital = current assets – current liabilities

$$\text{Ratio indicator of liquidity} = \frac{\text{short term assets} - \text{short term liabilities}}{\text{short term assets}}$$

$$\text{Indicator of overcapitalizing} = \frac{\text{equity}}{\text{LTA} + \text{LIA}}$$

$$\text{Indicator of undercapitalizing} = \frac{\text{equity} + \text{debts}}{\text{LTA} + \text{LIA}}$$

Activity

$$\text{Turnover of total assets} = \frac{\text{income}}{\text{total assets}}$$

$$\text{Turnover time of commitment} = \frac{\text{commitment} \times 360}{\text{revenue}}$$

$$\text{Turnover time of assets} = \frac{\text{total assets} \times 360}{\text{revenue}}$$

$$\text{Turnover time of claims} = \frac{\text{claims} \times 360}{\text{revenue}}$$

Financial stability and indebtedness

$$\text{Equity portion on assets} = \frac{\text{equity}}{\text{total assets}}$$

$$\text{Degree of fixed assets covering} = \frac{\text{total assets}}{\text{fixed assets}}$$

$$\text{Total indebtedness} = \frac{\text{loan capital}}{\text{total assets}}$$

$$\text{Long term indebtedness} = \frac{\text{long term loan capital}}{\text{total assets}}$$

$$\text{Current indebtedness} = \frac{\text{current loan capital}}{\text{total assets}}$$

$$\text{Equity indebtedness} = \frac{\text{loan capital}}{\text{equity}}$$

$$\text{Assets coefficient} = \frac{\text{total assets}}{\text{equity}}$$

Own evaluation

<u>DCF-Entity method</u>

$$H_b = \sum_{t=1}^{T} \frac{FCFF_t}{(1+i_k)^t} + \frac{PH}{(1+i_k)^T}$$

where T = last year of prognoses

PH = following value

i_k = calculating interest rate on the level of weighted average costs of capital

Following value in time T = $\frac{FCFF_{T+1}}{i_k - g}$

where T = last year of prognoses

i_k = average costs of capital

g = supposed growth rate of free cash flow during whole second phase, that is to infinite

FCFF = free cash flow into the firm

under condition: $i_k > g$

DCF-Equity Method

$V = \frac{FCFE}{R_E}$

Method of capitalized profit

Permanently removable net profit = $\frac{\Sigma_{t=1}^{K} q_t \check{C}V_t}{\Sigma_{t=1}^{K} q_t}$,

where $\check{C}V_t$ (net profit) is previous edited net profit, q_t are weights which determines meaning of net profit per certain previous year for the estimation of future permanent removable net profit and K is number of previous years included in calculation.

V = $\frac{T\check{C}V}{i_k}$,

where TČV is permanently removable net profit and i_k is calculated interest rate (costs on own capital)

Free cash flow

FCFF – Free Cash Flow for the Firm

Tab. 1 - FCFF

	Operating profit (from profit and loss account)
-	Operating profit single and unrelated with operating assets
+	Operating costs single and unrelated with operating assets
+	Income from financial investment and interest income, if flowing from necessary operating assets
-	Financial costs related to needed operating assets
=	Corrected operating profit or loss
-	tax
=	Corrected operating profit or loss after tax
+	Depreciation
-	Investment (gross weight)
=	FCFF

Costs of capital

WACC (Weighted Average Cost of Capital) = $\frac{R_D(1-t)\cdot D + R_E \cdot E}{D+E}$, where R_D are costs on interest liabilities, t is income tax rate, D is interest liabilities (Debt), R_E are costs of equity, E is equity, $C=E+D$ is total invested capital.

Costs on foreign funds (liabilities)

$R_D = i\ (1-t)$, where i is interest rate from debit, t is tax rate.

Costs on equity – sectional model

According to this model in step with MM II are total costs of insolvent firm determined like this,

$$WACC = WACC_U \cdot \left(1 - \frac{D}{A} \cdot t\right),$$

costs of total capital of no insolvent firm are determined like this,

$WACC_U = R_F + R_{entrepreneurial} + R_{finstab} + R_{LA}$,

where R_F is riskless interest rate, R_{LA} is risk additional charge for the size of firm, $R_{entrepreneurial}$ is risk additional charge for business entrepreneurial risk, $R_{finstab}$ is risk additional charge for risk resulting from financial stability.

Costs of equity like this,

$$R_E = \frac{WACC_U \cdot \frac{UZ}{A} - (1-t) \cdot \frac{Ú}{BU + OBL} \cdot \left(\frac{UZ}{A} - \frac{VK}{A}\right)}{\frac{VK}{A}} ,$$

where $UZ = VK + BU + OBL$, are total source, A are assets, $Ú$ are interests, BU are bank loans, OBL are obligations, VK is equity.

Determination of risk additional charge characterized the size of company R_{LA}

If UZ > 3 bln. CZK, R_{LA} = 0,00 %. This border results from the experience of firms which offer risk capital. If UZ < 100 mil. CZK, then R_{LA} = 5,00 %. If UZ > 100 mil. CZK and at the same time is UZ < 3 bln. CZK, is used following calculation

R_{LA} = (3 bln. CZK – UZ)^2 / 168,2.

Determination of risk additional charge characterized the production power $R_{entrepreneurial}$

Risk additional charge depends on indicator $EBIT / A$ which is compared to indicator $X1$ expressing replacing corruptible foreign fund by equity. This indicator is defined as follows

$$X1 = \frac{(VK + BU + OBL)}{A} \cdot \frac{Ú}{BU + OBL} .$$

If $\frac{EBIT}{A} > X1$, pak $R_{entrepreneurial}$ = 0,00 %. If $\frac{EBIT}{A} < 0$,

then $R_{entrepreneurial}$ = 10,00 %. If $\frac{EBIT}{A} \geq 0$ and also $\frac{EBIT}{A} \leq X1$,

then $R_{entrepreneurial} = (X1 - EBIT / A)^2 / (10 \cdot X1^2)$.

Determination of risk additional charge of financial stability on the bases of liquidity $R_{finstab}$

Starting indicator is indicator of total liquidity *OA/current liabilities*, whereas is determined marginal value of liquidity, *XL*. If the average of industry is lower then 1,25 then the upper border *XL* = 1,25, if the industry average is bigger then 1,25 then *XL* = industry average.

If the total firm's liquidity > *XL* then $R_{finstab}$ = 0,00 %. If the total liquidity < 1 then $R_{finstab}$ = 10,00 %. If total firm liquidity > 1 and at the same time total liquidity < *XL*, calculation of $R_{finstab}$ will be like this,

$R_{finstab} = (XL - \text{total liquidity})^2 / 10 \cdot (XL - 1)^2$

3 Literature overview

3.1 Company

Company is defined in many ways. Rosochatecká and collective (2006) define company as fully business entity which decides about the flow of financial sources in the process of their creation, distribution and usage.

According to Mařík and spol. (2007) have the biggest meaning for valuator the definition referred to the Commercial Code. That in § 5 define company as a set of tangible, as well as private and intangible components of entrepreneurial activity. To a firm appertain things, laws and other property values which belong to enterpriser and serve to company operating or they should serve like this according to their character.

Firm should be established because of performing a business activity. This is defined by the Commercial Code in § 2 as pursuit conducted by single enterpriser by own name and at own liability in order to make a profit.

„A legal entity, allowed by legislation, which permits a group of people, as shareholders, to apply to the government for an independent organization to be created, which can then focus on pursuing set objectives, and empowered with legal rights which are usually only reserved for individuals, such as to sue and be sued, own property, hire employees or loan and borrow money.“ [21]

3.2 Evaluating principles

According to Mařík and collective (2007) in profession we often meet with requirement that valuator should determine “objective” value of the firm. It is necessary to point out that something like objective value of the firm does not exist.
Firm’s value is set by expected future income (either on the level of owners or on the level of all investors in the company) converted (discounted) on their present value. Value of the firm is not objective feature of the unit named company because it is founded on projection of future progress. It is a judgment.

3.2.1 Reasons for evaluation

Evaluation of a company is needed in many cases and even in many cases law dictates it. Here is a specification for which cases the evaluating is done.

a) Evaluation related to proprietary changes, for example:
    - purchase and sale of a company on the base of contract about firm sale according to § 476 of Commercial code
    - nonmonetary deposit in an enterprise according to § 59 of Commercial code (in this case is concretely deposit of a firm)
    - evaluation in a context of fusion according to § 69a of Commercial code
    - evaluation in a context of fission of a company according to § 69c of Commercial code

- evaluation in a context of offer on takeover (voluntary offer on takeover or obligatory offer on takeover when capturing of target enterprise) - § 183a up to 183g of Commercial code
- evaluation in a context of offer on repurchase of participant securities - § 183h of Commercial code
- evaluation in a context with redemption law of participant securities, that is squeeze-out - § 183i and following of Commercial code
- receiving of business share on a settlement of debts - § 117a, paragraph 7 of Commercial code

b) Evaluation for those cases where proprietary changes do not happen to, for example:

- change of legal form of a company according to § 69d of Commercial code
- evaluation in a context with granting credits (when granting credit it is often desired to emanate not only from accounting view on the assets and liabilities but also to elaborate a real evaluation)
- evaluation in a context of a firm rescue (from the financial point of view is suitable to rescue a company primarily at that time, when the firm's liquidity value is lower than the company value after rescuing lowered by other necessary capital deposits)

3.2.2 Process of company evaluation

1) Collection of enter data
2) Data analysis
   a) Strategic analysis
   b) Financial analysis for the findings of financial health of a company
   c) Division of firm assets on operating needful and needless
   d) Analysis and prognosis of generator values
   e) Orientation evaluation on the basis of value generators
3) Evaluation
   a) Choice of method

b) Evaluation according to chosen method
c) Overall evaluation

In practical usage these individual steps will have different shape, deepness and stress according to concrete method which will be used for own evaluation.

3.2.3 Value category

3.2.3.1 Market value

Market value is estimated price for which an estate should be exchange on the date of evaluation between willing buyer and willing seller in the transaction between independent partners after appropriate marketing in which should both sides act reasonably, well informed and without any constraint.

Market value is understood to be assets value regardless of expenditures of sales or purchase and related taxes inclusion. It presumes the price agreed on free and competitive market. Evaluating on the market is generally based on information regarding to adequate and relevant market researches.
Valuator must gain all important data and analyze all relating facts. Where are data about market narrow or even do not exist, there valuator has to appropriately clear the situation up and bring out whether it was caused by some non adequate data.
Any evaluation cannot be without own judgment of the valuator. However, report should features to what degree the valuator bases his details for the estimation of market value on a facts about the market or whether the estimation is based on own valuator's judgment from the reason of estate character and absence of comparable data about market.
Nevertheless, in every case it is governed, that assets evaluating based on the market supposed market activity, which happens during the transaction, without limits in off-market powers.

Then it holds:

- Evaluation based on market has to identify and conclude definition of market value used in the certain evaluating.
- Evaluation based on market has to determine the highest and the best usage.
- Evaluation based on market is derived from specific data for reasonable markets and it should rely on methods and procedures which try to reflect thought processes of certain market participant.

Market value should be an estimation of equilibrium price, compensative of supply and demand where sufficient amount of subjects trade with more or less homogenous estate. This conception conforms to the trade with crude oil.

If here does not exist any sufficient operating market, it is very problematic to determine market value as a point estimation, so is one number. A real view of thing says that market value understood as the estimation is expressed only like the interval estimation. Nevertheless it can be expected that this interval can be very wide which relies mostly to those assets such as enterprise.

