

King's College
2010 Sophomore-Junior Diagnostic Assessment Program
Guidance for Performing Financial Analysis

Introduction

In order to evaluate your understanding of the use financial information in decision-making, you are asked to assume the role of a financial analyst. Your team will study the profitability, stability, solvency, and potential for growth of a publicly-held company from the perspective of outside users consisting of investors and creditors. Try to think of your analysis as a form of story telling. You are going to tell the story of what your company has been doing for the past three years and where you think it will be going in the future.

Before you begin to create your written outline and undertake the analysis of your company's financial statements, you will need to compile the relevant information. The lists presented in this document are intended to serve as guides to help you accumulate useful information and to organize that information effectively. *Not every item listed will be relevant to your company.* Further, based on your outside resources, you may wish to include additional facts or opinions not covered in the document. Be sure to cite any outside resources used where necessary.

Remember that your team's audience is investors, who want help making investment and lending decisions. The suggested content outlined below is designed to help you develop a successful presentation for investors and creditors. Each individual team member's presentation should focus on one or two of the six topics listed below. No two members of a team should present the same information. Ideally, the team, as a whole, will adequately address all of the suggested elements.

Suggested Content:

1. Company description (no more than 3 to 5 minutes):
 - a. Information for this section can be found
 - On the investor relations portion of the corporate web site.
 - By searching library data bases.
 - b. For this element, you should present:
 - A synopsis of your company's operating activities and environment.
 - Any current news events that may affect the company's future profitability.
 - c. The following basic facts about your company could be covered by your presentation.
 - Legal name of the company
 - URL of company Web site
 - State and year of incorporation
 - Stock ticker symbol and stock exchange where shares are traded
 - History of the company's stock price
 - Company's independent auditor. Has there been a recent change in auditor? What fees have been paid to the auditors for audit fees, audit related fees (probably tax-related), and any other type of service such as information technology or consulting?
 - Composite of your company's Board of Directors (i.e., age, gender, ties to the company, etc.)
 - Any news events that may affect the company's current or future operations..
 - Overview of company's key financial data, such as total revenues and expenses, total assets and liabilities, numbers of shares of stock outstanding, etc.
 - Proposals or topics submitted for stockholder in the most recent proxy statements.

2. Analysis of the Company's industry and Management's Discussion and Analysis (no more than 3 to 5 minutes):
 - a. Information pertaining to your company's operating activities can be found in
 - Management's Discussion and Analysis from the company's Form 10-K filed with the SEC
 - Library data bases such as LexisNexis Academic, Mergent Online, .and Business Source Premier.
 - Financial service, such as Morningstar, Money Central (MSN), Yahoo! Finance, MarketWatch.com, or StreetInsider.com.
 - b. You want to analyze the company's operating activities in relationship to the strengths and weaknesses of its industry and major competitors.
 - c. Some suggested items to be included in this section are listed below.
 - Company's primary and secondary SIC or NAICS industry codes
 - Industry segments – how many, which segments are the largest and strongest?
 - i. Segment revenue, assets, expenses, gross margin, etc.
 - ii. The main products and target customers for those products
 - Your company's competitors, competitive strategy, and competitive condition
 - Company size based on:
 - i. Dollar amount of assets, sales/revenues, and net income
 - ii. Market share
 - iii. Earnings per share (diluted) and number of common shares outstanding
 - Research and development efforts and spending
 - d. You might also want to perform a SWOT analysis of the company's competitive strengths, weaknesses, opportunities, threats that promote or impede its growth and profitability.
3. Overview of the annual reports (no more than 5 to 7 minutes):
 - a. Your diagnostic report should include an analysis of your company's accounting practices and financial highlights. You should also discuss any problems involving the acquisition of materials and other inventories, the seasonality of business, or impairment of assets. You should also examine your company's financial statements in order to determine the degree to which the firms' accounting captures their underlying business reality.
 - b. You will want to evaluate key accounting policies and the quality of the disclosures. You should also look for any potential red flags or indications future problems. You should briefly explain the policies for:
 - Inventories (if any)
 - Depreciation
 - Income taxes, including the effective tax rate
 - Employee benefit plans
 - Contingencies
 - Dividends (if any)
 - c. Your company's Financial Highlights are a part of the annual report to shareholders and the SEC form 10-OK. You should track changes in the following items over the prior three to five years:
 - Total assets and total liabilities
 - Short-term debt and long-term debt
 - Revenues, expenses, and net income
 - Dividends per share
 - Basic and diluted earnings per share
 - Other comprehensive income items

