# Financial Statements and their Reporting Ability for Management

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**ABSTRAKT**

Správně vypočítaná a vysvětlená finanční analýza založená především na finančních výkazech může být přínosná pro každou společnost. Tato bakalářská práce se zabývá finančními výkazy a jejich vypovídací schopností pro management. Cílem je poskytnout analyzované společnosti – ComIT services s.r.o. komplexní informace o jejich finanční situaci.

Bakalářská práce je rozdělena do dvou částí – teoretické a praktické. V teoretické části jsou popsány typy finančních výkazů, jejich uživatelé a cíle a metody finanční analýzy. Praktická část zahrnuje finanční analýzu společnosti ComIT services s.r.o. za období 2007 – 2009. V závěru práce jsou shrnuty výsledky analýzy a jsou navrhnuta řešení pro zlepšení stávající situace.

Klíčová slova: účetní výkazy, finanční analýza, poměrová analýza, vypovídací schopnost.

**ABSTRACT**

Well calculated and explained financial analysis based mainly on financial statements can be essential for each company. This bachelor thesis deals with financial statements and their reporting ability for management. The aim is to provide to analyze company ComIT services s.r.o. complex information about their financial situation.

Thesis is divided into two parts – theoretical and analytical one. In the theoretical part there are defined types of financial statements, their users and objectives and methods of analysis are described. The analytical part deals with the financial analysis of financial statements of ComIT services s.r.o. during the period 2007 – 2009. The conclusion presents evaluation of the reached outcomes and recommendation for improving the current situation.

Keywords: financial statements, financial analysis, ratio analysis, reporting ability.

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# CONTENTS

# INTRODUCTION

The objective of my bachelor thesis is to elaborate the theoretical and methodological evidence relating to the reporting ability of the financial statements and then by using the tools of financial analysis evaluate them in ComIT services s.r.o.

The work consists of the theoretical and analytical parts and each is further divided into several chapters.

The theoretical part explains the various financial statements and their reporting ability. In the first chapter there is discussed the basic financial statements (the balance sheet, the income statement, the statement of cash flow and the statement of changes in shareholders´ equity), their users and objectives. In the following part there are clarified purpose of financial analysis, its users and described the various methods.

This bachelor thesis deals with financial analysis not only in general, but especially the analysis of financial situation of ComIT services s.r.o.

The primary aim of the practical part of the thesis is to evolve a financial analysis of the selected company. The analysed company ComIT services s.r.o. is described in the first part for better understanding of the situation in the enterprise. Furthermore, the thesis focuses on financial analysis, in which is gradually implemented a horizontal and vertical analysis, subtractive indicators and ratio analysis for the period 2007 – 2009. Individual results of financial analysis of ComIT services s.r.o. are compared with the industry and recommended values of the Ministry of Industry and Trade. The assessment of the results of financial analysis is presented in the final part of my work as well as suggestions of possible solutions to improve the current situation.

# I. THEORY

# 1 FINANCIAL STATEMENTS

Accounting is an information system that identifies measures, prepares and presents financial information about the company, under which can be made correct judgments and qualified decisions.

From above definition is visible, that accounting is a broad concept. It can be seen from two sides – from the perspective of those who "make" accounting and from the perspective of those who use outputs from the accounting. The first approach emphasizes the concepts and techniques that are used by accounting personnel in collecting, sorting, summarizing, checking the accuracy, compilation and presentation of accounting information. The second approach emphasizes the knowledge that users of accounting information must have in order to understand the financial statements. This approach can be approximated by an example of an aviator. As a user of the devices, pilot has to understand the device's messages, but he may not be familiar with the manufacturing process in detail. Similarly, those who use accounting information need to know what each accounting amount approximately express. (Kovanicová 2004, 6)

*"A good working knowledge of financial statements is desirable simply because such statements, and numbers derived from those statements, are the primary means of communicating financial information both within the firm and outside the firm. Furthermore there are many different ways of using financial statements information and many different types of users. This diversity reflects the fact that financial statement information plays an important part in many types of decisions."* (Dittmar 2000, 47)

## 1.1 TYPES OF FINANCIAL STATEMENTS

Financial statements contain huge quantities of useful information showing how successfully a company operates, which management strategy is used and of course current financial position of a company.

Individual accounting items enter these statements in the interconnected relationships therefore the major financial statements are mutually conditioned, coordinated, showing the fact of multiple angles.

A corporate annual report contains four basic financial statements:

- The balance sheet
- The income statement

- The statement of cash flow
- The statement of stockholders equity

Each of these statements will be described and discussed in one of the following subchapters. (Fraser and Ormiston 2001, 7)

### 1.1.1 Balance sheet

Balance sheet provides valuable information about the financial situation, which is necessary for management. As far as the balance sheet is prepared at a point in time at the end of an accounting period, a year, or a quarter, it shows this financial position of a company on a particular date. This statement is basically a summary of what the firm owns – assets. And what the firm owes to people, companies or other institutions – liabilities and to internal owners – stockholders equity. This fact affects the structure and arrangements of the assets and liabilities. Assets are divided by degree of liquidity and by groups of ownership elements, liabilities are divided on own resources and foreign resources. To follow rules, the account balances on a balance sheet have to balance which means that the total amount of assets must be equal to the sum of liabilities and stockholders' equity.

