**EXERCISE 2 - FINANCIAL ANALYIS 10 Points**

**The following two income statements and statements of financial position are of two companies operating in the pharmaceutical industry. Both companies are based in Europe. One prepares its financial statements in US$ the other DKK. Both use International Financial Reporting Standards.**

**Required: Using ratios and Common Size Analysis Techniques compare and contrast the two companies profitability, liquidity, efficiency, investment potential etc. N.B. Ignore VAT in your calculations of DSO .**

|  |  |  |  |
| --- | --- | --- | --- |
| **Income statement** | Y.e. 31.12.2014 | | Y.e. 31.12.2014 |
|  | US$ millions |  | DKK millions |
| Sales | 52,419 |  | 88,806 |
| Cost of sales | (17,345) |  | (14,562) |
| Gross profit | 35,074 |  | 74,244 |
| Operating expenses | (23,985) |  | (39,752) |
| Operating profit | 11,089 |  | 34,492 |
| Interest income(expense) | (735) |  | (396) |
| Share of results of Assoc Cos | 1,918 |  |  |
| Pre-tax profit | 12,272 |  | 34,096 |
| Income tax | (1,545) |  | (7,615) |
| Net profit continuing operations | 10,727 |  | 26,481 |
| Discontinued operations | (447) |  |  |
| Net profit | 10,280 |  | 26,481 |

**Profitability ratios**

|  |  |  |
| --- | --- | --- |
|  | Company A | Company B |
| Gross Margin %  Comments | 35,074/52419x100%  67% | 74,244/88,806x100%  84% |
| Operating Margin % | 11,089/52419x100%  21% | 34,492/88,806x100%  39% |
| Return on Capital Employed (ROCE) % | (11,089+1,918)/(70,844+13,799/x100%  15% | (34,492+0)/(40,294+0)x100%  86% |

|  |  |  |  |
| --- | --- | --- | --- |
| **Statement of financial position** | 31.12.2014 |  | 31.12.2014 |
|  | US$ millions |  | DKK millions |
| **Non-current assets** |  |  |  |
| Goodwill and intangible assets | 53,143 |  | 1,378 |
| Property Plant & Equipment | 15,983 |  | 23,136 |
| Investments | 8,432 |  |  |
| Deferred taxes | 7,994 |  | 5,399 |
| Other | 2,274 |  | 856 |
|  | 87,826 |  | 30,769 |
| **Current assets** |  |  |  |
| Inventories | 6,093 |  | 11,357 |
| Trade receivables | 8,275 |  | 13,041 |
| Other current assets | 3,369 |  | 7,469 |
| Cash | 13,023 |  | 14,396 |
| Assets related to discontinued operations | 6801 |  |  |
|  | 37,561 |  | 46,263 |
| **Total assets** | **125,387** |  | **77,032** |
|  |  |  |  |
|  |  |  |  |
| **Current liabilities** |  |  |  |
| Borrowings | 6,612 |  | 720 |
| Trade payables | 5,419 |  | 4,950 |
| Income taxes | 2,076 |  | 2,771 |
| Provisions | 10,448 |  | 11,590 |
| Other current liabilities |  |  | 13,658 |
| Liabilities related to discontinued operations | 2,418 |  |  |
|  | 26,973 |  | 33,689 |
| **Non-current liabilities** |  |  |  |
| Long-term Borrowings | 13,799 |  |  |
| Provisions | 7,672 |  | 2,041 |
| Pensions and employee benefits |  |  | 1,031 |
| Other | 6,099 |  | 7 |
|  | 27,570 |  | 3,079 |
| **Shareholder's equity** | 70,844 |  | 40,294 |
| Total Equity and liabilities | **125,387** |  | **77,062** |

**Liquidity ratios**

|  |  |  |
| --- | --- | --- |
|  | Company A | Company B |
| Current ratio | 37,561/26,973  1,39 | 46,263/33,689  1,37 |
| Quick ratio | (37,561-6,093)/26,973  1,17 | (46,263-11,357)/33,689  1,04 |

**Efficiency ratios**

|  |  |  |
| --- | --- | --- |
| Asset Turnover | 52,419/87,826  0,60 | 88,806/30,769  2,89 |
| Inventory Turnover | 17,345/6,093  2,85 | 14,562/11,357  1,28 |
| Trade receivables collection period (DSO) | 8,275/52,419x365  58 | 13,041/88,806x365  54 |

**Investment ratios**

|  |  |  |
| --- | --- | --- |
| Debt/equity ratio (Gearing) | 13,799/70,844  0,19 | 0/40,294  0 |
| Interest cover | (11,089+1,918) 735  17,7 | 34,096/396  87,1 |

**Which company would you prefer to be a shareholder in and why?**

B is the more attractive company to invest in in virtually all aspects.

**What additional information would be useful to help you make your decision?**

Additional information could include:

3-5- year data to make trend analysis

Segment information

Future prospects, new products in the pipeline etc.