

Australian Shareholders' Association

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An investor's guide to understanding financial statements

Session two

Statement of income (profit and loss account), and its comparison with underlying earnings and operating cash flows.



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Learning outcomes for this session

- ▶ How to interpret a statement of income (profit and loss account) when determining whether a company's financial position supports a wise investment decision.
- ▶ How to assess the contents of a statement of income in more depth than merely using normal data based ratio analysis.
- ▶ Understanding the effect of accounting standards on the composition of a profit and loss account.
- ▶ How to reconcile an accounts profit with the operating cash surplus contained in the statement of cash flows.
- ▶ How to reconcile the audited accounts profit (statutory profit) with company and media reporting of “underlying profit”.



Income Statement

- ▶ This statement matches revenue with expenditure incurred in the same accounting period.
- ▶ Will contain some estimates (depreciation, value of inventory, part finished construction profit).
- ▶ The profit result will differ from the operating cash flow due to non-cash items included in calculating profit.
- ▶ Need to look out for abnormal items in assessing profit for the period under review.
- ▶ Underlying earnings comparison – useful for investors, a worry for ASA monitors!



CONSOLIDATED

2017

2016

\$m




\$m

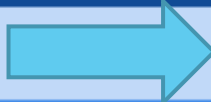
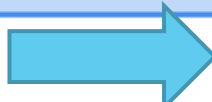
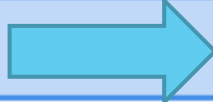
	Note	2017 \$m	2016 \$m
Revenue	1	68,444	65,981
Expenses			
Raw materials and inventory		(46,359)	(45,525)
Employee benefits expense	2	(9,132)	(8,847)
Freight and other related expenses		(1,096)	(1,078)
Occupancy-related expenses	2	(3,229)	(2,959)
Depreciation and amortisation	2	(1,266)	(1,296)
Impairment expenses	2	(49)	(2,172)
Other expenses	2	(3,346)	(3,107)
Total expenses		(64,477)	(64,984)
Other income	1	288	235
Share of net profits of associates and joint venture	18	147	114
		435	349
Earnings before interest and income tax expense (EBIT)		4,402	1,346
Finance costs	2	(264)	(308)
Profit before income tax		4,138	1,038
Income tax expense	3	(1,265)	(631)
Profit attributable to members of the parent		2,873	407



Wesfarmers 2017 Annual Report – Underlying earnings

KEY FINANCIAL DATA

		2017	2016
Revenue from ordinary activities	\$m	68,444	65,981
Earnings before interest, tax, depreciation and amortisation	 \$m	5,668	2,642
Earnings before interest, tax, depreciation and amortisation (excluding significant items) ¹	\$m	5,668	4,903
Net profit after tax	 \$m	2,873	407
Net profit after tax (excluding significant items) ¹	\$m	2,873	2,353
Return on average shareholders' equity (R12) (excluding significant items) ¹	 %	12.4	9.6

Twelve months ended 30 June (\$'m)	2017	2016
Statutory Revenue and Other income 	1,820.6	829.9
Underlying EBITDA ^{1 2}	366.4	215.6
Statutory EBITDA	335.5	194.1
Underlying EBIT ^{3 4}	260.2	170.2
Statutory EBIT ³	141.9	116.5
Underlying NPAT ^{5 6} after minority interests 	152.3	101.7
Statutory NPAT ⁶ after minority interests 	(1,464.9)	64.1
Basic earnings per share - ¢	(237.65)	18.6
Diluted earnings per share - ¢	(237.65)	18.6
Fully Diluted Underlying EPS (¢) ⁵	24.7	29.5
Net tangible asset backing per share - ¢	14.6	(109.3)
Final dividend per share - ¢	-	8.0
Full year dividend per share ^{4 7}	6.0	15.6

Reconciliation between the Underlying and Statutory Result



Twelve Months Ended 30 June 2017 (\$'m)	EBITDA	EBIT	NPAT
Underlying Result	366.4	260.2	152.3
Significant Items:			
Gains on total return swaps	0.1	0.1	0.1
Gains/losses associated with foreign exchange & other	(0.6)	(0.6)	(1.3)
Net gain/loss on disposal of investments	(4.7)	(4.7)	(4.1)
Amortisation of acquired customer intangibles	-	(61.0)	(42.7)
Amortisation of acquired software intangibles	-	(26.4)	(18.5)
Acquisition & Integration Costs	(25.7)	(25.7)	(18.6)
Goodwill Impairment	-	-	(1,532.1)
Total Significant Items	(30.9)	(118.3)	(1,617.2)
Statutory Result	335.5	141.9	(1,464.9)