The balance sheet summarizes all transactions which are recorded in its accounting. All other statements only expand one balance sheet item (Income statement deals with Profit for the period) or group of balance sheet items (the statement of Cash flow). (Paseková 2007, 26)

### 1.1.2 Income statement

The income statement also called the statement of earnings, shows how profitable the company has been over the past year. This statement provides information about the company's financial performance – efficiency. Single balance sheet item is amplified in detail – profit or loss for a specified period of time. The role of income statement is detailed insight into the structure of the results and determines which expenses and revenues influenced the profit/loss for the period. Net profit/loss is the difference between revenues and expenses (included a tax on profits). It is also a measure of the extent to which the company contributed by its activities in a given period to the growth of owners wealth. Thanks to Income statement it is visible which operations increased the amount of the equity by revenues (output) and decreased by the costs (inputs) in each period.

The income statement together with balance sheet displaying two basic views of the same economic phenomenon:

- The assets and liabilities value (balance sheet)
- The results achieved by using (valorizing) of assets and liabilities in a given period (income statement)

The arrangement of the Income statement is vertical (stepped) form and contains costs structured by type and by purpose and revenues broken down by source. The Income statement find out:

- Operating profit/loss
- Profit/loss from financial operations
- Profit/loss from ordinary activity
- Extraordinary profit/loss

Accounting units may prepare the Income statement in two basic formats. These two formats distinguish from each other by classification of operating revenues and costs. The structure of statement is still consistent in the part of financial and extraordinary revenues and costs.

**Income statement in generic structure -** according to origin of costs, which means what was used, for example materials, labor, depreciation.

**Income statement in purpose-built structure -** on what were the costs spent, for example manufacturing, supplying or retail.

For comparison, monetary amount of income statement’s single entries are reported for two accounting period (the reality of current period id compared with the reality of previous period). The reason is to trace back the development of financial performance (Paseková 2006, 30).

“The income statement is one of many pieces of a financial statement package, and like the other pieces, the income statement si partially the product of a wide range of accounting choices, estimates, and judgments that affect reported results, just as business policies, economic conditions, and many other variables affect results” (Lyn and Ormiston 2001, 92).

### 1.1.3 Statement of cash flows

Statement of cash flows becomes increasingly important in recent years. The statement recorded cash flow through the accounting period. The purpose of the compilation is to explain the difference in cash at the beginning of the period and at the end. The statement explains changes in cash as well as cash equivalents change. Cash equivalents mean highly liquid short-term financial assets that can be easily and quickly converted into cash for a predictable amount of money and do not undergo significant changes of value during period. It can be named liquid securities for trading in public markets as an example.

**Cash flow** is understood as a cash income and expenses and inflows and outflows of cash equivalents in the given period.

Reporting cash flows separately for operating activities for investment activities and for activities related to the financing is required.

- **Investment activities** – covers acquisitions and disposal of fixed assets (including sales)
- **Financing** – include operations which affect the size and structure of long-term sources.
- **Operating activities** – mainly include basic gainful activities and other activities which can not be incorporated into two previous groups (Kovanicová 2002, 340).

In drawing up the cash flows statement, cash flows from investing and financing activity are embodied by the direct method according to major groups of inflows and outflows, which is determined by company itself (the report do not list non-monetary transaction).

For calculating cash flow from operational activities can be used either direct or indirect method (Kovanicová 2002, 341)

**Direct method** – deal with cash collections from customers, interest and dividends collected, other operating cash receipts, cash paid to suppliers and employees, interest paid, taxes paid, and other operating cash payments (Fraser and Ormiston 2001, 125).

**Indirect method** – profit/loss of accounting unit is modified mainly by non-cash transactions in the operating activities, changes in inventory, receivables, payables, unpaid deferred expenses and revenues and items of inflows and outflows connected with Investment activities and financing (Paseková 2007, 35).

### 1.1.4 The statement of changes in shareholders´ equity

The aim of this report is to provide information about increase or decrease of equity items occurred between two balance sheet dates. These changes of equity reflect increase/decrease of wealth during the period. Information about causes of these changes is definitely very helpful for external users.

## 1.2 Users of financial statements

Financial statements are crucial for decision making as well as for giving information of financial situation of company. This is important for users of this information. These users can be divided into two groups – internal and external users.

Internal users include:

- Managers
- Owners
- Shareholders
- Employees

External users include:

- Bank/loan companies
- Suppliers
- Government
- Competitors
- Investors
- Share brokers

**Managers** need information for short-term and especially for long-term financial management. Knowledge of financial situation of their company allows them to make a right and efficient decision. The main purpose of managers is to increase the market value of the shareholders´ equity.

**Owners/Shareholders** want to make sure that their money is properly saved and the company is well managed. They are interested in the stability and liquidity of the company and whether managers provide business development.

