

# Financial statement analysis of bata pakistan from 2005- 2010

[Countries](#)



Running head: Financial Statement Analysis of Bata Pakistan “ Bata Pakistan”; Financial Statement Analysis From 2005 to 2010 Anum Fatima BSc. IV Section: B Lahore School of Economics This report is submitted as partial requirement for Financial Statement Analysis of Pakistani Companies to Dr Farooq Chaudhry Abstract This paper does an in depth analysis of Bata Pakistan Limited. It includes a brief summary of accounting policies and standards of the company. The analysis revolves around financial statements, their horizontal and vertical analysis.

It also includes a detailed analysis of different financial ratios to measure different aspects of the company’s performance. Weighted average cost of capital is calculated on the basis of which intrinsic value of the stock is calculated. It also includes analysis of economic value added and Du Pont. Introduction Bata Pakistan is a public limited company and it is listed on Lahore and Karachi stock exchange. The main office of the company is at Batapur, Lahore. This company manufactures all kinds of footwear with accessories sells them at its outlets.

Sales are both local and export The parent company is Bafin B. V. , Netherlands whereas above it is Compass Limited, Bermuda. The financial data disclosed in the annual report has been prepared in accordance with IFRS (International Financial Reporting Standards) stated by International Accounting Standards Board. These standards are applied under the Companies Ordinance of 1984. The company made some amendments to account standards; some of them are effective whereas some of them will be effective in the near future.

According to the company's opinion, these amendments didn't have a significant effect on their financial statements. The financial statements follow the principle of historical cost rather than the fair value concept except for some employee benefits whose details will be discussed later. All statements except the statement of cash flow are recorded on an accrual basis. After giving a brief summary of accounting policies, there is an in-depth analysis of the company's financial statements, the company's valuation, and then recommendations based on that analysis.

### Accounting Policies

Employee benefits are calculated through the defined benefit plan. A defined benefit plan basically involves a determined amount of gratuity dependent on factors like age, years of service, compensation, etc. The company has an unfunded gratuity scheme for all employees excepting management. The provision for employees who are also members of the provident fund is calculated on the basis of 3 weeks' basic salary for every year of service, whereas for employees who are not members of the provident fund, it is calculated on the basis of 30 days' gross highest salaries/wages.

The actuarial gains and losses are recognized as per defined in IAS 19 over the expected average remaining working life of the employee. The company also operates a provident fund scheme in which equal monthly contributions by the company and the employee at the rates of 8% and 10% are made to the employee and managerial staff respectively. The current taxation is calculated on the taxable income from local sales at the present tax rate after accounting for the tax credits, rebates, or exemptions if any. Deferred tax is calculated by using the balance sheet liability method for all temporary differences between tax bases of assets and liabilities.

The carrying amount of deferred income tax asset is revised at each balance sheet date. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the liability is calculated on the basis of tax rates applicable on the balance sheet dates. Revenues, expenses and assets are recognized net of sales except when sales tax is recognized as part of cost of acquisition of asset and when receivables and payables include the amount of tax. Property plant and equipment are reported at cost minus depreciation and impairment losses which are accumulated but land is stated at cost.

The method used to calculate depreciation is the reducing balance method. Recognized expenditures, related to an item of property plant and equipment, are added to the carrying amount of asset when future economic benefits are expected. To measure the impairment of non financial assets, at each balance sheet date the carrying amount of assets is revised to check for any impairment loss. If such is the case then recoverable amount of the asset is calculated. Recoverable amount is higher of an asset's fair value less cost to sell and value in use.

The company's rubber factory represents assets that are leased out under the operating lease and that has been leased out to a third party for processing products and is included in the fixed assets of the company. Their depreciation is calculated in the same way as done for the other assets. Intangible assets are calculated on initial recognition at cost. After that they are carried at cost minus any amortization and impairment losses that are accumulated. If such assets have finite lives then they are amortized over

that life and assessed for impairment if any. The amortization mechanism is reviewed at least once every financial year.

This expense is recognized in the income statement. Gain and loss from intangible assets are measured as the difference between net disposal proceeds and carrying amount of asset and recognized in the profit and loss account. The investments of the company have fixed maturity and the company intends to hold till maturity. These investments are first recognized at cost including transaction costs and then carried at the amortized cost. Stores and spares which are purchased are valued at weighted average cost whereas in transit stores and spares are valued at actual costs.