		Consolidated	
		2017 \$m	2016 \$m
Revenue	Notes	5,628.0	3,954.5
Cost of sales		(4,397.5)	(3,089.1)
Gross profit		1,230.5	865.4
Other income		2.0	0.6
Sales and marketing expenses		(580.1)	(404.6)
Occupancy expenses		(248.6)	(173.8)
Administration expenses		(36.2)	(27.2)
Acquisition transaction and implementation expenses		(22.4)	–
Other expenses		(75.3)	(38.7)
Finance costs	5	(10.7)	(3.9)
Profit before tax		259.2	217.8
Income tax expense	6	(86.8)	(65.6)
Profit for the year attributable to Owners of the Company		172.4	152.2
		<i>Cents</i>	<i>Cents</i>
Earnings per share			
Basic (cents per share)	3	154.30	151.90
Diluted (cents per share)	3	152.94	150.30

STATEMENT OF CASH FLOWS

for the financial year ended 30 June 2017

JB Hi-Fi Australia

		Consolidated	
		2017	2016
		\$m	\$m
	Notes		
Cash flows from operating activities			
Receipts from customers		6,205.5	4,355.7
Payments to suppliers and employees		(5,908.8)	(4,101.2)
Interest and bill discounts received		1.7	0.5
Interest and other finance costs paid		(9.3)	(3.7)
Income taxes paid		(98.5)	(66.2)
Net cash inflow from operating activities	 16	190.6	185.1

For the purposes of the cash flow statement, cash and cash equivalents includes cash on hand and in banks, net of outstanding bank overdrafts.

(a) Reconciliation of net cash inflow from operating activities to profit

	Consolidated	
	<i>2017</i> \$m	<i>2016</i> \$m
Profit for the year	172.4	152.2
Depreciation and amortisation	53.9	40.9
Impairment of plant and equipment	1.1	0.6
Impairment of goodwill	14.7	–
Non-cash employee benefits expense - share-based payments	5.3	4.3
Net loss on disposal of non-current assets	4.5	4.1
Change in operating assets and liabilities net of effects from acquisition of businesses:		
(Increase) decrease in inventories	(56.3)	(64.8)
(Increase) decrease in current receivables	3.0	(16.3)
(Increase) decrease in other current assets	(3.0)	1.3
(Increase) decrease in deferred tax assets	(8.5)	(3.3)
(Decrease) increase in current payables	(5.8)	58.2
(Decrease) increase in current provisions	4.2	5.3
(Decrease) increase in other current liabilities	1.4	0.2
(Decrease) increase in non-current provisions	(0.2)	0.3
(Decrease) increase in other non-current liabilities	7.2	(0.7)
(Decrease) increase in current tax liabilities	(3.3)	2.8
Net cash inflow from operating activities	190.6	185.1

Financial Ratios

- ▶ Essential to choose relevant ratios when analysing a company's performance.
- ▶ Understand the purpose of chosen ratios e.g. eps growth trend.
- ▶ Use as a “rule of thumb” to lead to further analysis.
- ▶ Understand impact of changes in components of calculation.
- ▶ Trends are all important as distinct to one-off numbers, e.g. operating margins.



Popular Ratios using the Financial Statements

- ▶ Earnings per share ($\text{NPAT}/\text{Issued Shares}$)
- ▶ Return on capital ($\text{NPAT} + \text{Interest} / \text{Debt} + \text{EQ}$)
- ▶ Return on assets ($\text{NPAT} / \text{Total assets per B/S}$)
- ▶ Return on equity ($\text{NPAT} / \text{equity}$)
- ▶ Debt/Equity ($\text{Int. bearing debt} / \text{equity}$)
- ▶ Interest cover ($\text{NPAT} + \text{Int(AT)} / \text{Int}$)
- ▶ Current ratio ($\text{Current assets} / \text{Curr. liabs}$)
- ▶ Operating margin ($\text{EBITDA} / \text{Revenue}$)



Popular Ratios – Market Driven

- ▶ Price/earnings ratio (P/E) MP/EPS
- ▶ Total shareholder return (TSR) $DIVS+MP$
Inc/Dec.
- ▶ Price to book (PB) $MP/Book\ value\ (Net\ assets)$
- ▶ Dividend yield (DPS/MP)
- ▶ Earnings yield (EPS/MP) – Reverse of P/E
- ▶ Payout ratio ($Dividend/NPAT$)
- ▶ Price to earnings growth PEG ($PE/EPS\ growth$)



Preparation for next week

1. Study the statement of cash flows included in the 2017 annual report of JB HIFI (JBH).
2. Examine the investing cash flows section, identify and explain the most significant transaction.
3. Examine the financing cash flows section, identify the two most significant transactions and explain the relationship with the transaction in 2.