With the problem of market value is necessary to point out that it is not always needed to have existing operating market only like local market. When we look at the present practices of enterprise evaluation in the Czech Republic, we can see that during the formation of evaluation are strongly promoted the usage of data from abroad markets which applies mainly on routine method of discount rate estimation. But it is obvious that with increasing of market diversity, from where we borrow data towards the relationship to local conditions, the market evaluation is becoming more problematic. [6]

3.2.3.2 Subjective (investment) evaluation

From the view of concrete subject mainly in German theory and practice was introduced a new conception for evaluation such as subjective value. We also find subjective value in International evaluating standard number 2, so between evaluating on different principle than is market value. It is referred to as investment value and it is defined as following:

Investment value of worth is a measure of the worth or value that a given piece of real estate has to a particular buyer or investor. Depending on the circumstances of the investor,

this value may be the same as the current market value identified for the property, assuming that the investor has the resources at hand to maximize the returns generated by the purchase. Should the investor currently not have those resources in place, the investment value of the property may be less than the current market price. [9]

Basic characteristics of investment value are following:

- Future cash flow is estimated almost entirely on the basis of images of evaluated company's managers. Eventually it is usually slightly changed against these images down. However, it represents in decisive measure image of directive labour of the evaluated subject, perhaps even investor.
- Discount rate is set on the basis of alternative possibilities to invest, which the subject has, from whereof view the evaluating is analyzed.

If the valuator infers future cash flow in decisive measure from data of financial plan provided by itself company, without any corresponding reason to test its adequacy, then he or she is not license to label these evaluations as market value.
Investment value is in decisive measure assigned by subjective opinions, images and eventually concrete conditions of subject, from whereof view is set up. The differences between investment and market value can be set for example by that the concrete subject:

- expect certain synergy from the intended transaction,
- plan perforation on new markets,
- has different attitude to risk, than it is usual on the market as complex,
- is in different tax position, than it is usual,
- is more optimistic or contra pessimistic than "average" investor, etc. [6]

3.2.3.3 Objectification value

Objectification value points at substantial diversity of objectification value from subjective access. The subjective value is possible to be calculated just by the owner or buyer who does not have the best financial knowledge.

Before now specialists in German speaking countries agreed on that objective value basically does not exist, that value is not an objective feature of enterprise. That is why appraisers started to work with the conception "objectification" value.

According to German evaluating standards the objectification value is defined as follows:

Objectification value represents yield value by other subjects re-examined, which is set from the point of view of domestic person – owner (or the group of owners), without restrain liable to tax, whereas this value is set on condition that enterprise will continue in non-changed concept with usage of realistic expectations in the frame of market possibilities, risks and other influences effecting the enterprise value.

According to currently represented opinions should be this value in the biggest measure build around generally reputable data and during its calculation should be kept certain principles and requirements. The aim is to gain the biggest reproducibility of evaluation. These principles are following:

Maintain of substance – objective evaluation requires that from enterprise should be collect just that amount of monetary sources as there would not be a danger of estate essence (substance).

Free profit – evaluation is based on free profit that means the part of profit which I can withdraw without any danger of enterprise substance.

Unnecessary assets – company assets are divided into part which is necessary for self operating and part of everything else. Yield evaluation is concerned especially with that part which is operationally necessary. Other assets are separately evaluated.

Possibilities of changes in enterprise – when evaluating we result from company as "stands and lies" in the moment of evaluation. It is assumed continuation in operating in the frame of existing concept. Changes are in point of the range which is already in present state contained, for example the influence of finalization already under construction investment, or investment of which was already decided. However, many times would be difficult to determine what growth measures would be considered as sufficient in order to its resulting growth of income will be considered as enough probable, thus chargeable into objectification value.

Method – evaluating method should be clear and unique. Explicitness means that other valuator should repeat without any problem whole evaluation with the same or similar result. That is why the preference has combination of assets and gained method.
Management – gained method often depend on continuance in management in the company. In the frame of objectification value we assume that standing management outlasts. This standard presumption is part of standardization situation creating in the frame of objectification value.
Taxation – against standard practice in the Czech Republic it is recommended to notify also taxes on the level of owner, on standardization level as well.

The concept of objectification value, let us call it estimator's concept, differs from other evaluations a lot, but it is still possible to find a point of concurrence. In the first level it takes into account only general known actualities which are relevant to the date of evaluation. In the second level is taken to account of facts which have an influence on the evaluation, they are generally known, even though they are referring to the future, but their incidence do not have to be definite. Until the third level it is possible to bring into the evaluation purely subjective view, how it is in the investment value.

The market value can be also understood as certain form of objectification. Objective is evidently that, what exists independently on our sense and pertinently on our decision making. Objectification can be understood as a progress based on data which are independent of concrete expert or investor, and on generally accepted methods. It is obvious that objectification by means of method is more or less similar to market value, so to objectification value as well. Objectification of data can be made by two basic processes.

Firstly, we use data from market, above all from the capital market. During the usage of these data the objectification and market values are to a great extend coincident. But they do not coincide totally because the objectification value is basically based on continuance in current concept of the enterprise, if this change is known and ideally accepted by the market.

Objectification can also have other form, and that is accepted usages by skilled community. These usages are accepted mostly in that time, when accessible data are not available or if it is not very clear what source of data is possible to use.

From above mentioned definitions results that objectification value do not aspire to be at least approximate estimation of probable selling price. Concrete data from the transaction with huge German enterprises indicates that realized prices were largely higher than objectification value determined by experts. In perspective companies is possible to expect this relation pretty logically. [6]

3.2.3.4 Cologne school

In European countries is often referred to the fact that generally it is problematic to speak about market value, because market with companies in European conditions has still many restrictions:

- size of transactions with “analogous” companies is not big
- market is without transparency (it applies mainly in overview of transactions and their conditions)
- it is not evident if price was paid under continuing company or if it contains certain synergism

Real market is according to Mařík and collective (2007) only capital market. That is why in evaluation of most of companies is used the subjective evaluating. Here is a starting point the subjective value of concrete seller and on the other hand subjective value of concrete buyer.
On this subjective position is about to established so called Cologne school. The Cologne school maintains that evaluation do not have sense to modify in dependence on single impulses, but on common functions which have evaluation for users of its results.
Cologne school distinguishes several basic functions of evaluations and along with this even function of valuator:

a) counselling function

b) arbitration function
c) argumentative function
d) communication function
e) tax function

In the course of tax function the aim is to afford details for tax purposes.
In the course of communication function the aim is to afford data for communication with public, above all with investors and banks. The function is essentially derived.
The most important one is considered to be the counselling function. The sense of this function is very easy – to afford data and information to the buyers about:

- maximum price, which the buyer can still pay without becoming off a loser on a the transaction (border value of the buyer)
- minimum price, which the seller can still accept without becoming off a loser on the sale (border value of the seller)

In the function of counselling the evaluating offers so called border values or values for counselling. Border values delimit a space for own price negotiation. Naturally just in the case that border value of buyer is higher than border value of seller.
It is assumed that border value as individual (subjective) estimation is unknown for the second side. Individual means that it is established on the estimation of individual possibilities of each transaction sides, how further treat with enterprise and individual chances of alternative investment.
After counselling function is entering the arbitration function. In this function, it is the performance of the independent valuator, arbitral.
This valuator should:

- at least estimate border values of participants of the transaction
- find rightful value in the frame of estimated range

Last function is argumentative function. In this function the valuator is finding arguments which would improve the position of certain side and serves as data for negotiation.
Special attention is paid to arbitration function. The valuator's aim in arbitration function is to find a "resultant" value which would in certain way neutralize value views and interests of transaction participants. Arbitration value is linked to the position of participant sides

and it will be probably also different for those several involved sides. However, it is not an estimation of any general price. [6]

3.3 Tools and methods of company evaluation

3.3.1 Strategic analysis

Basic resource for a formulation of strategy comes from results of strategic analysis. Strategic analysis contains several analytical techniques used also for identification of relationships between company environments, including macro-environment, branches, competitive power, market, competitors and source potential company. The aim of strategic analysis is to identify, analyze and evaluate all relevant factors, where we can suppose they will have influence on final choice of aims and company strategy. [5]

3.3.1.1 Analysis of external environment

Here it is especially focus on detection of development trends acting in external environment (in community, in economy), which can firm notably influence in the future.

Delimitation of relevant branches

According to Sedláčková and Buchta (2006) branches are usually define as group of companies proffering similar product or service on the market. The borders of branches are defined as substitutability on the side of supply and also demand. Designed borders of branches and markets are a thing of opinion which has to consider the purpose and connections of analysis. [5]

Basic characteristic of branches

Separate branches are in own basic characteristics very different. For this reason it is suitable to start analysis just with these basic characteristics. From their impact on company's strategy these basic characteristics of branches are very important. Between

particular factors belong for example the size of market, geographical sphere of competitors, growth of market and phases in life cycle, input and output barriers, rate of technological changes, demand on capital and differentiation of product. [5]

Sector of customers

The rule distinguishes three classes of customers, each can be identify by different factors which influence their decision of purchasing. This shows a following chart.

Tab. 2 – Customer classes and their influencing factors

Customer class	Factors influencing their decisions about purchase
Consumers	availability, price, variety, comfort, quality, guarantee, loans
Wholesale, resp. retail	competitor's ability of product, availability of product, supply dependence, recognition to consumers, product turnover, potential profit, variety (width)
Industry and institutions	expenses vs. profitability, financing, price, meeting the norms and laws, product information, performance of product, maintenance and service

[2]

Sector of suppliers

Here it is mostly about the analysis of availability and costs of all inputs needed for production and for the stability of delivery rounds. Costs and availability of sources are especially determined by the relationship quality between certain company and its suppliers.

Sector of competitors

The aim of the competitor analysis is to evaluate competitive positions of main competitors in the relation to own enterprise, diversify advantageously situated ones from advantageously situated and in key competitors:

- pursue if they are putted at pressure in order to better operating results
- monitor opinions about the branches progress presented by managers of competitive companies

- study background and philosophy managers of competitive companies in order to foresee step's character which can be take in hand
- study the preferences of competitive enterprises and their performance goals
- estimate the probable next moves of particular competitors

Strategic maps

Mapping of strategic groups is very useful analytic tool mainly for those branches of which exists several characteristic groups of competitors where every group takes a significant position on total market and has a good resound by consumers. Strategic group contains of competing enterprises with similar market approaches. By recording market strategic positions like axis is created strategic map. This map serves as useful "bridge" between view of branch as a unit and situation of each company apart.

Porter's five forces model

Threat of entry – new entering companies bring into branch new capacity, effort to gain share in the commodities and often considerable sources. This can lead to price decline or rise of costs, thereby decline of profitability. Threat of entering new firms into the branch depends on existing entering barriers in the combination of current participant reactions which can entering firm expected. If the barriers are too big, threat of entry is small.