Stock in trade is valued at lower of cost and net realizable value. Raw materials that is own production and purchased are valued at weighted average cost whereas in transit are valued at actual cost. Work in progress is valued at the production cost. Finished goods that own production are valued at production cost on FIFO basis, purchased are valued at actual cost on FIFO basis whereas in transit are valued at the actual cost. Cost is calculated on the basis of cost of material, labor and production overheads. Net realizable value is based on estimated selling price minus estimated cost to completion and estimated cost to make sale.

Provision for doubtful debts and other receivables are decided by management's assessment of customer's creditworthiness. It is recognized in the profit and loss account. Contingencies and commitments are also important. Contingent liabilities are disclosed when there is a possible obligation from the past due to any future event not within control of the company or when there is a present obligation from the past events but the <https://assignbuster.com/financial-statement-analysis-of-bata-pakistan-from-2005-2010/>

amount of that obligation cannot be measured in a reliable manner. Borrowings are recognized at fair value net of transaction costs then they are carried at amortized cost.

Any difference between proceeds and redemption value is recognized in the P and L account using effective interest rate method. Provisions are recognized when there is an obligation from past events and it can be estimated in a reliable manner. This amount is the best estimate while taking into account the risks. When the amount required settling a provision is expected to be recovered from a third party then a receivable is recognized if it is certain and estimate is reliable. Revenue recognition is done as stated below. The revenue from wholesale is recognized when company has delivered the product to the wholesaler.

Retail sales are recognized when product is sold to the customer by cash or by credit. Customer loyalty card sales are recognized as revenue over the period that the award credits are redeemed. Profit on investment is recognized on accrual basis by using effective interest method. Profit on bank deposits is recognized on accrual basis whereas rental income is recognized on accrual basis over the duration of lease agreement. Cash and cash equivalents include cash in hand, deposits with banks, other short term investments with original maturities of three months or less and bank drafts.

In cash flow statement, it is cash in hand; cash in transit, bank balances and short term investments. Recognition and measurement of financial instruments is done at times when company enters the contract. All financial assets and liabilities are measured at fair value. Major categories of assets are investments, advances, deposits, trade debts, other receivables and cash

<https://assignbuster.com/financial-statement-analysis-of-bata-pakistan-from-2005-2010/>

and bank balances. Financial liabilities are creditors, accrued expense and other payables. Any gain or loss is recognized in the P and L account for the period.

Offsetting of financial assets and liabilities is done and the net amount is reported in the balance sheet if the company has a legal right to set off. Corresponding income and charge are also off set. The amount of loss is the difference between asset's carrying amount and present value of the estimated future cash flows discounted at effective interest rate. Related party transactions are conducted at arm's length just as with the third party using comparable uncontrolled price method whereas related parties are those who are able to influence the operating and financial decisions of the company.

Dividends and other appropriations to reserves are recognized when these are approved. Operating segments are reported in a manner consistent with the internal reporting. Board of Directors is the chief operating decision maker that makes strategic decisions. Significant changes observed during the 6 year period under consideration are discussed below. In 2006, stores and spares and stock trade didn't use FIFO or LIFO, rather purchased units were valued at lower of moving average cost and net realizable value. In 2007 same method was used whereas in 2008 FIFO was used for similar valuation of inventory.

This change of method has been effective since. When this method was used there was a remarkable increase in the amount of stock in trade as well as cost of sales and gross profits from the previous years. Other than that no significant policy changes are observed except some minor changes in <https://assignbuster.com/financial-statement-analysis-of-bata-pakistan-from-2005-2010/>

standards which according to the company's opinion had no significant effect on financial statements, Analysis of Financial Statements First of all we will be analyzing the financial statements indirectly through financial ratios divided in feasible groups. Liquidity Ratios

The working capital of the company has shown healthy growth over the year. Working capital is useful in evaluating company's ability to meet currently maturing liabilities. The working capital of the company is not only positive but it is growing at an average rate of 44.46%. It also means that current assets are growing at a rate faster than current liabilities. Working capital took a jump in 2007 which proved to be a prosperous year for the company due to favorable economic conditions and the company used this opportunity in an efficient manner to gain from the situation.