- d. If a new financial accounting standard affect the financial statements during the current year, you should briefly explain the potential affects on the company's financial statements.
 - e. You might want to discuss risk management from the Management's Discussion and Analysis section of the annual report.
 - f. You may want to present a selection of financial ratios (listed under part 4 below) within this section.
4. Assessment of the company's general financial condition (no more than 5 to 8 minutes):
- a. Using the financial ratios, you are required to analyze your firms' profitability, solvency, and operating efficiency. The information discussed above should provide support for your conclusions based on ratios.
 - b. You should compare your company's ratios across at least three years and also compare them with at least one competitor or to industry averages. Which ratios you choose to discuss in your presentation will depend on which issue are critical to your conclusions.
 - c. At a minimum your presentation should cover the following:
 - Liquidity Ratios:
 - i. Current Ratio or Working Capital Ratio
 - ii. Quick Ratio
 - iii. Cash flow adequacy ratio
 - iv. Times Interest Earned Ratio or Interest Coverage
 - Profitability Ratios:
 - i. Gross Profit Percentage
 - ii. Return on Investment (ROI) or Return on Financing (ROF)
 - iii. Return on Assets (ROA) and Asset Turnover
 - iv. DuPont Analysis of Return on Equity
 - Leverage Ratios:
 - i. Debt to Total Assets
 - ii. Debt-to-Equity
 - iii. Times Interest Earned or Fixed Charge Coverage
 - Efficiency Ratios:
 - i. Accounts Receivable Turnover and Average Collection Period
 - ii. Inventory Turnover Ratio and Average Days Sales in Inventory
 - Stock Ratios:
 - i. Basic and Diluted Earnings per Share
 - ii. Price Earnings Ratio (PE ratio)
 - iii. Book Value per Share
 - iv. Dividend Payout Ratio or Dividend Yield
 - d. Cash flows are important because investors want cash dividends or they want cash reinvested to increase future earnings. Creditors want debt to be repaid and to receive interest payments. From the investors' and creditors' perspective, you should discuss where cash come from and how is it used. Items that you may want to present include:
 - The method that your company uses to report cash flows -- direct method or the indirect method and what disclosures accompany the statement
 - The change in the cash balance over the past few years

- A comparison net cash flow from operating activities to net cash flow from investing activities to determine whether operating cash flows used to purchases of operating assets or if it was necessary to incur debt to purchased assets
5. An ethical audit of the company (no more than 2 to 3 minutes):
 - a. An ethical audit examines the company's social responsibility policies as well as its public ethical reputation. Determine any ethical issues that result from the nature of a company's products, operations, governance structure or competitive environment.
 - b. Gather relevant facts needed to analyze the ethical issues relevant to the company's annual reports and form predictions of future outcomes from the company's ethical choices.
 - c. Executive compensation: Information of executive compensation is usually included in Form 10-K. Related information may be presented in the proxy statement.
 - For your firm's highest paid executive, total the dollar amounts paid for salaries and bonuses that were received in each of the last three years. If this amount seems high, you might want to compare this to the executives of your company's competitors.
 - Does the trend in stock returns match the trend in compensation being paid to the company's top executive?
 - i. You might want to compare the increase or decrease in executive compensation to the stock performance graph near the end of the proxy statement.
 - ii. You can also compare your company's stock price performance to the S&P 500, NASDAQ average or the Dow average.
 6. Conclusions (no more than 2 minutes):
 - a. In this section, your team should make recommendations to investors and creditors.
 - As an investor, would you purchase this company's stock? Why or Why not?
 - As a creditor, would you lend this company more funds? Why or Why not?
 - b. A member of your team should summarize the key points made by other team members to support your recommendations.