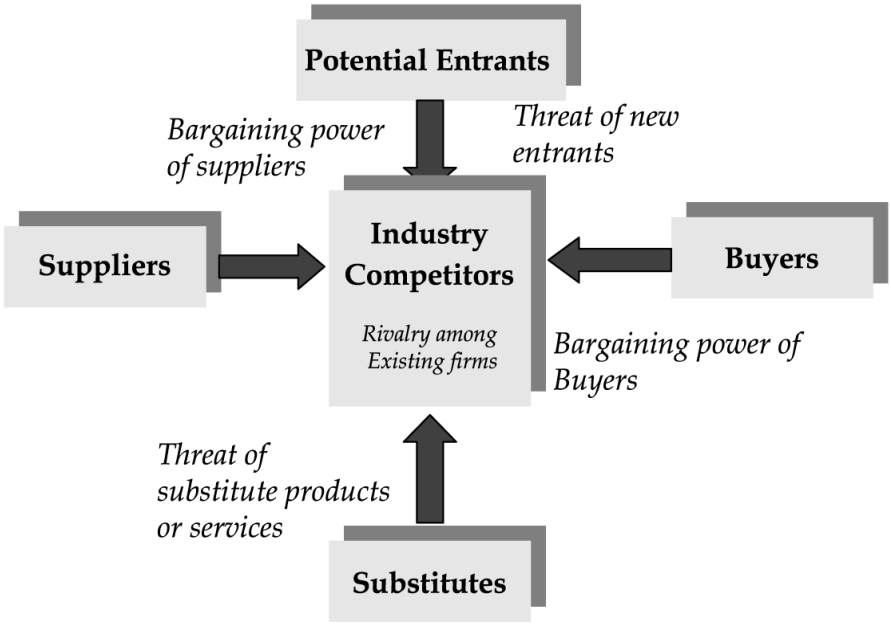
Competitive rivalry within industry – rivalry between current competitors has common form of well maneuverability in order to gain favourable position. Here are used methods such as price competition, advertising campaign, placing product on the market and better service to customers or guarantee.

Threat of substitutes – all firms in the branch compete in a large sense with branches which produce substitutes. Substitutes limited potential revenues in the branch by determination of price freeze, which can be charged by profitable firms in that branch. The more attractive price alternative offered by substitutes, the firmer is price freeze over profitability of branches.

Bargaining power of buyers – customers compete with branches by pushing prices down, struggle for gaining the highest quality or the best services and place competitors against each other – this all at the expense of branch profitability.

Bargaining power of suppliers – suppliers can apply negotiation superiority over other participants in the branch by threat of increasing of prices or decreasing of quality of purchasing goods and services. In an unable branch influential suppliers can compensate the increase of costs by increasing of own prices.

Pic. 1 – Porter's model of 5 forces



[22]

3.3.1.2 Analysis of internal environment

Identification of company resources and their analysis

Resources of company are divided into those following four groups.

Tangible resources – typical tangible sources are machines and equipment, property, buildings and halls or vehicles. Besides basic characteristics such as amount, capacity, size or consumption, it is necessary to also know their next features which influence their potential for creation of competitive advantage and good starting position of the company – for example: age, production capability, technical condition and dependability, flexibility of machinery park, flexible production systems or contest location.

Human resources – the main characteristics show the amount and structure according to qualification is it suitable to supplement other data, for example motivation or adaptability. Analysis of human resources deals with many questions and connexions.

Financial resources – characterized by own resources and liabilities influencing financial structure and stability of the company. Analysis of financial resources contains broad range of aspects from gaining capital, resp. access to foreign capital, amount of own equity, managing of labour capital, rate of indebtedness, costs on capital, commitment settlement until relations with debtor and creditor.

Intangible resources – comprises partly technology sphere, for example: patents, licences, business secrets, know-how, and other part is sphere containing reputation of the firm, trademark, logo and so on. The key indicators are number and sense of patents, earnings from patents and licences, portion of labour in the research and development of the total number of employees, etc.

Marketing and distributing factors

Importance of marketing factors for individual companies can be different. Křekovský and Vykypěl (2006) mention an example with enterprises which supply their products to several customers, which specify very exactly their requirements, do not have to have their marketing forces too strong. On the other hand is standing another extreme, relating to companies which produce consumer goods with high market share, which must have marketing functions very strong, and the biggest portion in allocating their internal resources often falls just on business marketing entity. [2]

3.3.2 Financial analysis

3.3.2.1 Characteristics of financial analysis

Financial analysis constitutes the data studying, who's primary and on principle mainly source is financial accounting. By analyzing the data obtained from financial accounting and financial statements, we can get a survey of property, financial and income company

situation, and also the basis for financial decision making and financial operating management.

Financial analysis is the conversion of financial data into useful information for decision making. Therefore, virtually any use of financial statements or other financial data for some purpose is financial analysis and, essentially, is the primary focus of accounting and finance professionals. Financial analysis can be internal (e.g., decision analysis by a company using internal data to understand or improve management and operating results) or external (e.g., comprehensive analysis for such purposes as commercial lending or investment activities). The key is how to analysis available data to make correct decisions.

Using economic and accounting information, financial analysis aims at discovering a company's real situation, based on coded data. It also makes it possible to make a full assessment of the analyzed company and its future prospects. On a practical level, financial analysis first places the company in its economic environment: market, sector, production processes, distribution channels, motivations of the people working for the company. Then, the analyst progressively studies wealth creation, investment and financing policies, and concludes on the profitability of the company. [4]

3.3.2.2 History of financial analysis

The historical roots of financial analysis are in the USA, where the usage was not just the theoretical, but also a practical work. Originally it was specialized just to represent changes in absolute indicators, but later on the financial analysis also acts in detection and attestation of company credit ability. After the world economic crisis in the 30^{th} years the interest in liquidity and the survival ability approached. Afterwards the heed turned around on the profitability and therewith on the questions of economization. The USA is also the cradle of the processing branch statements, which those the data from other individual firms were compared with. In Germany the financial analysis is titled as the balance analysis (Bilanzanalyse) or the balance critique (Bilanzkritik). The financial analysis

comprises of profiling and valuation of all these documents: balance sheet, profit and loss account (income statement), annual report and supplement.

In the Czech Republic the title for financial analysis was “rozborová činnost”, analytical operation, which was the loanword from the English. Before 1989 the Czech analysis was executing as so-called “rozbory hospodaření” economy analyses. So it is not that new section, which would not have been existed here, but financial analysis has got a new and wider content. So it is not just about performing the plans, but also about controlling the aims completion, which is set by the firm itself. Financial analysis interprets the financial information attached with the efficiency examination and the perspective of company, even in confrontation with other firms and branch average. [7]

3.3.2.3 Methods of financial analysis

Firstly I would like to point out these methods are not set up from any legislation neither from system of law. For that reason sometimes it can come about not that exact interpretation of financial analysis results. There does not exist an uniform terminology and uniform elaborating processes. None the less certain analytical processes were developed and they were also generally accepted.

The basic criteria for ordering the financial analysis methods are simplicity, or more precisely, complication of applied mathematical procedure. On the basis of this viewpoint we can divide the methods into elementary methods and methods of financial analysis (mathematical-statistical and non-statistical methods).

Elementary methods of financial analysis are farther classified into:

- analysis of absolute indexes
    - horizontal analysis
    - vertical analysis
- analysis of differential indexes and cash flow

    - cash flow
    - net working capital
    - net quick assets
    - net monetary assets
- analysis of ratio indexes
    - profitability
    - activity
    - liquidity
    - financial stability and indebtedness
- analysis of indexes system
    - Du Pont pyramid analysis
    - Altman model (Altman Z-Score)

3.3.2.4 Analysis of absolute indexes

Status indexes come out directly from account statements. Those analyzed data are compared with the current account year and the previous account year. In those certain data we have to observe the absolute changes and the percentage changes (relative). The analysis of absolute indicators comprises of horizontal analyses (trend analysis) and vertical analysis (percentage component analysis).

Horizontal analysis

In the horizontal analysis of the absolute indicators we have to find out how the certain item in the account statement is changing against to the previous year. And this is measured in as absolute amount as relative (percentage) amount. Comparing the accounting items between certain years is done by line, horizontal – that is why we speak about horizontal analysis.

Vertical analysis

Vertical analysis compares the accounting statement of the certain period with the statements of the previous period. And specially compares the several companies of a

different size. The concept “vertical” is mentioned here in the meaning of that, the technique analysis is usually processes in the certain periods from up to down.

Percentage analysis

This method is based on transferring indicators in absolute values into the relative percentage expression. In comprises of calculation of chain indexes, vertical analysis and horizontal analysis.

Percentage analysis is advantageous in comparing the firm statement in the long time period, in the case of the whole and also as the in-house system. Its disadvantageous is in not pointing the problem of the changes, the absolute base for the calculation changes and the balance data can include incomparable (different kinds of depreciation methods, merchandize estimating).

3.3.2.5 Analysis of differential indexes and cash flow

Differential indexes serve to analyze the operating financial situation of the company (with marked orientation on its liquidity) are denoted as financial funds (funds of financial resources).

Cash flow

In investments, cash flow represents earnings before depreciation, amortization, and non-cash charges. Sometimes it is called cash earnings. Cash flow from operations (called funds from operations by real estate and other investment trusts) is important because it indicates the ability to pay dividends. [8]

The amount of cash earned after paying all expenses and taxes. Cash flow is calculated by adding net after-tax income plus any bookkeeping expenses that result in items being deducted but not paid out in cash. Such bookkeeping entries include amounts charged off for depreciation, depletion, amortization and charges to reserves. Cash flow is a measure of a company's worth and its ability to pay dividends on its stock.

Closing balance of money = opening balance of money + receipts - expenditures

Net working capital

Net Working Capital, is defined as Current Assets minus Current Liabilities. Current assets include stocks, debtors, cash & equivalents and other current assets. Current liabilities include all the short-term borrowings. The formula is following: (stocks + debtors + cash & equivalents + current assets, other) - creditors, short.

Net quick assets

Current assets are readily convertible into cash minus current liabilities. A large amount of net quick assets often characterizes a conservative firm with a very liquid financial position. Cash, accounts receivable, and marketable securities, minus current liabilities. Inventory is excluded in order to determine whether, if sales evaporate, a business could meet its current liabilities with the readily convertible (to cash) assets on hand. [10]

Net monetary assets

(Monetary demanding financial fund) represents certain compromise, the middle way between those indicators mentioned above, it is designed in order to include the short term receivables (without unenforceable) complete with quick assets and their equivalents.

3.3.2.6 Analysis of ratio indexes

Ratio indexes are the basic methodical implement, the staple of financial analysis procedure. They are in the numeric form, in which are the financial-accounting information putting in. The ratio indexes are ordinarily counted from dividing certain item by another item listed in the statements, where between those elements exists certain connection. The construction and the selection of these items are subjected mainly to what we want to measure. The analysis externalization has to be relevant to the surveyed problem or to the decision transaction.

Profitability indexes

Profitability index is a finance term that tells us the potential payoff of an investment compared to the initial cost of investing. Profitability index, often abbreviated as P.I., is a great indicator of how good of an investment you are making. It is especially useful if you can only invest a limited amount. You can calculate the profitability index for multiple investment possibilities, and the one that has the highest P.I. value is the one where you should focus your resources. [11]

Profitability indicators measure profit with the amount of resources which were spent on creation of this gain. They are used for appraisal of exploitation intensity of reproduction and evaluation of the company.
When calculating the indicators we result from balance sheet and profit and loss statement. Profitability indicators differ from each other according as profit is put in numerator and what paid capital is put in denomination of the fraction in the indicator.