This shows that current assets are always in excess of current liabilities which is a good indicator. Comparing working capital with the industry is not very useful because it depends on the size and scope of the company. The Current ratio is basically another way of expressing the relationship between current liabilities and current assets. Minimum it should be equal to 1 meaning that current liabilities are exactly matched with current liabilities. The company is showing good performance in this regards as the current ratio is greater than 1 and increasing steadily over the years from 1.1 in 2006 to reach 2.66 in 2010. This again points to the fact that current assets are covering current liabilities effectively. Inventory and accounts receivables are forming major part of current assets. It still remains to be seen that whether this growth in current assets is solely due to increasing accounts receivables and inventory and then whether accounts receivables

<https://assignbuster.com/financial-statement-analysis-of-bata-pakistan-from-2005-2010/>



are being collected of inventory being sold in time. The current ratio was a little behind the industry averages in 2006 but it soon caught up and is growing side by side the industry averages.

Quick ratio is calculated by excluding inventory from current assets as they are considered to be least liquid assets. It is a better measure of liquidity. Quick ratio shows a significant decline from current ratio owing to the fact that inventory is a major part of the current assets. It caught u with the industry average in 2009 when it went from 0. 51 to 1. 15. This also points to the fact that low quick ratio is not an indicator of less liquidity rather it points to the nature of the business and its dependence on inventory because it is in line with industry averages.

Collection period measures the length of time after which the company expects to realize cash from its accounts receivables. Company has improved from 2006 to 2010 remarkably. In 2006 it was 30 days which reduced to 11 days in 2010. A major change was in 2007 as collection period fell by 10 days. They caught up with industry averages in 2009 which is 10 days. It shows that company's accounts receivables are enforceable and not resulting in defaults. Days to Sell Inventory is the length of time after which company realizes sales from its inventory.

They have improved from 2006 to 2010, falling from 131 to 101. They are in line with industry averages of 113 days. Major improvement was again seen in 2007 when days fell from 131 to 116. This is a good achievement as inventory has increased over time. Looking at all these indicators there isn't any cause of concern for the company in terms of liquidity. Capital Structure

and Solvency Ratios Solvency means the ability of the firm to meet its long  
<https://assignbuster.com/financial-statement-analysis-of-bata-pakistan-from-2005-2010/>

term obligations which also involves analysis of capital structure of the company that is the debt and equity mix.

The debt to equity ratio of 0.52 means that for each one rupee of equity, 0.52 is provided by creditors. This ratio is very low showing high percentage of equity. This is in line with industry average and has decreased over the 5 year period. This ratio should be typically low for a manufacturing company which is the case for Bata. This means that the company is in good position to meet its long term obligations. The long term debt to equity ratio is even lower meaning the company is relying very little on long term debt. It is less than 1 and decreases from 0.13 to 0.05.

It has shown a slight decrease over the years and is in line with the industry averages. Times Interest Earned measures the times for which the amount of interest can be paid out of income before tax. This ratio was low in 2006 but it rose from 8 to 24 times in 2007 which is a big improvement. After that it came in line with industry average of 29 times. This also points to the fact that the interest charges of the company are very low and are only less than 1% of total sales. These set of ratio indicate that the debt equity mix of the company is satisfactory. Less reliance on debt means lower risk of default.

So the company is in a great position to manage its long term liabilities which are meager in quantity as compared to equity. Return on Investment Ratios Return on assets determines the amount of return when 1 Rupee is invested in assets. In 2006 it was 18.18% which later rose sharply in 2007 to 34.79% and maintained the position till 2010 with slight variations. Industry average has been slightly higher that is 35% but in any case the performance of company's assets is a satisfactory and generating good

<https://assignbuster.com/financial-statement-analysis-of-bata-pakistan-from-2005-2010/>

return. Another side is the return on common equity because shareholders are interested in the returns on equity.

Return on equity shows the same pattern as return on assets. It was 16.66% in 2006, rose sharply to 43% in 2007 and then maintained steady levels until 37% in 2010. Industry average has been almost 36% so company is earning good returns as per industry. Operating Performances This set of ratio link income statement line items with sales. These basically measures profit margins in different forms. Gross profit measures the relationship of cost and sales. Gross profit margin has maintained a steady well and increased from 37% in 2006 to 41% in 2007. The usual impact of 2007 boom is not very much apparent here.

