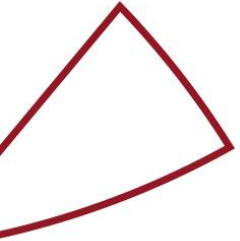
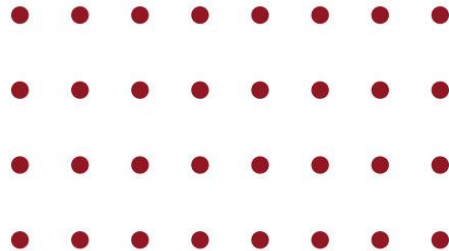


Class 3

UG3F14 Corporate Finance



GBSB GLO
BUSINESS SCHOOL

Class 3 Topics and Contents

1. ***The role of Financial Information for Decision Making:-Understanding the Business from its Financial Statements:***

2. Interpreting the Business Financial Performance:
 - Connection between Financial Statements:
 - ✓ Financial Ratios:
 - a) Liquidity Ratios
 - b) Activity/Operating Efficiency Ratios
 - c) Debt/Leverage Ratios
 - d) Profitability Ratios
 - e) Market Ratios
 - ✓ Industry Specific - Ratios and Analysis

Class 3

I. *The role of Financial Information for Decision Making - Understanding the Business from its Financial Statements:*

1. The Annual Report: The Four Financial Statements
2. Interpreting the Business Financial Performance:
 - *Connection between Financial Statements: Ratios*
 - Ratios: Convert financial statement data into formats that facilitate the evaluation of a firm's financial condition and performance, both over time and in comparison with industry competitors, and eliminates the size problem:
 - ✓ Financial Ratios: Standardize financial data available in the annual report, and it is expressed as percentage (%) or times (X)
 - Analyzing and monitoring a company's performance using financial ratio analysis, and comparing those measures to industry ratios (benchmarks) leads to actions and strategies to improve the business performance for sustainability
 - Financial ratios major categories are: Liquidity Ratios, Activity Ratios, Debt Ratios, Profitability Ratios, and Market Ratios

Class 3

I. *The role of Financial Information for Decision Making - Understanding the Business from its Financial Statements:*

2. Interpreting the Business Financial Performance:

➤ *Connection between Financial Statements: Ratios*

✓ Financial Ratios:

- a) Liquidity Ratios: Measure whether there will be enough cash to pay vendors and creditors of the company
- b) Activity/Operating Efficiency Ratios or turnover ratios explains the level of effectiveness and efficiency with which the business is using its assets in order to generate sales, revenue, and cash
- c) Debt/Leverage Ratios: Measures how much capital comes in the form of debt (loans) or assesses the ability of a company to meet its financial obligations

Class 3

I. *The role of Financial Information for Decision Making - Understanding the Business from its Financial Statements:*

2. Interpreting the Business Financial Performance:

➤ *Connection between Financial Statements: Ratios*

✓ Financial Ratios cont..:

d) Profitability Ratios: Profitability ratios show a company's overall efficiency in using its assets and performance at the end of each period

➤ Profitability ratios are divided into two types:

- Margin ratios which represent the firm's ability to translate sales dollars into profits at various stages of measurement, and;
- Return ratios that represent the firm's ability to measure the overall efficiency of the firm in generating returns for its shareholders

e) Market Value Ratios: Evaluates the economic status of companies and can play a role in identifying stocks that may be overvalued, undervalued, or priced fairly, and trends

✓ Industry Ratios

Class 3

- I. **The role of Financial Information for Decision Making - Understanding the Business from its Financial Statements:**
 2. Interpreting the Business Financial Performance - *Connection between Financial Statements: Financial Ratio Calculations – Set Exercise:*

Malta Cruises* is the world's fifth-largest cruise brand as well as the leader in Europe, South America, the Gulf region and Southern Africa, with more market share in addition to deployed capacity than any other player. Despite of the Covid-19 Pandemic industry crisis, they are the fastest-growing global cruise brand with a strong presence in the Caribbean, North America and the Far East markets. The business is a publicly held company that trades in the NASDAQ @20 Euros/Share (Dec 31, 2020) and @18 Euros/Share (Dec 31, 2019), and it is headquartered in Valleta, Malta. The industry considers Malta Cruises the leading worldwide shipping and logistics conglomerate with over 300 years of maritime heritage. Currently they employ over 50,000 staff globally, and sell cruise holidays and provide logistic services in many countries around the world. The CFO of the business is to perform a financial ratio analysis based in their recent 2020 financial reports available in the Annual Report.