Return on assets

The profitability of the total capital (return on assets – ROA) or the profitability of assets represents the whole effectiveness of the company. We can display it as a tax less or taxed profitability. The profitability of total capital represents the productivity of the total capital no matter from which the resources were financed**.**

Return on equity

The profitability of the shareholder's capital = return on equity – ROE. The amount of net income returned as a percentage of shareholders equity. Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

This indicator is used for tasting:

- possible implication in shareholder's equity for the increasing capital source

- maintainable increasing rate of the company derived from the increasing shareholder’s equity
- the opportunity on the maintenance of actual value of shareholder’s capital under the inflation conditions
- the productivity levels of shareholder’s capital compare to expenses of loan capital

Return on sales

A ratio widely used to evaluate a company's operational efficiency. ROS is also known as a firm's "operating profit margin". It represents the ability of company to gain a profit during certain level of sales. From the result we are able to find out, how many crowns of profit brought one crown of sale to the firm.

In the development rank this indicator should record increasing trend, in average it is about the value 10 % with that in branches with higher turnover can be also smaller value.

Return on costs

This indicator represents the effectiveness of the firm’s economic actual, how many percent of profit falls on 1 CZK of expended expenses. It should have an increasing movement in the time series. The optimum value can be considered to be above 10% of the indicator height.

Activity indexes

These indicators show us how effectively the accounting entity with its own activity economizes. If the accounting entity has more activity than is needed, the useless expenses rise. If the accounting entity has less than is needed, the potential sale decreases. These activity indexes are represented in two forms – firstly, indicators of turnover amount or secondary, indicators of turnover period (time). The turnover amount indexes predicate of how many times the set time period turns certain type of asset. The turnover period index watches the time where the asset is bounded in a certain form.

The company should press for the turnover period to be as shortest as is possible, because in an inventory are bounded finances. On the other hand the company has to take heed to still have enough inventories for the fluent operating.

Turnover of total assets

It is measure of total usage of accounting item assets.

This indicator shows how long it takes to get to the total assets turnover in the relation to sales. Positive is the shortest time of turnover, value is determined by turnover of fixed and working capital. The higher portion of fixed assets, the higher is the value of indicator. It is also affected by the dynamism of sales.

The time period of merchandise turnover

This represents the average time, which goes between material buying and product selling. It represents certain number of days, where the short term assets are bounded in the form of merchandise. Ideal is to gradually decrease the value of indicators in certain period.

In our condition, the satisfactory is considered to be lower than 100, the optimum is between 30 – 50 days. In the time series should be the decreasing trend of indicators.

The time of commitment turnover

It is also called as the time of the payments delay. It shows us the time period between the merchandise purchase and the payment for the purchase. The interest of company is on the longest time period of the commitment turnover, or at least it should not decrease below the time period of the claim in the liquidity section.

The time of receivable turnover (payment time)

It represents the time period, in which lapses from the date of consumer invoice till the date of receiving the payments. It shows the time of the payments of the claims in average. The accounting unit has an interest in the shortest time period of payment.

Ability to pay

Ability to pay is one of the most important characteristics of financial situation. It reflects short term financial stability of the company. In the conditions of self-financing and competitiveness on the market is very important if the firm is able to perform payment duties and comply its own financial commitment.

Liquidity basically represents firm's ability to cover own commitments and obtain enough funds on making needed payments.
Liquidity has adverse relation to profitability of accounting entity. Accounting entities with big share of high liquid assets reach usually lower profitability.
If these indicators are too low, it can mean payment problems. If they are too high, it can mean non-effective usage of assets. Resulting values show us how many times company is able to meet its commitment, if the firm would transform its certain assets into cash.

Immediate liquidity (liquidity of the 1. level)
It represents the ability of the company to a certain day, the ability of the company to cover usual neediness by its own financial funds. The optimum value of the indicators are between 0,2 – 0,6.

Current liquidity (liquidity of the 2. level)
It evaluates the payment ability from the view of relatively longer period. The time progress of the indicator tells about the financial and payment situation of the company.
It shows if the company is able to cover the usual necessity and the short term debts by its own claims and by financial funds. The optimum value of the indicators is between 1 – 1,5.

The height of indicator depends on the type of firm activity, branch, and company strategy in the sphere of financial management and so on. The importance also has the evaluation of progress of this indicator. Growth should signal expected improvement of financial and payment situation and vice versa.

Total liquidity (liquidity of the 3. level)

The indicator shows how the company is able to cover its own short time period commitment by short term assets. The indicator is used for the basic orientation about the firm's payment readiness. The indicator value should be between 2 – 2,5.

The most important is to compare companies with similar character of activity or with the average of branch. The main groin of this index is that often is not realized main presumption that all current assets would be able to transform in money in short time period. Part of merchandize can be already unusable for production and at the same time hardly salable. The indicator of total liquidity is also influenced by way of merchandize evaluation (method of average costs, FIFO, etc.). Disadvantage of the indicator consists in non consideration of structure in current assets in light of liquidity, structure of short-term commitments in light of their validity. The level of indicator is affected by respite of some purchases. Indicator is state type and that is why it should be under discussion in time period.

Share of receivables on current assets

It denotes the structure of current assets. Increase of this index is positive in the case of regular amortization from the customers. If there is bigger amount of bad receivables or it is after long time payback period, it is better if the indicator would decline.

Ratio indicator of liquidity

It is built with the help of net working capital. If we would criticize only the value of net working capital, it cannot reach negative, which would show evidence of fixed assets coverage by current resources. The value of this ratio index should be from 30 to 50 %.

Indicator of overcapitalization

This index shows the rate of long-term tangible assets coverage by equity. Equity should be fund long-term assets, typically for certain branch. It characterizes presumptions for financial structure stability.

Indicator of undercapitalization

It represents conditions for equilibrium firm's funding. Value cannot decline under 1 because the long-term tangible assets would be coverage from apart by current resources, which threaten next development of the company.

Financial stability and indebtedness

It generally represents the ability of a company long term providing the financial commitment and long term achieve adequate efficiency. The basic information source for the financial stability analysis is the balance sheet. The financial stability of the company is characterized by a structure of financial source, which is responsible for the composition of the economic resource. In the case of some problem in this section, it can get to heavy indebtedness and finally that the company bankrupt. The company financial non-stability means the decrease of the trust of the accounting payees.

Total indebtedness

Indicator of the creditor point of view, the total indebtedness, shows the loan capital payment percentage on total assets. At the same time, the accounting payees will have rather lower value of this indicator and then the lower rate of indebtedness, while the owner will prefer higher rate of indebtedness.

The indebtedness of equity

It is supplementary indicator of total indebtedness. It tells us the relation between loan and equity.

Accepted indebtedness of equity depends on development period and on position of owner to risk. In stable companies it should be approximately in the zone from 80 to 120 %.

Interest coverage

It shows how those interests are covered by a profit. The higher indicators value the accounting unit reaches, the stronger its financial stability has.

It informs us, how many times the interests are covered by profit. It expresses the firm's ability to fulfill the installments of interests. The optimal progress of the indicator should have the value higher than 5.

Share of equity on the assets (coefficient of self-financing)

The indicator characterizes long term financial stability and states how the company is able to cover the funds by its own resources. The increase of this indicator means the stronger financial stability. If the indicator value is bigger than 30 %, it characterizes good financial stability. The extreme indicator values mean over-capitalization or under-capitalization of the company.

Level of fixed assets coverage

Fixed assets of firm, long tangible and intangible assets should have been coverage by long term resources. The higher both two indicators, the better is financial stability of the firm. Level of coverage should reach at least the value of 100 % that means all fixed assets should be coverage by fixed capital.

Financial lever (coefficient of assets)

Main aim of financial operating is to gain optimal proportion of own and foreign funds, in other words optimal indebtedness. The coverage of needs mainly by own resources, which are usually more expensive way of financing, can lead to financial straining of company and to insufficient elastic reaction on financial needs of the firm. Insolvency is not only negative characteristic of the company. In healthy, financial stable company can be its growth administer to total profitability and so to market value of the firm as well. Here does not exist even direct connection between insolvency and indebtedness because higher indebtedness leads firm into payment difficulties.

3.3.2.7 Analysis of indexes system

Altman model

It is bankruptcy indicator, which means, it determines the rate of threat of company in bankruptcy. That is why are chosen just the financial indicators, which have influence and according to them it is possible to measure financial threat and company problems. It is used mainly by creditors because they have an interest in firm's ability to be solvent.

Altman index tries to predict financial situation of the company by one number, let us say number Z. It was calculated by the sum of values of five ratio indicators. To them were set different weights in similarity of coefficients. The result is possible to compare with recommended values, and find out, if company records average, under average or above average value.

$Z = 0{,}717_{x1} + 0{,}847_{x2} + 3{,}107_{x3} + 0{,}420_{x4} + 0{,}998_{x5}$

x_1 … working capital / total assets

x_2 … (operating profit + funds from profit) / total assets

x_3 … profit before taxation and interest / total assets

x_4 … market value of registered capital / liabilities

x_5 … income / assets

Interpretation of result: if $Z < 1{,}2$ … zone of bankruptcy

$1{,}20<Z<2{,}90$ … zone of grey area

$Z > 2{,}90$ … zone of prosperity

Spider graph

It provides quick and well-arranged evaluation of position of certain company in rank of indicators with regard to branch average (like this it is usually used); but possible is also in comparison with the best ones (in branch or specialization) or with competitive enterprise. It usually uses 16 ratio indicators (amount is possible to change). These are represented in percentage towards branch average (possible to use median or other medium value); the branch average is considered to be 100 %.

Indicators, which have to be minimize (for example: time period of debt collections), are calculated by reciprocal value (branch average divided by value of analyzed company). Especially we have to be careful on indexes which should take optimal value (they should be neither too high nor too low – these are for example indicators of liquidity).

Bases of the graph are concentric circles, from where the first from the centre shows branch average, that is 100 % of indicator value, next 200 % and so on. Graph is divided into four quadrants, from where the first contains indicators of profitability, second contains indicators of liquidity, third one the composition of financial resources and fourth show activity. In every quadrant is four beams (in total 16), which run out from the centre of graph. On these are applied values of indicators of evaluated company. Neighbour values marked on single beams will be put together and by that we get final spider graph.

Already on the first view graph usually offers idea of evaluating company: if spokes overreaches the circle of average values (circle 100 %), is concerned above average company, if spokes are closer to the centre from circle 100 %, then it is under average company. In one graph is possible to record even several enterprises, but graph is less synoptic. However, graph cannot replace detailed analysis of individual indicators and their relationships.

3.3.2.8. Users of financial analysis

Managers

The information giving in financial analysis is the basic stones for the operating management. They are for the long term as well as for the operating managers. Financial analysis gives the opportunity for the detailed understanding of financial situation in the company, and that is why it also helps to the correct decision making with getting the financial funds, with optimal property structure and its right financing. [12]

Investors

An individual who commits money to investment products with the expectation of financial return. Generally, the primary concern of an investor is to minimize risk while

maximizing return, as opposed to a speculator, who is willing to accept a higher level of risk in the hopes of collecting higher-than-average profits.

An investor is a person or entity that purchases assets with the objective of receiving a financial return. The assets an investor may buy range widely, but include stocks, bonds, real estate, commodities, and collectibles (e.g. art). The portfolio of an investor commonly includes a variety of assets that balance the rewards and risks of each investment. An investor is distinguished from a speculator, who seeks to make quick, large gains from price increases on risky assets. Generally, an investor has a longer time horizon for achieving a return, which may include regular cash payments from the income the asset generates, capital appreciation from the rise in the asset price, or both. A young investor tends to buy assets with price appreciation potential, because a 25-year-old investor has many years for the asset to appreciate before the funds are needed for retirement. An older, retired investor ordinarily seeks income and thus wants assets that offer regular cash payments. [13]

Banks and its other accounting payees

Potential payees basically need many information about the financial standing of the potential debtor, because the bank have to decide if they offer the loan, what amount of money and under which conditions.