Then it maintained a steady level till 2010 of 40%. This is in line with industry average of 41%. Industry averages also doesn't show much variation over the 5 years. Operating profit margin was initially 9% in 2006 but improved to 14% in 2007 and maintained the level till 2010. Industry average has remained more or less around 14% so compared to the industry company is doing fine and generating good returns. Net profit margin was 3.67% but improved greatly in 2007 to 9.05%. It has improved to 10.46% in 2010. The industry average is around 9% according to which net profit margin of the company is satisfactory.

Overall operating performance shows a good picture. Asset Utilization Ratios Asset utilization relates sales to different assets and their importance lies in the fact that they are important determinants of return on investment. Cash Turnover is the firm's efficiency in its use of cash for generation of sales revenue. This ratio shows a volatile trend. The value in 2006 is 36 fell to 16  
<https://assignbuster.com/financial-statement-analysis-of-bata-pakistan-from-2005-2010/>

in 2007, rose to 57.4 in 2008 and then maintained 13% to 15% from 2009 to 2010. This can be explained by rather volatile cash and bank balances portraying varying liquidity requirement each year.

Accounts receivable turnover is an indicator of how many times company has collected its receivables in a year. This has increased steadily from 2006 to 2008 and shows a sharp rise in 2009 due to high sales and 31 in 2010. This is almost in line with industry average which is 35. This shows that the company is not having any significant problem in receivable collection. Inventory turnover is steady over the years from 2.74 to 3.56 in 2010. It shows that how many times inventory is sold during the year. This is in line with industry average.

It may seem quite low but seasonality has a big factor in shoe business as business peaks when season changes but after that it slackens until the next change. Working capital turnover is high in 2006 and 2007 but falls in 2008 till 2010. Still there isn't any significant difference between industry average and the company's average. Property Plant and equipment turnover maintains a steady growth profile from 9.72 in 2006 to 13.73 in 2010. Industry average is also steady around 12 so that show good results. Total asset turnover varies around 2 but is steady same as the industry average.

#### Market Measures

Price to earnings ratio shows that how much investor is willing to pay per rupee of the profits. It was 8.90 in 2006 but rose to 10.23 in 2007, rose steadily in 2008 and 2009 and rose to 17% in 2010. This increase is attributed both to increasing market share price and rising earnings per share. This too is more or less around industry average and rose above <https://assignbuster.com/financial-statement-analysis-of-bata-pakistan-from-2005-2010/>

industry average in 2010. Earnings yield is the reciprocal of price to earnings. It shows the percentage of each rupee invested in stock that was earned by the company. They dipped in 2007 to 2009 but then rose above industry average in 2010.

Dividend yield shows how much a company pays in dividends relative to its share price. Dividend yield is not steady but 4.24% in 2010. This means that the dividends are not stable but they are showing growth rather than decline and has risen significantly from Rs1.50 per share in 2004 to Rs 12 per share in 2009. Dividend Payout Rate basically shows the percentage of earnings paid to the shareholders. This ratio is quite high supporting the same growth in dividends. This ratio increased considerably to 27% in 2006 but then EPS rose significantly because of which the ratio fell to 10%.

This is also in line with industry average of around 10%. Price to book value of the share has increased over time significantly indication high growth in the market value of the stock. But if we look at industry average they are also quite high showing the trend in the industry of increasing stock prices. Overall the company's stock is performing well in the market and also its dividend policy is investor friendly and ensures high and stable returns as compared to the industry in which dividends are not very common and that too every year. Bata also gave interim dividends in 2006 in addition to the usual annual dividends.

Du Pont Analysis Return on common equity is disaggregated into its component to have a better look at what drives this return on common equity. Return on common equity was 13.57% in 2005 then increased sharply in 2007 to 42.94% then falling to 39%, 34% and 37% in 2008, 2009  
<https://assignbuster.com/financial-statement-analysis-of-bata-pakistan-from-2005-2010/>

and 2010 respectively. The good economic conditions in 2007 were efficiently utilized by the company. It is disaggregated in profit margin, asset turnover and leverage. Profit margin is basically net income divided by sales or net income as a percentage of sales. It measures how much a company keeps out of sales revenue as earnings.