Class 3

I. The role of Financial Information for Decision Making - Understanding the Business from its Financial Statements

Financial Statements from the business audited Annual Report*:

Malta Cruises Corporation

Income Statement (MM)	31-Dec-20	31-Dec-19	31-Dec-18
Total Revenue	215,600 €	153,000 €	140,700 €
Cost of sales	129,364 €	91,879 €	81,606 €
Gross Profit	86,236 €	61,121 €	59,094 €
Selling & Adm Expenses	45,722 €	33,493 €	32,765 €
Advertising	14,258 €	10,792 €	9,541 €
Dep & Amortization	3,998 €	2,984 €	2,501 €
Repairs and Maintenance	3,015 €	2,046 €	3,031 €
Operating Profit	19,243 €	11,806 €	11,256 €
Interest Income	422 €	838 €	738 €
Interest Expense	-2,585 €	-2,277 €	-1,274 €
Profit before income taxes	17,080 €	10,367 €	10,720 €
Income Taxes	7,686 €	4,457 €	4,824 €
Net Income	9,394 €	5,910 €	5,896 €
Basic earning per common share	€ 1.96	€ 1.29	€ 1.33
Diluted earning per common share	€ 1.92	€ 1.26	€ 1.31

Malta Cruises Corporation

Balance Sheet (MM)	31-Dec-20	31-Dec-19
Assets		
Current Assets		
Cash	4,061 €	2,382 €
Mkt Sec	5,272 €	8,004 €
Acct Receivable	8,960 €	8,350 €
Inventory	47,041 €	36,769 €
Prepaid expenses	512 €	759 €
Total Current Assets	65,846 €	56,264 €
Property, Plant & Equip		
Land	811 €	811 €
Building	18,273 €	11,928 €
Equipment	21,523 €	13,768 €
Less: Accum Dep and Amort	40,607 €	26,507 €
Net Property, Plant & Equip	29,079 €	18,977 €
Other Assets	373 €	668 €
Total Assets	95,298 €	75,909 €
Liabilities & Stockholder's Equity		
Current Liabilities		
Acct Payable	14,294 €	7,591 €
Notes Payable	5,614 €	6,012 €
Current Mat of long term debt	1,884 €	1,516 €
Accrued liabilities	5,669 €	5,313 €
Total Current Liabilities	27,461 €	20,432 €
Deferred federal income tax	843 €	635 €
Long term debt	21,059 €	16,975 €
Total Liabilities	49,363 €	38,042 €
Stockholder's Equity		
Common stock, par value Euro 1 (MM)	4,803	4,594
Additionan Paid in Capital	957 €	910 €
Retained Earnings	40,175 €	32,363 €
Total Stockholder's Equity	45,935 €	37,867 €
Total Liab & Stockholder's Equity	95,298 €	75,909 €

Class 3

I. The role of Financial Information for Decision Making - Understanding the Business from its Financial Statements: Financial Ratio Calculations – Set Exercise **Malta Cruises***:

a) Liquidity Ratios:

Current Ratio = Current Assets/Current Liabilities = (X) times

2020 € 65,846 / € 27,461 = 2,40x or 2,40:1

2019 € 56,264 / € 20,432 = 2.75x

- Measures whether a firm has enough resources to meet its short-term obligations (<1Y) with its own resources (without raising external capital)
- In 2020, the business has €2,40 of current assets for every €1 of current liability
- In theory the higher, the more capable a company is of paying its obligations because it has a larger proportion of short-term asset value relative to the value of its short-term liabilities
- If the current ratio is too high, the company may not be using its current assets or its short-term financing facilities efficiently indicating problems in working capital management
- From the current ratio perspective, the business decrease the coverage from 2019, but any number between 1.5 and 2 in general, is considered satisfactory

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Class 3

I. The role of Financial Information for Decision Making - Understanding the Business from its Financial Statements: Financial Ratio Calculations – Set Exercise **Malta Cruises***:

a) Liquidity Ratios:

Avg. Collection Period = Acct receivable/Avg. daily sales = days

2020 € 8,960/(€ 215,600/365 days) = 15 days

2019 € 8,350/(€ 153,000/365 days) = 20 days

- The average number of days between the dates that credit sales (account receivables) were made, and the dates that the money was received / collected from the customers
- A lower Avg. Collection Period is in general, more favorable than a higher one
- From the Avg. Collection Period perspective, the business collected their account receivables faster by 5 days in 2020 compared to 2019 meaning that collection for the business was efficient and effective
- Most businesses invoices are required to be paid within 30 days (depending on the industry), so anything above 30 days can be considered overdue

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Income Statement (MM)		31-Dec-20	31-Dec-19
Total Revenue		215,600 €	153,000 €

Class 3

I. The role of Financial Information for Decision Making - Understanding the Business from its Financial Statements: Financial Ratio Calculations – Set Exercise *Malta Cruises**:

b) Activity Ratios:

Inventory Turnover = Cost of goods sold / Avg. Inventory for the same period = X times

2020 € 129,364/€ 47,041 = 2.75 times

2019 € 91,879/€ 36,769 = 2.50 times

- Inventory turnover measures the number of times inventory is sold or consumed in a given time period
- In 2020, the inventory was sold or used 2.75 times
- A high inventory turnover generally means that goods are sold faster and a low turnover rate indicates weak sales and excess inventories, which may be challenging for a business-inventory means money tied to a product
- In 2020, the ratio was higher than 2019 meaning that goods and services had higher demand.

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Gross Profit	86,236 €	61,121 €	59,094 €

Class 3

I. The role of Financial Information for Decision Making - Understanding the Business from its Financial Statements: Financial Ratio Calculations – Set Exercise *Malta Cruises**:

b) Activity Ratios:

Total Asset Turnover = Net sales / Total assets = X times

2020 € 215,600/€ 95,298 = 2.26 times

2019 € 153,000/€ 75,909 = 2.02 times

- Efficiency with which a company uses its assets to produce sales
- A low turnover ratio means the assets are used inefficiently
- In the retail industry, a total asset turnover ratio of 2.5+, and the utilities industry is between 0.25-0.50
- In 2020, for every 1€ in total assets, the company generated €2.26 in sales meaning that the assets were more efficiently used than in 2019 that the ratio was 2.02

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Class 3

I. The role of Financial Information for Decision Making - Understanding the Business from its Financial Statements: Financial Ratio Calculations – Set Exercise **Malta Cruises***:

c) Leverage Ratios:

Debt Ratio = Total liabilities / Total assets = %
 2020 € 49,363/€ 95,298 = 51.8% or .52
 2019 € 38,042/€ 75,909 = 50.1%

- Is a solvency ratio that measures a firm's total liabilities as a percentage of its total assets
- Measures the proportion of assets paid for with debt
- In 2020, the debt ratio was .52 meaning that for the firm has €0.52 of debt and €0.48 of equity, and experienced very little variation from 2019 results
- From a risk perspective, a debt ratio between 30% and 60% is consider satisfactory
- Ratios higher than 60% compromises de business operations and further borrowing

Malta Cruises Corporation			
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Class 3

I. The role of Financial Information for Decision Making - Understanding the Business from its Financial Statements: Financial Ratio Calculations – Set Exercise **Malta Cruises***:

c) Leverage Ratios:

Debt to Equity (D/E) = Total liabilities/Stockholders' equity =
 2020 €49,363/€ 45,935 = 1.07 or 1.07:1

2019 €38,042/€ 37,867 = 1.00 or creditors and investors own equal parts of company assets

- The D/E ratio shows the percentage of company financing that comes from creditors and investors or how much debt you use to run the business
- A higher debt to equity ratio indicates that more creditor financing (bank loans) is used than investor financing (shareholders), and a lower a more stable business
- In 2020, the ratio was 1.07:1, which means the company has \$1.07 in debt for every \$1 of equity or a debt level of 107% of the business equity, higher than 2019.
- Debt implies risk, and also introduces potential for increased benefits to the firm's owners if it is used successfully: earnings > the fixed charges associated with the debt
- In general, a D/E ratio between 1 and 1.5 is considered ideal, and more than 2, for most industries, is too high

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I. The role of Financial Information for Decision Making - Understanding the Business from its Financial Statements: Financial Ratio Calculations – Set Exercise **Malta Cruises***:

d) **Profitability Ratios:** Measures efficiency and performance of the operations