Bank always verifies the financial standing of its future client before offering the loan. This financial standing valuation is done by analysis of its financial management. Here it is found out, if the needful funds the company needs because of the bad firm’s economy or because of the financial necessity for assets acquisition, which is needed for the certain economical actual. The financial analysis gives the bank the answer, whether the debtor has enough amounts of funds to be able pay back the loan with its interests.

Business partner

Business partners are divided into two groups – supplier and customer

Suppliers

Suppliers have the interest in the company (their business partner) to be able to refund short term liabilities and invoices. They mainly want to see the company's ability to pay.

Customers

Customers have the interest mainly in situation from the view of the long term period. They would like its supplier (our company) do not get into big financial troubles, not even in the bankruptcy situation. Finally the customers would have their own problems with the funding production. In a way they are dependent on it.

Competitors

Competitors need the comparability of their financial standing information with the companies similar (the same) to business activity. This information could have effect in certain competitive advantage. They are very hardly to find.

Employees

Employees have natural interest in the prosperity, economic and financial stability of their firm, because they would like to keep the same or even better their working place and salary. They are often motivated by the results of the firm's economy.

State and its bodies

The state and its bodies are interest in the financial – accounting data from many reasons; for example: for the statistics, control of tax duty, control of the companies with the portion in state property, financial help out dividing (direct grant, warranted loans by the state, etc.), getting the overview about the firm financial standing with the state commission. They require information to formulate the state economic policy (monetary, fiscal and so on) towards the business sphere.

3.3.3 Own evaluation

3.3.3.1 Free cash flow

Flow of cash and financial resources is real measure and indicator of economic actual. Important and sectional usage in financial operating, such as financial planning, investment decisions making, evaluation of company and financial tools, has the entry free cash flow (FCF). Category of free cash flow is usually understood as disparity between incomes and expenditures, which are generated by company assets and refers to stated type of capital. According to how the category of capital is defined differs free cash flow for owners and creditors (Free Cash Flow to the Firm - FCFF), free cash flow for owners (Free Cash Flow to the Equity – FCFE) and free cash flow for creditors (Free Cash Flow to the Debt – FCFD).

Free cash flow relative to total capital FCFF represents all cash flow, which company generates from assets regardless of whom are given (owners, creditors). These are composed of two files, from cash flow for owners FCFE and from cash flow for creditors FCFD.

Free cash flow for owners FCFE characterizes flows from the point of view of owners, for example stockholders and they are created from financial flow from operating, investment and financial activities.

If total capital is created purely from equity and it is unleveraged firm, then cash flow from equity $FCFE_U$ and total capital $FCFF_U$ identical. Free cash flow of unleveraged firm $FCFE_U$ is in this case created only from financial flow of operating and investment activities and interests connected with foreign capital does not occur.

3.3.3.2 Costs of capital

The notation costs of capital are most often understood as costs of company on reaching single component part of business capital. Costs on capital represents minimal required rate of effectiveness (internal earnings percentage) of capital. Costs of individual units are different and are subject to progress in time. Costs on capital are possible to understand as

costs of capital as price of gained capital for another development of activity. From the point of investor's view concerns requirement on effectiveness which has to be reached by the firm in order to not reach decline of value (worth) for investors. In general, the size of costs on capital depends on risk of particular assets. Generally it consists of risk-free rate R_F and risk premium R_P.
Costs on total capital (Weighted Average Cost of Capital – WACC) are combination of costs of different forms of capital. Costs of capital correspond to earnings which investors expect from their investment into firm and so corresponding risk as well. Let us remind that here we do not concern real earnings but costs of loss opportunities.

Costs of foreign capital are possible to express as interests or coupon payments which have to be paid to creditors. Basic interest rate is set by situation on financial market. Costs of capital which firm gains by the form of debt R_D (for example: bank credit, emission, debenture bond) is represented in the form of lowered interest by tax shield.

Costs on equity R_E are for the company usually bigger than costs on foreign capital. Basic methods which are used for cost estimation of equity are:

- Capital Assets Pricing Model – CAPM
- Arbitrage Pricing Model – APM
- Dividend growth model
- Modular model

3.3.3.3 Yield methods

In this method group is start from the presumption that estate value is determined by expected utility fro its holder. In company the utility are the future economic effects, such as profit, dividends, cash flow. Value in these methods depends mainly on definition of future earnings, choice of time period horizon and fixing costs of capital. Into this category also belong two basic methods of evaluation: method of discounted cash flow (DCF) and method of capitalized profit.

Methods of discounted cash flow

These methods are based on estimations of future free cash flow which unwinds from business activity. Future free cash flow is one of the most important measurement used in company evaluation because with increasing income increases value of the certain firm.
When using these methods we meet with several basic tasks. The first one is right delimitation of future cash flow suitable for evaluation, the second is fixation of capital costs by which cash flow is discounted and the third one is value fixation by the help of evaluating method.

Method of DCF-Entity

In this method is evaluated total capital. Free cash flow for owners and creditors FCFF is discounted by costs of total capital WACC. The aim of this method is market evaluation of total company capital.
With using method DCF entity a calculation proceeds in two steps. Festival, we go out of cash flow which would be available to owners and creditors as well and by their discounting we reach company value as a complex (we will call it V_g, gross value). From that in the second step we subtract value of foreign capital on the date of evaluation and reach value of own capital (we will call it V_n, net value).
Standard two-phase method is in practice usual. It comes from simple image that future period is possible to separate on two phases. First phase contains period for which the valuator is able to draw a prognosis of free cash flow for single year. Second phase contains period from the end of first phase till infinite. Company value in the period of second phase will be in following text mark as continuing value. Continuing value is understood as present value of expected cash flow from the end of first phase till infinite. This present value is calculated to the date of first phase ending (this moment is identical with the beginning of the second phase).

Method of DCF-Equity

In this case is evaluated just equity. Free cash flow is related only to equity FCFE and is discounted by costs of equity R_E. Evaluation of market value of equity is one of the key tasks of financial management and decision making. We finds out the value which falls on owners of the company and increase of this value means realization of owner interests as decision motives and aims in financial management.
When using method DCF equity we start from cash flow which is disposable only to owners of the firm. By their discounting we get value of equity.

Yield capitalization method

It is method of "net" (or equity), that means yield value is calculated from revenues to only owners of equity and thus the result is also the value of equity. It is based on principle of present value of future profit. Revenues are estimated from historical data. Starting point of determination is data from balance sheet and profit and loss account for period from 3 to 5 years. Key data is so called sustainable profit, that is accounting profit which is subjugate to rank of corrections, such as correction of depreciation by real amortization, exclusion of extra profit and extraordinary costs in transition period, exclusion of revenues and expenditures which are not related to main activity of the company, averaging of irregular revenues, exclusion of hidden reserves, methodical changes corrections and so on. If we do objectification evaluation we should result from the line of removable net income. Then this is defined as real, income from operations is influenced as low as possible by accounting policy where the income from operations can be divided unless the yield potential of the company is at risk.

4 Characteristics of a chosen firm

4.1 AUDITOR Praha s.r.o.

The auditing company AUDITOR Praha s. r. o. has 14 employees and 2 auditors at present. The company has been registered in the official list of auditors of the Czech Republic since 1999.

Trade name:	AUDITOR Praha s.r.o.
Address:	Praha 1, Haštalská 6/1072, PSČ 110 00
Identification number:	257 51 301
Legal form:	s.r.o. – limited company
Date of registration:	6. April 1999
Registered capital:	100 000, - CZK

Subject of enterprise:

- Activities of an accounting advisers
- Activities of economic advisers
- Tax consulting
- Auditing activities

Statutory body: executive: Ing. Irena Pospíšilová

Copartners: Eta Invest, s.r.o.

Deposit: 60 000,- CZK

Business share: 60 %

Ing. Irena Pospíšilová

Deposit: 40 000,- CZK

Business share: 40 %

The affiliated company Auditor spol. s r. o. (provides services in tax consulting and book-keeping with 90 employees and 8 tax advisors) was founded as a 100 percent subsidiary company of an Austrian consulting firm in May 1991 in Prague.

The company in Austria with locations in Vienna and Horn provides economic and tax service, has a staff of about 25 employees, including four tax advisors. The affiliated company in Slovakia with location in Bratislava has a staff of 35 employees.

The services provided by AUDITOR Praha s.r.o. and Auditor spol. s r.o. in Prague correspond to the service of international auditing and tax consulting firms.

The company AUDITOR Praha s.r.o. provides auditing services for about 80 clients. They have extensive experience with audits of medical companies (Mediscan, Multiscan, Eurodiagnosis, NH Hospital, Jessenia (=hospital) and of companies from other branches (Amtek, Gebrüder Weiss, Cargo-Partner, VA TECH (VÖST-koncern), VA-MCE, Oberbank, McCain, Promat, Alcar, Flaga, Panalpina, etc.).

AUDITOR Praha provides their reports in two language versions. All employees speak two languages.

Since 1998 in both the Czech Republic and the Slovak Republic AUDITOR Praha has represented UHY – Urbach Hacker Young International, a worldwide network of auditors and tax consultants in more than 50 countries. They can offer a solution of foreign tax matters directly with experts in the countries concerned.

AUDITOR Praha s.r.o. has a responsibility for provided services in an extent according to Czech law.

4.2 HAYEK, spol. s r.o., holding – the competitor

The group HAYEK holding consists of HAYEK, spol. s.r.o., holding (formerly HLB HAYEK), which was founded in 1991 and deals with auditing, accounting and tax advice, and HAYEK TAX, spol. s r.o., holding, founded in 2001 and specialized exclusively in tax services. The founder and only partner in both companies is the auditor and tax adviser Ing. Ivan Hayek who is a much-sought specialist in the field of business combination including company transformations, acquisitions and due diligence.

Trade name: HAYEK, spol. s r.o., holding
Address: Praha 1, Jindřišská 5/901, PSČ 110 00
Identification number: 438 75 092
Legal form: s.r.o. – limited company
Date of registration: 28. January 1992
Registered capital: 100 000, - CZK

Subject of enterprise:

- Activities of an accounting advisers
- Activities of economic and organizing advisers
- Tax consulting
- Auditing activities

Statutory body: executive: Ing. Ivan Hayek

Copartners: Ing. Ivan Hayek
Deposit: 100 000,- CZK
Business share: 100 %

HAYEK company and valuating AUDITOR Praha company are competitors to each other. Both companies run a business very well in the Czech Republic. They both provides very similar, even I would say the same, services. From these reasons is Hayek company

considered as the competitor and at the same time it will also pose branches values for comparison.

5 Economic evaluation - own analysis of a chosen firm

5.1 Strategic analysis

5.1.1 External environment

Delimitation of relevant market and its characteristics

The service which is offered to the customers is called auditing and consulting. AUDITOR Praha belongs among the leading auditing companies and tax consultants in the Czech Republic. According to Chamber of Auditors of the Czech Republic (KAČR in Czech) Auditor Praha belongs to the higher middle out of 338 auditing companies operating in the Czech Republic. It is defined according to the share on Czech market of auditing services.
The obligatory audit is understood as verification of ordinary and extraordinary accounting settlements or consolidated accounting settlements if this verification requires other legal enactment; eventually verification of interlocutory accounting settlement, if this verification requires other legal enactment.

The aim of audit of accounting settlement is to enable auditor to express opinion, if the accounting settlement is in every important aspects agreeable with appropriate frame of accounting audit (International auditing standard ISA 200 Aims and general principles of accounting settlement audit).