Both net income and sales of the company has increased over time. The ratio increased significantly in 2007 and after that maintained same level of around 9% which rose to 10% in 2010. Then sales divided by average assets shows a steady trend over the years which show company's ability to generate revenues from investment. This means that the growth of sales and although higher than growth in assets but still the increase is more or less proportionate. Average assets over equity fall in 2007 and then maintain same level till 2010. It tells how much assets are owned by the company and how much are leveraged.

A low ratio indicates that the company is strong and relies more heavily on equity rather than debt. So we can say that Net income over sales or profit margins are driving the return on common equity. This points towards the strength of the company that is a stable growth in sales and also a stable growth in net income that is ensuring good returns to the shareholders. Common size Balance Sheet Common size balance sheet means all components of balance sheets as a percentage of total assets. We will start with the analysis of current assets. In this company current assets form a major part of the total assets.

In 2005, they were 74.66% of total assets, varied slightly till 2008, increased to 78.68% in 2009 and then 82.82% in 2010. This is a good sign but it can <https://assignbuster.com/financial-statement-analysis-of-bata-pakistan-from-2005-2010/>

be an indicator of deficient investment in long term assets or property plant and equipment. In current assets, inventory and accounts receivables form the major component of total assets. Inventory was 44.45% in 2005, increased to 50% in 2006, decreased to 41% in 2007, increased to 55.97% in 2008 then started to decline till 36.56% in 2010. Stock in trade and stores and spares determine total amount of inventory.

High value of inventory may be inherent to this type of business as seasonal changes induce sales and hence inventory to sale out but in any case high inventory are required to be maintained. Next major component is account receivables or trade debt which shows the good credit policy of the company as receivables have significantly decreased over the years from 23.27% in 2005 to 0.53% in 2010 indicating majority of sales are in cash that solves many problems. A steady level of cash is being maintained showing slight dips in 2005, 2006 and 2008. Cash is 13% of total assets in 2010.

This shows that liquidity position is very strong but it can also means that company may be holding idle cash that can be invested somewhere to generate returns. Non Current assets form a small portion of total assets which means that the company is not very ambitious and doesn't involve in expansionary operations. In 2005 they were 25% of total assets whereas they have fallen to 17.18% in 2010. in long term assets only property plant and equipment noteworthy and constitute almost all noncurrent assets. They have declined in conjunction with total noncurrent assets.

Total equity as percentage of total equity and liabilities has increased over the years. In 2005 it was 45.278%, showed a slightly downward trend in 2006 and 2007 but rises from 63% to 65% from 2008 to 2010. It shows that <https://assignbuster.com/financial-statement-analysis-of-bata-pakistan-from-2005-2010/>

company is using more equity financing as compared to debt financing. Even in debt financing, current liabilities form a higher percentage of total liabilities and equity. It was 48% in 2005, showed a significant decrease in 2008 and then 31% in 2010. It shows that the even in liabilities the company prefers to finance its assets with current liabilities and trade payables in current liabilities.

Provision for taxation has shown significant increase from 0.24% in 2005 to 7.47% in 2010. The major increase was from 2009 to 2010. Noncurrent liabilities form a small portion of total liabilities and equity. It was 6.47% in 2005 and decreased to 3.23% in 2010. This also indicates that the company is matching its current and noncurrent assets with current and noncurrent liabilities so that there is no liquidity or solvency problem. Common size balance sheet shows good financial health of the company. Common size Income Statement Analysis Common size income statement measures all income statement components as a percentage of net sales.

Cost of goods sold is a major component of net sales but it hasn't increased significantly over time showing company is employing good cost minimization measures. It was 63% in 2006 then decreased till 57.62% in 2008 then increased slightly to 60% in 2010. Managing costs is not creating problems for the country. Gross profit as a percentage of sales the opposite trend of cost increases till 2008 then falls to 40% in 2010. This is a reasonable percentage of gross profit. Interest expense of the company is very low so there remains a bigger chunk for the shareholders.

Next major component is operating expenses which is the only significant expense due to the requirement of maintain international standard outlets <https://assignbuster.com/financial-statement-analysis-of-bata-pakistan-from-2005-2010/>



throughout the company and hiring specialized staff. But operating expenses has shown decrease over time from 29% in 2005 to 24.80% in 2010 with slight variation in between. Profit before taxation has shown good improvement over time. It increased from 5.05% in 2005 to 14.27% in 2010 with a steady increase over the year. Profit after taxation has increased over the years which is also a good sign. It was 3.03% in 2005.