- Gross profit margin, operating profit margin, and net profit margin indicates the business ability to translate sales dollars into profits at different stages

Gross Profit Margin = Gross profit / Net sales = %
2020 € 86,236 / € 215,600 = 40 % or 0.4
2019 € 61,121 / € 153,000 = 39.9%

- Measures the proportion of revenue left after accounting for production costs or it is more efficient at converting direct costs into income
- The higher the margin means that more funds are available to reinvest, save and/or pay expenses
- The business has been consistent in this ratio @40% in 2019 and 2020

Malta Cruises Corporation

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Operating Profit Margin = Operating profit / Net sales = % (EBIT)

2020 € 19,243 / € 215,600 = 8,9% or 0.089

2019 € 11,806 / € 153,000 = 7.7%

- Measure of overall operating efficiency, incorporates all of the expenses associated with ordinary business activities or operations (operating and non-operating expenses)
- The business in 2020 improved its operating profit margin since it was able to control the operating expenses while increasing sales
- The higher the ratio, the more efficient the performance
- In 2020, Malta Cruises generated for € 1 in sales € 0,089 in earnings after expenses are paid

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Net Profit Margin = Net earnings / Net sales = %

2020 € 9,394 / € 215,600 = 4.4%

2019 € 5,910 / € 153,000 = 3.9%

- Measures profitability after consideration of all revenue and expense, including interest, and taxes
- Shareholders look at net profit margin closely because it shows how good a company is at converting revenue into profits available for shareholders
- In 2020, the business generated 4.4% profit margin indicating the company earns 4.4 cents in profit for every euro it collects higher than 2019

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d) Profitability Ratios: Measures efficiency and performance of the operations

Return on Total Assets (ROA) = Net income / Total assets = %
 2020 € 9,394 / € 95,298 = 9.9%
 2019 € 5,910 / € 75,909 = 7.8%

- It is the financial benefit received from an investment
- For every € that Malta Cruises has invested in assets, it generated 9.9 cents of net income
- Measures how profitable a company's assets are
- Gives the end user or how efficient a company is in managing their assets – also known as Return on Investment (ROI)
- The business has improved the return to investors from 7.8% in 2019 to 9.9% in 2020

Malta Cruises Corporation			
Income Statement (MM)	31-Dec-20	31-Dec-19	31-Dec-18
Income Taxes	7,686 €	4,457 €	4,824 €
Net Income	9,394 €	5,910 €	5,896 €

Malta Cruises Corporation			
Balance Sheet (MM)	31-Dec-20	31-Dec-19	
Assets			
Current Assets			
Cash	4,061 €	2,382 €	
Mkt Sec	5,272 €	8,004 €	
Acct Receivable	8,960 €	8,350 €	
Inventory	47,041 €	36,769 €	
Prepaid expenses	512 €	759 €	
Total Current Assets	65,846 €	56,264 €	
Property, Plant & Equip			
Land	811 €	811 €	
Building	18,273 €	11,928 €	
Equipment	21,523 €	13,768 €	
	40,607 €	26,507 €	
Less: Accum Dep and Amort	11,528 €	7,530 €	
Net Property, Plant & Equip	29,079 €	18,977 €	
Other Assets	373 €	668 €	
Total Assets	95,298 €	75,909 €	
Liabilities & Stockholder's Equity			
Current Liabilities			
Acct Payable	14,294 €	7,591 €	
Notes Payable	5,614 €	6,012 €	
Current Mat of long term debt	1,884 €	1,516 €	
Accrued liabilities	5,669 €	5,313 €	
Total Current Liabilities	27,461 €	20,432 €	
Deferred federal income tax	843 €	635 €	
Long term debt	21,059 €	16,975 €	
Total Liabilities	49,363 €	38,042 €	
Stockholder's Equity			
Common stock, par value Euro 1 (MM)	4,803	4,594	
Addition Paid in Capital	957	910	
Retained Earnings	40,175 €	32,363 €	
Total Stockholder's Equity	45,935 €	37,867 €	
Total Liab & Stockholder's Equity	95,298 €	75,909 €	