Sector of customer

AUDITOR Praha s.r.o. provides auditing services for about 80 clients. They have extensive experience with audits of medical companies (Mediscan, Multiscan, Eurodiagnosis, NH Hospital, Jessenia (=hospital) and of companies from other branches (LRS, Amtek, Gebrüder Weiss, Cargo-Partner, VA TECH (VÖST-koncern), VA-MCE, Oberbank, McCain, Promat, Alcar, Flaga, Panalpina, etc.). AUDITOR Praha does not have

any biggest customer who would perceptually overtop the total turnover. All their customers are quite the same size, the biggest one is LRS which has 6 % of the total firm's turnover.

Sector of supplier

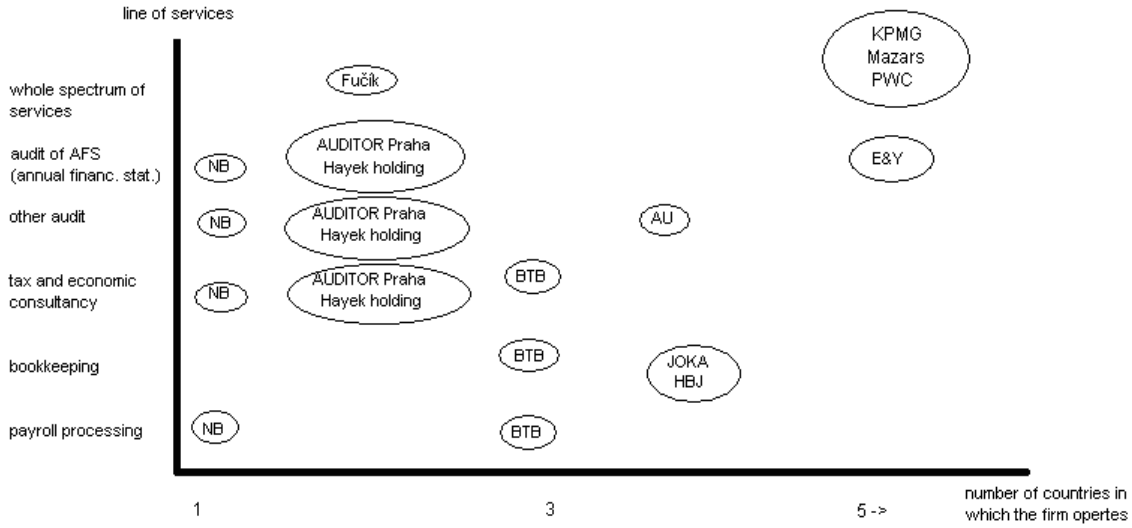
AUDITOR Praha does not have very important suppliers. Company only needs office supply, office rent, phones, internet, bookkeeping and payroll processing.

Sector of competitors

The competition in this branch is very high. Mainly nowadays the competition increases more and more. The main competitors with similar turnover are Hayek, Proxy, Fučík and Rödl. AUDITOR Praha has the advantage that it started run a business quite early (before there was a huge boom and also its advantage is that it focuses on German-speaking customers which are subsidiaries from Austrian and German parent firms (which takes about 60 % of the total contracts).

Map of strategic groups in the branch of auditing in the Czech Republic in 2010.

Pic. 2 – Map of strategic groups



For the main characteristics were chosen 5 different services connecting to audit and accounting. First one is audit of annual financial statement (according to Czech las), second one is other audit – 1) audit in the transformation (fusion) of the company, 2) audit in accuracy of the transfer of Czech AFS into IFRS or GAAP. Onethor sector of service is tax and economic consultancy, then bookeeping and finaly payroll processing. From the picture we can see that the whole spectrum of services have only the biggest companies, such as KPMG, Mazars, PWC and then are smaller companies which operate with just some of the sphere of the service. AUDITOR Praha has activities in audit of AFS, other audit and tax and economic consultancy.

Porter´s five forces

Threat of entry: this branch is long acting and long competitive, it is necessary to certain have know-how for pursuit of audit. It the firm acts on market longer time, it means better cooperation. There is a certain threat of entry, especially in subsidiary companies from already operating concerns from abroad.

Competitive rivalry within industry: AUDITOR Praha provides high quality services and their prices are not that expenses, so here is the good comparison of price and service. Long company operating means stable clients. AUDITOR Praha has employees who know at least two languages, which is advantage as well.

Threat of substitutes: Here is no direct threat because auditing is a very specific branch of activity.

Bargaining power of buyers: It cannot be treating because audit is obligatory. Here exist three conditions under which the certain firm has to carry out an audit.
Three conditions:

- total assets have to be over 40 000 000, - CZK
- annual turnover has to be over 80 000 000,- CZK
- average number of employees has to be over 50

Bargaining power of suppliers: AUDITOR Praha does not have that important suppliers which would influence this.

5.1.1 Internal environment

Identification of company resources

Tangible resources – AUDITOR Praha does not own any huge tangible resources, it only has one type of tangible fixed asset and that is company car. It has two cars where the total purchase price was 1 153 000, - CZK. Nowadays both cars are fully depreciated in an accounting.

Human resources – average number of employees in individual years

Tab. 3 - average number of employees

Year	2006	2007	2008	2009
Average number of employees	8	10	11	15

In the company is only one executive and she has 15 employees. Firm has one office in Prague where they do the work. In 2009 company spent 73 705, - CZK on employees vocational training.

Financial resources - company does not make use of credit or another subsidy. Everything is financed from own resources. In 2009 equity was topped from 2 681 to 3 202 thousand CZK. Other financial indicators are mentioned in sub capitol 5.2.2 – ratio analysis.

Non tangible resources – firm uses attendance software where the purchase price was 20 000, - CZK and auditing software IDEA where the purchase price was 60 000, - CZK. In 2009 AUDITOR Praha spent 166 000, - CZK on software services.

Marketing and distribution factors – AUDITOR Praha has no advertisement. It is mainly because affiliated company AUDITOR contracted few clients to AUDITOR Praha and then it started to have good contacts with other firms.

5.2 Financial analysis

5.2.1 Vertical and horizontal analysis

Vertical and horizontal analysis of balance statement

Tables of horizontal and vertical analysis of balance statement are possible to find in supplements.

Total assets (further TA) are created from fixed assets, current assets and temporary accounts of assets and liabilities. TA are mainly from current assets; it is 75 – 95 %. During years 2004 and 2009 is little increase, mainly in 2006 and finally in 2009 total assets is the highest. From 2008 and 2009 is the relative change 10, 64 %. But if we look at it from 2004 to 2009 the change in TA is 35 % of increase. The biggest decrease in TA was in 2008 towards 2007, there was a change of 6, 39 %, which is 297 thousand CZK, it is mostly caused by decreasing of short-term receivables.

Total assets are created mostly from short-term assets, which are short-term receivables, which are mainly receivables from partners. In calculated years also a big part from current assets is created from short-term financial assets, mainly in bank accounts.

Total liabilities (further TL) are created from equity, foreign funds and temporary accounts of assets and liabilities. TL are mainly crated from equity and foreign funds. In 2004 equity and foreign funds were almost 50 – 50, even foreign funds created bigger part (around 62 %) and equity only 37 % but as time goes on in 2009 TL are crated mainly from equity (66 %) and foreign funds are only 26 %. It is mostly caused by the decrease of short-term liabilities from partners; nowadays AUDITOR Praha has only 2 % of it and in 2004 it was 38 %. Another fact is that retained profit from previous years is increasing almost year by

year. In 2009 net profit to be approved is 521 thousand CZK comparing to year 2008 where net profit was 395 thousand CZK, so the relative change is 126 thousand CZK.
Foreign funds are mainly created from short-term liabilities, where the biggest part is in liabilities from partners, co-operative and group competitors (it creates 11 % from TL).
Firm does not create reserves; here is no case where the market and accounting valuating differs markedly. In 2009 was no change in the amount of registered capital. Company does not have liabilities after date maturity.

Vertical and horizontal analysis of income statement

Tables of horizontal and vertical analysis of income statement are possible to find in supplements.
In AUDITOR Praha company from 2004 to 2009 the operatings (revenues from own sales and products) increase year by year, except 2008 (there was a little decrease in amount of 676 thousand CZK). In 2009 operatings were 14 719 thousand CZK. Operatings are mostly created from costs of sales and value added. From 2004 to 2007 costs of sales were the bigger part, it has around 60 % of operatings and value added has just around 40 %. In contrast, in 2009 value added creates bigger part in operatings. It has around 52 % and costs of sale create 48 %. Costs of sales are created from services because AUDITOR Praha provides auditing services at most. Value added is created mainly from personnel expenses, which are wages and salaries, and social security costs.
Profit for the accounting period is every year lower than operating income statement and this is caused mainly by the lowest (almost zero) financial income statement. The relative change in profit from 2008 to 2009 is 31, 9 % of an increase. In 2009 the total profit is the highest comparing to previous years. In 2009 profit before taxation is 672 thousand CZK.

5.2.2 Analysis of ratio indexes

Sales per employee

Tab. 4 – Sales per one employee AUDITOR Praha

AUDITOR Praha s.r.o.	2006	2007	2008	2009
Average number of employee	8	10	11	15
Revenues from own sales and products (CZK)	12 325	14 066	13 429	14 694
Sales on 1 employee (CZK)	**1 540**	**1 406**	**1 220**	**979**

Tab. 5 – Sales per one employee HAYEK, spol. s r.o., holding

HAYEK, spol. s r.o., holding	2006	2007	2008	2009
Average number of employee	13	13	13	14
Revenues from own sales and products (CZK)	21603	21 170	22 655	21 065
Sales on 1 employee (CZK)	**1 661**	**1 628**	**1 742**	**1 504**

The amount of revenues per one employee is surely relevant data from which is possible to reason certain efficiency, respectively effectiveness of the company. AUDITOR Praha has almost the same number of employees except in 2006 (there the number is lower) nevertheless is still able to create in 2006 sales on one employee 1 540 thousand CZK. In this year the competitor creates profit of 1 661 thousand CZK (with 13 employees). From 2006 evaluated company still decreases sales on 1 employee and in 2009 it is 979 thous. CZK.

Profitability

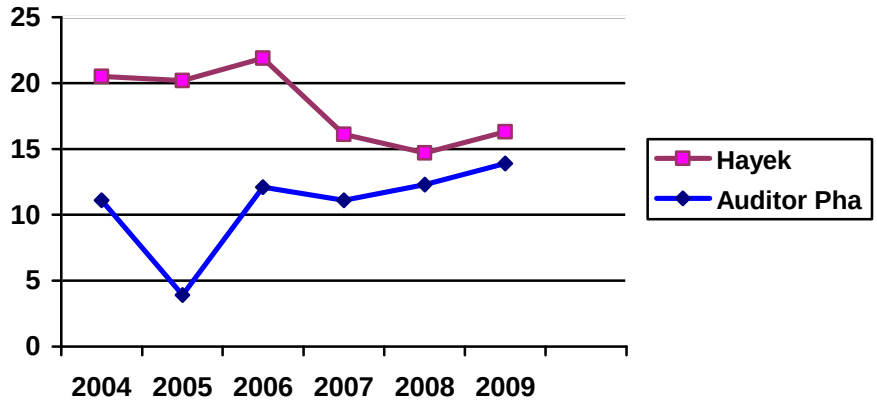
Tab. 6 – Profitability of AUDITOR Praha s.r.o.