There was a significant increase in 2007 due to favorable economic conditions and then that level was maintained with slight increases over the years finally 10.46% in 2010. Common size income statement shows that the company's profit and loss account is in good health. Balance Sheet Horizontal Analysis (Year over Year Analysis) This analysis is useful in tracking the trends of different components of balance sheet over the years and then analyze those trends. Starting with current assets, from 2005 to 2006 current assets showed a slight decrease of 0.51%.

Within current assets the major assets of the company that is account receivables and inventory decreased by large percentages whereas cash and loans showed increases. This fall in current assets may not be harmful as it may pertain to inventory sale out or realization of accounts receivables. After that there is a consistent increasing trend. From 2006 to 2007, current assets increased by 37.87% because all major assets showed increase. They dipped slightly from 2007 to 2008 but gained paced later. From 2009 to 2010 they increased by 43.58% with different components showings different inconsistent trends.

Noncurrent assets increased from 2005 to 2006 by 15.82% and kept increasing each year at an increasing rate. The trend was broken in 2008 to <https://assignbuster.com/financial-statement-analysis-of-bata-pakistan-from-2005-2010/>

2009 when the increase was only 4.49%. Property plant and equipment shows an increasing trend till 2008. After that they are increasing but at a much lower rate. Largest increase was in 2007 to 2008 of 33% indicating expansionary phase of the company. Total equity is increasing over the years at an increasing rate. From 2005-2006 it increased by 12.84% but in the next year it increased by 39.49% and showing a major increase from 2008 to 2009 of 47.5%. This is a favorable trend showing that the shareholders are putting in more and more equity and less and less debt. Current liabilities show an inconsistent trend sometime decreasing and some time increasing. Only significant current liabilities are provisions for taxation which show significant increases over the year. Noncurrent liabilities show an increasing trend over the years but by a small amount. The overall trend is inconsistent but not unfavorable. Income Statement Horizontal Analysis (Year over Year Analysis) Net sales show a reasonable trend.

From 2005 to 2006 net sales increased by 17.54% but the rate almost double next year when net sales increased by 32.60% as compared to previous year. This again is the result of boom year of 2007. The rate fell to 29% next year but maintained its pace. This shows that growth of sales is healthy. Cost of goods sold increases at same rate over the years as the net sales with a slight variation. Gross profit has peaked from 2006 to 2007 at an increase of 47% and then the rate normalizes. The achievement of the company lies in the fact that gross profits have increased steadily over the years.

The next important item is the operating expenses that increased over the years but the company managed to decrease the rate from 28.09% to 16.

<https://assignbuster.com/financial-statement-analysis-of-bata-pakistan-from-2005-2010/>

04 in 2009 to 2010. Operating profits have shown positive increase from year over year. From 2006 to 2007, operating profits increased by 133.98% again showing effects of favorable economic conditions of the economy. Provisions for taxation have increased at an increasing rate over the years. Profit after taxation shows the same trend. From 2006 to 2007, profit after taxation increased by 227% which shows great performance.

After that rate increase lowers down significantly but rises again from 2009 to 2010 when profit after tax increases by 48.81%. The overall year over trend is quite favorable with no major setbacks in different measures of profit such as gross profit, profit before tax and profit after tax. Statement of Changes in Equity Statement of changes in equity also shows favorable trends. From 2006 to 2007 total equity increases by 39.49% which is again owing to economic conditions but the good thing about the company is that they profited by this big push and maintained and even improved same levels.

From 2007 to 2008 equity increased by 47.55%. It increased by 36.57% next year and finally increased by 39.81% from 2009 to 2010. Dividends also show healthy growth over the years showing consistent dividend policy of the company. Cash Flow Analysis Company is generating enough cash flows from operating activities to cover its investing and financing activities. In 2005 net cash flows were coming out to be negative but combined with previous cash flows the end result was still positive. From 2006 onwards the amount became positive and showed a major increase.