Class 3

I. The role of Financial Information for Decision Making - Understanding the Business from its Financial Statements: Financial Ratio Calculations – Set Exercise **Malta Cruises***:

d) Profitability Ratios: Measures efficiency and performance of the operations

Return on Equity (ROE) =

Net income / Total Stockholders' Equity = %

2020 € 9,394 / € 45,935 = 20.5%

2019 € 5,910 / € 37,867 = 15.6%

- Shows the firm's ability to turn equity investments into profits
- Rate of return that the owners of common stock of a company receive on their shareholdings
- In 2020, ROE was 20.5% meaning that for very 1 euro of common shareholder's equity, the business produced 20.5 cents of profit which is substantially higher than the 2019 result (15.6%)
- Most of the times, a 20% or more ROE is considered satisfactory

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Class 3

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e) Market Value Ratios:

Measure returns to stockholders and the value the marketplace puts on a company's stock

Earnings per common share (EPS) =

Net Earnings / Average # of shares outstanding = Currency (€)

2020 € 9,394,000 / € 4.803,000 = €1.96

2019 € 5,910,000 / € 4,594,000 = €1.29

- EPS must be disclosed on the face of the income statement for publicly held companies
- Measures the amount of net income earned per common share
- In 2020, the business earned €1.96 per common share, substantially higher than the 2019 result – the higher the more profitable the business is.

Malta Cruises Corporation

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Basic earning per common share	€ 1.96	€ 1.29	€ 1.33

Balance Sheet (MM)	31-Dec-20	31-Dec-19
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Class 3

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e) Market Value Ratios:

Measure returns to stockholders and the value the marketplace puts on a company's stock

Price-to-Earnings Ratio (P/E) = Market price of common stock / EPS = P/E

2020 €20/€1.96 = 10.20 P/E meaning an investor is willing to pay €10.20 for €1 of current earnings

2019 €18/€1.29 = 13.95 P/E meaning an investor is willing to pay €13.95 for €1 of current earnings

- P/E Ratio compares the price of a company's stock to the earnings the company generates
- The P/E is the price and investor of common stock is paying for 1 Euro of the business earnings or profit
- A high P/E ratio means that the company's stock is over-valued, or investors are expecting high growth rates in the future
- P/E Ratio is higher in 2019 meaning that investors are willing to pay a higher share price because of growth expectations in the future

Malta Cruises Corporation

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Class 3

I. The role of Financial Information for Decision Making - Understanding the Business from its Financial Statements: Financial Ratio Calculations – Set Exercise **Malta Cruises***:

e) Market Value Ratios:

Measure returns to stockholders and the value the marketplace puts on a company's stock

Dividend yield = Annual dividend per share / The Stock's price per share * 100

2020 €1.96/€20 = 9.8%

2019 €1.29/€18 = 7.2%

- Measure the amount of cash flow per year an investor is getting back for each euro invested in common stock per year
- The higher the better for income investors, and it also depends on the industry and the markets conditions
- In 2020, the business yield higher returned than 2019

Malta Cruises Corporation

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Class 3

I. *The role of Financial Information for Decision Making - Understanding the Business from its Financial Statements:*

2. Interpreting the Business Financial Performance:

➤ *Connection between Financial Statements: Ratios*

✓ Industry Specific Ratios an Analysis:

- Industry-specific ratios are ratios that are useful only in a specific industry and hence calculated for analyzing entities in that industry only, and are meaningless for entities in other industries
- For example: Occupancy ratio for hoteling industry, capital adequacy ratio for banks, or sale per square foot for floor retail businesses
- In the case of *Malta Cruises Corporation** some of the industry specific ratios to compare performance are for the cruise line business: revenue per passenger, average spending onboard per cabin, number of shore excursions or number of passengers per cruise. In the case of the logistics line of business: average weight per package or revenue per foot

Class 3

I. *The role of Financial Information for Decision Making - Understanding the Business from its Financial Statements:*

2. Interpreting the Business Financial Performance:

➤ *Connection between Financial Statements: Ratios*

✓ Ratios uses and limitations:

- Valuable analytical tool
- Serve as a screening device, indicate areas of potential strength or weakness, and reveal matters that need further investigation
- Do not provide answers by itself, and they are not predictive
- They should be used with in combination with other elements of financial analysis
- It is highly recommended to compare the business ratios (financial and industry) with the competitors to assess better the financial position

We will be expanding in the topic in the next class:

The role of Financial Information for Decision Making - Understanding the Business from its Financial Statements:

Interpreting the Business Financial Performance: Connection between Financial Statements