Profitability Auditor Pha	units	2004	2005	2006	2007	2008	2009
ROA	%	11,1	3,96	12,1	11,1	12,3	13,9
ROE	%	20,5	20,2	21,9	16,1	14,7	16,3
ROS	%	4	1,2	4,6	3,6	3,9	4,5
Return on costs	%	7,7	9,5	8,9	7,8	7,1	10,8

Tab. 7 – Profitability of HAYEK, spol. s r.o., holding

Profitability Hayek	units	2004	2005	2006	2007	2008	2009
ROA	%	107,7	111,7	103,6	107,5	2,1	3,1
ROE	%	98,5	98,3	98,5	98,3	1,6	2,6
ROS	%	50,7	39,4	44,8	41,4	1,4	2,4
Return on costs	%	77,4	82,2	78,5	81,5	1,4	2,3

Graph 1 – ROA and ROE of AUDITOR Praha s.r.o.



ROA records the highest value in 2008 and 2009 where it was more than 12, 2 %. ROE records higher values in 2004 – 2006 where it was around 20 %. From that period of time ROE records decline which in 2008 was 14, 7 %. Important is that ROE exceeds the certain interest rate; and this implies that for the company is better to operate with business activity than to have money in deposit.

Tab. 8 – Average interest rates from crown client's deposit

Year	2004	2005	2006	2007	2008
Interest rate	1,407	1,247	1,28	1,411	1,589

Liquidity

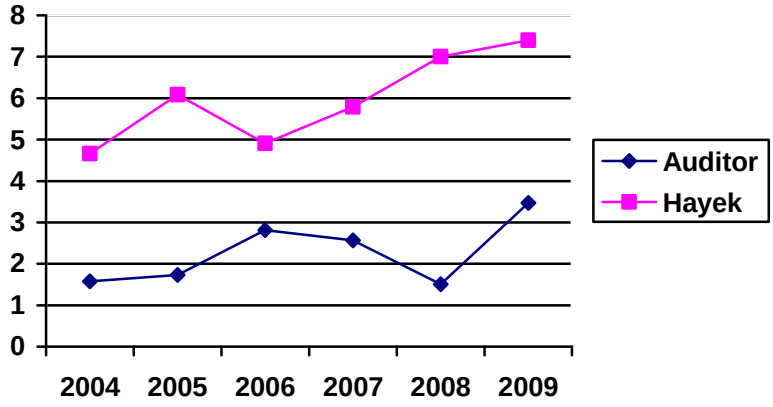
Tab. 9 – Liquidity of AUDITOR Praha s.r.o

Liquidity of Auditor Pha	units	2004	2005	2006	2007	2008	2009
Total liquidity	ratio	1,58	1,73	2,81	2,57	1,51	3,47
Current liquidity	ratio	1,52	1,6	2,68	2,47	1,47	3,37
Immediate liquidity	ratio	0,88	0,59	1,44	0,16	0,61	1,20
Share of receivables on CA	%	39	58	44	89	57	62
Net working capital	thous.czk	1142	1011	2696	2645	1313	3184
Ration indicator of liquidity	%	36	42	64	61	33	71
Indicator of overcapitalization	ratio	0	2,32	4,46	10,6	6,61	11,9
Indicator of undercapitalization	ratio	0	2,32	4,46	10,6	6,61	11,9

Tab. 10 – Liquidity of HAYEK, spol. s r.o., holding

Liquidity of Hayek	units	2004	2005	2006	2007	2008	2009
Total liquidity	ratio	4,66	6,08	4,91	5,79	7	7,4
Current liquidity	ratio	4,66	6,08	4,94	5,79	2,52	5,2
Immediate liquidity	ratio	3,83	4	3,19	3,6	1,51	3,47
Share of receivables on CA	%	17	34	35	37	50	81
Net working capital	thous.CZK	1142	1011	2696	2645	1313	3184
Ration indicator of liquidity	%	78	83	79	82	85	86

Graph 2 – Total liquidity of Auditor Praha and Hayek



The total liquidity of AUDITOR Praha is moving from 1, 5 to 3, 5, that is somewhere between the recommended values, which are 2 - 2, 5. The correct values where between years 2005 and 2008. The competitor Hayek has its total liquidity values hardy over recommended values. The property of Hayek firm is not that liquid. Current liquidity has recommended values 1 – 1, 5. We can see that AUDITOR Praha is moving on the upper border of the recommended value or even little bit over that. Immediate liquidity should be between 0, 2 – 0, 6 and my evaluated company has its values around this recommended border. The portion of receivables on current assets is helpful indicator which can etch in the structure of assets. This index is better when it decreases. But this doesn´t happen in AUDITOR Praha. In last two years the share of receivables on CA was about 60 % and in 2007 came increase up to 89 %. Indicator of overcapitalization has values from 2 – 11, it shows us that in 2007 the fixed asset is 10times covered by equity. Generally it is possible to say that AUDITOR Praha has better position in the zone of liquidity than its competitors Hayek company.

Activity

Tab. 11 – Activity of AUDITOR Praha s.r.o.

Activity Auditor Pha	units	2004	2005	2006	2007	2008	2009
Turnover of total assets	Turnover/year	2,77	3,14	2,61	3,02	3,08	3,05
Turnover time of assets	days	130	114	137	119	116	118
Turnover time of receivables	days	50	50	54	99	59	68
Turnover time of liabilities	days	80	49	43	43	68	31

The turnover of total assets is relatively stable. The values are moving from 2, 6 to 3, 08 turnovers per year. Indicators of this should be in higher values. In time turnover of receivables and assets the emphasis is on lower values. Auditor Praha has its turnover of assets always a little bit over than 100 days and turnover time of receivables is moving between 50 – 99 days, that means receivables are on average paid-in 75 days. The time turnover of liabilities the emphasis is on higher values. Here it is moving between 31 – 80 days.

Financial stability and indebtedness

Tab. 12 – Financial stability and indebtedness of AUDITOR Praha s.r.o.

Financial stability and indebtedness	units	2004	2005	2006	2007	2008	2009
Equity portion on assets	%	37	47	40	49	61	66
Degree of fixed assets covering	ratio	0	4,92	10,94	21,6	10,7	17,8
Assets coefficient (financial leverage)	ratio	2,65	2,12	2,45	2,03	1,62	1,5
Total indebtedness	%	61	43	32	36	58	27
Long term indebtedness	%	0	0	0	0	0	0
Current indebtedness	%	61	43	32	36	58	27
Equity indebtedness	ratio	1,64	0,91	0,77	0,73	0,95	0,4

Equity portion on assets shows us to what extant the company is able to cover own assets by own resources (equity). In Auditor Praha the values are moving from 37 – 66 %. Here is an emphasis on higher value and we can see that these values are increasing year by year; the highest is in 2009 that is 66 %. Degree of fixed assets covering should reach at least value 1, in order to have covered total fixed assets by long-term funds. Here the company reaches good values except in 2004 there is zero because Auditor Praha did not have any fixed asset in 2004. Assets coefficient is in time period relatively stable. Its values are between 1, 5 – 2, 65, which means that equity creates smaller half of the total balance sum.

Long term indebtedness equals zero because Auditor Praha does not have any important amount of long term foreign fund. Total and current indebtedness values are moving from 32 – 61 %. We can see those values decreases as time goes which is positive. Equity indebtedness has recommended values between 0, 8 – 1, 2. Our values are from 0,4 – 1,64.

5.2.3 Analysis of indexes system

Altman model

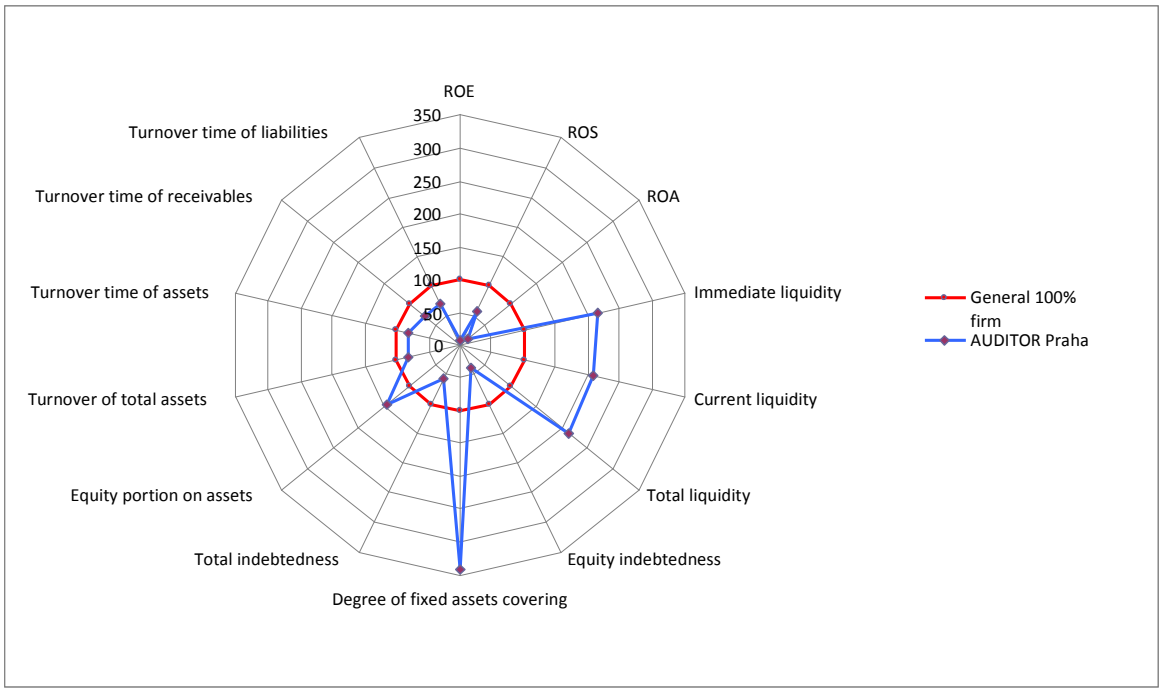
Tab. 13 – Altman model

year	2009	2008	2007	2006	2005	2004
Z-score	6,15	4,16	4,38	3,51	4,13	3,68

Altman bankruptcy model is calculated with the version which is determined for the companies which do not have business (listed) stocks on stock market. In every year the resulting Z-score was above the border 2, 9 points. This proves that AUDITOR Praha is not threatening with bankruptcy situation.

Spider analysis

Graph 3 – Spider analysis



Spider analysis is calculated with data in 2009. Here were used basic ration indicators which are mentioned in literature. AUDITOR Praha lags behind its "competitors" almost in every indicator. This is most obvious in quadrant of profitability. Here AUDITOR Praha reaches only the minimum percentage of profitability value. In the liquidity quadrant is the difference also known. Only the indicator of degree of fixed assets covering AUDITOR Praha has much better result than the competitor. The turnover time of assets, receivables and liabilities are moving on 80 % of competitor's values.

5.3 Own evaluation

5.3.1 Free cash flow

Seeing that years 2010, 2011 and 2012 are prognoses of possible future progress of AUDITOR Praha company, here are not calculated any one time costs or revenues. Financial revenues and costs will be represented by profit or loss account. Data for capital investment in individual years are found in the cash flow statements as per certain period of time. Corrected profit or loss account after taxation is created by predicting profit or loss account for certain accounting period. In prognoses is calculated with the 19 % tax rate.