There is a major decrease in cash flows in 2008 because of very low cash generation from operation indicating some problem in realization of <https://assignbuster.com/financial-statement-analysis-of-bata-pakistan-from-2005-2010/>

receivables or sale out of inventories. There is also an increase in loss on net change in assets and liabilities and income tax paid. But the latest year of 2010 shows a favorable situation. Growth of cash flows over the years is very inconsistent. From 2005 to 2006, cash flow from operating activities is increasing by 2584. 57% which is a huge amount. Then from 2006 to 2007, cash flows from operating activities fell by 2. 5% and fell by 80% next year. Then there is a big increase from 2008 to 2009 of 1159. 73% and a fall of 48% from 2009 to 2010. Cash flow from investing activities shows same volatile trend but on average it is positive or increasing. Cash flow from financing activities decrease at a decreasing rate till 2007 to 2008. Later it increased by 300% from 2008-09 and also from 2009-10 by 49%. Total cash flows are also increasing from year to year but from 2006 to 2007, they are showing a decrease of 64%. So the only problem in the statement is the inconsistency of cash flows.

Economic Value Added Economic value added is the true economic profit of the business for the year and it is very different from the accounting profit. Its basically net operating profit after tax minus weighted average cost of capital into capital invested, where capital invested is working capital plus fixed assets. Economic value added deducts cost of all charges including equity which is basically opportunity cost of the invested equity capital. This basically measures the amount that the firm has added to shareholder's value.

Because of the way EVA accounts for the equity it is a better measure to decide upon corporate goals of the company and determining performance of the management. This number is positive for the company and also showing <https://assignbuster.com/financial-statement-analysis-of-bata-pakistan-from-2005-2010/>

year over year growth. From 2006 to 2007 it is showing a growth of 227.48%. As capital invested increased, NOPAT also increased. Company Valuation One of the most important task when analyzing a company is to gauge whether the current market price of the company's stock shows intrinsic value of the stock or whether it is overvalued or undervalued.

The first step is the calculation of weighted average cost of capital or WACC. For Bata Pakistan, WACC is calculated to be 13.83%. Next step is to apply different techniques for determining the rate at which the company is growing. The average growth rate of sales is coming out to be 26.89%. The average growth rate of dividends is coming out to be 60.33% which is abnormally high due to extreme values and sharp increases in the amount of dividends paid. The last technique is that of calculating growth of free cash flows.

The free cash flow is basically the amount available to the shareholders after deducting all charges. Values of free cash flows is coming out to be positive but again the average growth rate is coming to be 88.22% which is also due to extreme values attributed to uneven and inconsistent growth in the operating cash flows used in the calculation of free cash flows. So we didn't apply the dividend growth model. In any case WACC is coming out to be less than growth rate so we used free cash flow to equity model and assumed an average growth rate of 12% for the sake of simplicity.

The intrinsic value of the company is coming out to be 639.08. The stock price on 31st Dec 2010 was 660. The stock seems to be slightly overvalued but this amount is not significantly different and can easily be attributed to calculation mistakes. Recommendations \* The company seems to be <https://assignbuster.com/financial-statement-analysis-of-bata-pakistan-from-2005-2010/>

performing satisfactorily overall as it is making significant yearly profits. \* It has sound credit and dividend policy and managing its inventory effectively. \* Cash flows are inconsistent but that is not creating significant problems for the company. The company has the potential to expand if it increases its investment in long term assets. It basically means that the company needs to be a bit less conservative. \* The previous points follow to the fact that going for a certain percentage of debt financing may open new opportunities for the companies. \* Based on the analysis and valuation, we can positively say that even if the stock is slightly overvalued it is a good buy and a good hold for those who already have it. The stock price is not very volatile. The company is growing but still it has the potential to grow further or maintain its growth; nothing less.

Apart from intrinsic value, its dividend policy is very attractive and ensures good return for its shareholders. References Wild, J. & Subramanyam, K. (2008). Financial Statement Analysis (10th ed. ). McGraw-Hill Brigham, E. & Houston, J. (2003). Fundamentals of Financial Management (10th ed. ). South Western Publisher Arifeen, S. (2010). Financial Statement Analysis of Companies Listed at Karachi Stock Exchange (2005-2010). State Bank of Pakistan, Statistics and DWH Department [www.kse.com.pk](http://www.kse.com.pk) [www.investopedia.com](http://www.investopedia.com) [www.lse.com.pk](http://www.lse.com.pk)