Tab. 14 – Calculation of free cash flow (in thousand CZK)

Year	**2010**	**2011**	**2012**
Corrected P/L account after tax	552	658	674
Depreciation	0	61,6	123,2
Capital expenditure	0	560	0
FCFE	**552**	**159,6**	**797,2**
FCFF	**552**	**159,6**	**797,2**

Free cash flow of total capital and equity is the same. This is because AUDITOR Praha company does not use any bank loans or bailouts and that is why there is not included in cash flow any income or outcome from these foreign means.

5.3.2 Capital costs

For capital costs budgeting (even if we talk about equity costs or total capital costs) is used constructional model which is also used for example in Department of Commerce (s. www.mpo.cz). It results from presumption of model MM II (Miller and Modigliani), where accepted tax effects and tax shield are there.
Risk free interest rate is set according to return on treasury bonds with maturity of 10 years issued in 2009 and it is R_F = 4, 67 %
Ministry of Finance in the Czech Republic – interest rates [online]. [26/3/2011]
< http://www.mfcr.cz/cps/rde/xchg/mfcr/xsl/makro_pre_52646.html>

R_{LA} = 5 %
$R_{Entrepreneurs}$ = 0 %
$R_{Finstab}$ = 0 %
WAAC = 9, 67 %
R_E = 9, 67 %

5.3.3 DCF – Entity method

In evaluating AUDITOR Praha company was used in praxes commonly applied two step method. Firstly was calculated value of the first phase where the free cash flow to the firm (FCFF) was used, which was subsequently discounted in an individual years using the weighted cost of total capital. Individual years of this discounted free cash flow were counted and thus we get total value of the first phase. In the second phase was counted following value that is company value from the end of 2012 to infinity.
The first phase contains three forecast years (2010, 2011, 2012). Prognosis for this data was elaborated by AUDITOR Praha company and so it is assumed that data are correct and credible and so they are not verified.
In the second phase is calculated with discounted cash flow for following years. The GDP growth in 2009 is according to the Czech Statistical Office 4, 1 %.

Subtotals and final values of certain evaluating phases are possible to find in following table.

Tab. 15 – Evaluating of the firm (in thousand CZK)

Year	**2010**	**2011**	**2012**
FCFF	552	159,6	797,2
$1+ i_k$	1,0967	1,088	1,09
discounted FCFF	503,3	146,7	731,4
Value of the 1st phase	**1 381**		
Continuing value	**14 400**		
Total value of the firm	**15 781**		

This is a subjective (investment) evaluation because forecast data were supplied by itself evaluated company and were not verified. Therefore here does not exist any guarantee that data correspond to the market situation. DCF equity and DCF entity methods show the same values at this moment because AUDITOR Praha does not use any bank loan, so here are no interests with foreign fund and thus free cash flow in unleveraged firm is the same both for the owners and creditors.

The total value of AUDITOR Praha company as at 31 December 2009, calculated by the discounted cash flow method, amounted to 15 781 000, - CZK.

5.3.4 Yield capitalization method

In this method was used so called standard method which works with permanently removable net profit for distribution. Like the previous net profit here was used profit after taxation for the last six years; that is 2005 – 2009. Weights assigned to each period were chosen with taking into account changes in profit and the change in trend. Of course, the recent data have greater weight. Certain values are possible to find in the following table.

Tab. 16 – P/L account for the accounting period and weight in each period

Year	2009	2008	2007	2006	2005
P/L account for the accounting period (thousand CZK)	521	395	367	421	303
Weights in each period	9,8	2,7	0,8	0,2	0,1

The permanently removable net profit is 483 800, - CZK.

Value of the firm's equity as at 31 December 2009, calculated by yield capitalization method, amounted to 5 300 000, - CZK. This value is considered to be the lower limit of the yield value of AUDITOR Praha company in objective valuation and in permanent business activity on the market.

6 Conclusion

Strategic analysis

Determination of market and its customers is quite clear. Business companies are obliged by law to keep accounts and prepare annual financial statements. Information contained in the financial statements serve users of theses statements who can according to them evaluate their economic situation of the certain firm. Between these users we can include owners of the company, creditors, suppliers, customers, employees and so on.

Customers of AUDITOR Praha are very often owned by strategic investors and they are single parts of groups which have their affiliates in many foreign countries. AUDITOR Praha provides auditing services for about 80 clients. AUDITOR Praha does not have any biggest customer who would perceptually overtop the total turnover. All their customers are quite the same size, the biggest one is LRS which has 6 % of the total firm's turnover.

Suppliers of AUDITOR Praha are not that important for the company. It only needs office supply, office rent, phones, internet, bookkeeping and payroll processing.

Company has only one executive and she has 15 employees. Firm has one office in Prague where they work. Company does not use any bank loan or other borrowings.

Financial analysis

The total assets are created from about 80 % of current assets. Total assets increases until 2006, then there is a little decrease but in 2009 assets increases again and it is the highest amount from all years. Current assets are created mostly from current receivables which are mainly receivables from partners. In calculated years also a big part from current assets

is created from short-term financial assets, mainly in bank accounts. In 2009 total assets amounted to 4 813 thousand CZK and current assets amounted to 4 468 thousand CZK.

Total liabilities are created from equity, foreign funds and temporary accounts of assets and liabilities. AUDITOR Praha has TL crated mainly from equity and foreign funds. In 2009 total liabilities are crated primarily from equity (66 %) and foreign funds are only 26 %. Another fact is that retained profit from previous years is increasing almost year by year. In 2009 net profit to be approved is 521 thousand CZK comparing to year 2008 where net profit was 395 thousand CZK, so the relative change is 126 thousand CZK.

Firm does not create reserves; here is no case where the market and accounting valuating differs markedly. In 2009 was no change in the amount of registered capital. Company does not have liabilities after date maturity.

AUDITOR Praha company from 2004 to 2009 records increase year by year in operatings (revenues from own sales and products), except 2008 (there was a little decrease in amount of 676 thousand CZK). In 2009 operatings were 14 719 thousand CZK. In 2009 the total profit is the highest number comparing to previous years. In 2009 profit before taxation was 672 thousand CZK.

Own evaluation

Predicted financial plan was taken right from the evaluated company – AUDITOR Praha. There is a presumption of correctness and reliability of the data. These data were not any verify which means that evaluation cannot be consider as market. AUDITOR Praha is always valuated as at 31 December 2009 because to this date are the latest (actual) documents, needed for evaluation and caring out the necessary analyses, available. There are used two, respectively three methods of evaluating, but because AUDITOR Praha does not use any bank loan then the total free cash flow and CF for investors is the same. Thus there is an erase of the difference between methods of FCF-equity and FCF-entity. Furthermore, all the methods assume constant activity on the market which is considered particularly strategic and financial analysis. Using the method of FCF entity the company is evaluated in subjective (investment) value. The total value of the company is amounted to 15 781 000, - CZK. Using the yield capitalization method the last 5 years (2005-2009) of profit are taken into account. For each year are assigned weights of importance of individual year. The newest data have of course the greatest weight than the older ones.

This method is evaluating in objectified value and the value of equity is amounted to 5 300 000, - CZK. In this method of evaluation is certain benevolence of decision making of the evaluator and this especially in weight assigning to profit in each year. This is primarily why these two evaluations differ from each other a lot. In my opinion profit around 2007 and 2008 do not have too much weight and importance because of the financial crises. The future profit is predicted to increase year by year, so the value of this method may increase a lot in following years. The amount of calculated value in the second method is considered to be the lowest border of the company price. In this case the final value of AUDITOR Praha should be around the first calculated value and then it would depend, in case of evaluating value according to Cologne school, on exact purpose of the evaluation and argumentation abilities of interested parties. Then consensus of all parties would provide the resulting value.

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8 Supplements

Supplement no. 1:

Balance sheet of AUDITOR Praha s.r.o. (in thousand CZK)

Balance sheet	2004	2005	2006	2007	2008	2009
Total assets	3175	3174	4705	4647	4 350	4 813
Fixed assets (long-term assets)		644	430	215	406	269
Tangible fixed assets		644	430	215	406	269
Individual movable assets and sets of movable assets		644	430	215	406	269
Current assets (short-term assets)	3105	2379	4188	4327	3 868	4 468
Inventories	125	189	175	161	108	132
Work in progress and semi-finished products	125	189	175	161	108	132
Short-term receivables	1233	1381	1854	3888	2 217	2793
Receivables from partners	1056	1350	1264	3282	2 025	2 601
Other receivables	3	31	590	606	192	192
Short-term financial assets	1747	809	2159	278	1543	1543
Cash on hand	738	49	12	39	38	38
Bank accounts	1009	760	2147	239	1505	1505
Temporary accounts of assets and liabilities	70	151	87	105	76	76
Deferred expenses	70	137	67	105	76	76
Accrued revenue		14	20			
Total liabilities	3175	3174	4705	4647	5 562	4 813
Equity	1194	1497	1918	2286	2 681	3 202
Registered capital	100	100	100	100	100	100
Registered capital	100	100	100	100	100	100
Reserve funds	10	10	10	10	10	10
Statutory reserve fund	10	10	10	10	10	10
Net profit or loss from previous years	839	1084	1387	1809	2176	2 571
Retained earnings from previous years	839	1084	1387	1809	2176	2571
Net profit or loss to be approved	245	303	421	367	395	521
Foreign funds	1963	1368	1492	1682	2555	1284
Short-term liabilities	1963	1368	1492	1682	2555	1284
Short-term liabilities from partners	1227	1085	631	457	333	53
Liabilities from partners, co-operative and group competitors	260	107	241	693	1304	529
Liabilities to employees	119	151	109	213	251	287
Liabilities to social insurance	77	97	73	137	163	168
Liabilities to taxes and subsidies	280	315	115	182	153	193
Estimated payables (liabilities)					29	54
Other liabilities		-387	323		322	
Temporary accounts of assets and liabilities	18	309	1295	679	326	327
Accrued expenses	18	309	1295	679	326	327

Supplement no.2:

Profit and loss account of AUDITOR Praha s.r.o. (in thousand CZK)

Income statement (profit or loss account)	2004	2005	2006	2007	2008	2009
Margin of trade						
Operatings	8617	10051	12311	14052	13376	14719
Revenue from own sales and products	8795	9987	12325	14066	13429	14694
Change in inventory of own production	-178	64	-14	-14	-53	25
Cost of sales	5507	5753	7750	8911	7020	7161
Raw materials and consumables	206	168	476	361	212	277
Services	5301	5585	7274	8550	6808	6884
Value added	3110	4298	4561	5141	6356	7558
Personnel expenses	2734	3686	3713	4344	5207	6231
Wages and salaries	1986	2672	2693	3147	3776	4590
Social security costs	666	926	840	1098	1324	1518
Other social costs	82	88	80	99	107	123
Taxes and charges	8	8	26	32	56	13
Depreciation of intangible and tangible fixed assets		107	215	215	211	137
Change in provisions and adjustments and complex prepaid expenses written to operating income/expenses (+ / -)					293	482
Other operating revenues	34		44	85	51	50
Other operating expenses	40	98	145	121	165	120
Operating profit (loss)	362	399	506	514	475	625
Interest income	3	19	26	24	89	13
Interest expenses					25	24
Other financial revenues		26	73	21	12	72
Other financial expenses	11	18	35	40	16	14
Profit or loss from financial operations	-8	27	64	5	60	47
Income tax on ordinary profit (loss)	109	123	149	152	140	151
- tax due	109	123	149	152	140	151
- deferred tax						
Profit (loss) on ordinary activities after taxation	245	303	421	367	395	521
Profit (loss) for the accounting period	245	303	421	367	395	521
Profit (loss) before taxation (+/-)	354	126	570	519	535	672