**Employees** are interested in financial information, particularly in terms of the perspective of labor and social.

**Bank/loan companies** require from potential borrower information about its financial condition to decide whether they will lend or not. Also verify if the company can provide adequate guarantees for the loans and if it will be able to pay installments.

**Suppliers** choose their partners on the basis of information about their financial position. Suppliers especially look for ability to pay liabilities and long-term stability.

**Government** needs financial information for many purposes – for statistics, for monitoring of the tax obligations and so on.

**Competitors** are interested in information comparable to their own economic outcomes, particularly in profitability, the size of annual revenue, solvency and others.

**Share brokers** need to know as much information about financial situation as possible to be successful in trading securities (Kovanicová 2004, 9).

## 1.3 Objectives of financial statements reporting

The aim is to provide diagnosis of the **financial health** of the company by appropriate tools. The term financial health of the company is used to represent a satisfactory financial situation. The company which is at the moment able to fulfill its purpose may be consider as financially healthy. Another brief definition that defines the financial health: it´s liquidity plus profitability. The financial health depends on the profitability, but also with regard to the risk. Company should be able to create sufficient excess of revenues over expenses - make a profit. It must also be able to cover it´s payables and not to have problems with liquidity. From this point of view is important an assuption of long-term liquidity. Reflection of this ability in financial and accounting area is certain property and financial structure and also the height of the profit/loss.

The opposite situation is the **financial distress** which occur very serious problems in cash flow and liquidity and the situation is not manageable without significant changes in the company activities and in the method of financing. Between financial distress and financial healthy there is ample space in which the company can be situated, balance closer to one or another state. (Grünwald, Holečková 2008, 6)

# 2 FINANCIAL STATEMENT ANALYSIS

Financial statements as output of accounting do not yet provide a complete picture of the economic and financial situation of the company, its weaknesses, risks and trends. The climactic phase of the accounting process is to analyze financial statements. From the methodical point of view there can be distinguished three phases of analysis:

- Analysis
- Synthesis
- Formulation of conclusion (Kovanicová 2002, 381).

Basic methods used in financial analysis include analysis of absolute indicators, subtractive indicators, cumulative indicators and ratio analysis.

## 2.1 Absolute indicators

This analysis directly use the data contained in the financial statements to evaluate the financial situation of company. In addition to monitoring changes in the absolute values of indicators are usually collected their relative (percentage) changes. Practical application of absolute indicators is in the analysis of trends and percentage analysis of components. (Sedláček 2001, 15)

### 2.1.1 Vertical analysis

The vertical analysis considers the individual components of assets and capital – the structure of assets and liabilities of the company. This structure makes clear what is the composition of resources needed for production and business activities of the firm and from what sources they were taken. The ability to create and maintain a balance of capital assets and economic stability is crucial for economic stability of the company. (Sedláček 2001, 17)

### 2.1.2 Horizontal analysis

The horizontal analysis also called analysis of trends, examines the characteristic of absolute indicators and their percentage changes over time. Financial statements contain current year data, last years data or at least previos year data. It is inevitable to have information of two consecutive periods minimally. Comparison of individual items of statements at the time is made by line, horizontally, hence it is named horizontal analysis of absolute indicators. (Grünwald, Holečková 2008, 19)

## 2.2 Subtractive indicators

Subtractive indicators make for analyze and manage financial situation of company with a focus on its liquidity. The most important indicator is **Net working capital**, which is defined as the difference between the current assets and current liabilities and has a significant impact on the solvency of the company.

**Net working capital = current assets - current liabilities**

To be marked as a liquid company, it must have the necessary amount of relatively free capital, which means excess of liquid current assets in comparison with current liabilities.

Top management understands the Net working capital as a part of a long-term capital tied up in current assets. It therefore constitutes a relatively free capital whose managers use to ensure troublefree business.

The owners of company have somewhat different understanding of Net working capital. They reserve the right to decide about long-term financing. They also express their opinion in case of the purchasing of fixed assets and their changes. As a rational approach to financing requires long-term capital to be more than fixed assets, the owner himself decide what falls from the long-term capital on financing of operating activities. (Pavelková, Knápková 2005, 67)

## 2.3 Ratio analysis

To calculate financial ratios is way of comparing and investigating the relationships between different pieces of financial information. (Ross, Westerfield, Jaffe 2008, 45)

Financial ratios are traditionally grouped into the following categories:

- liquidity ratios
- profitability ratios
- solvency ratios
- market value ratios
- other ratios

**Solvency indicators** show how deeply in debt is the company.

**Liquidity ratio** measures how easily the company can get the money ready.

**Profitability indicators** are used to estimate how efficiently a company uses its assets.

**Indicators of market value** show how highly investors evaluate the company.

(Brealey, Myers 2000, 750)

### 2.3.1 Solvency ratios

Solvency ratios are used to monitor the financial structure of business resources. The financial stability of the company is affected by portion of internal and external resources. A high proportion of own resources make company stable, independent. But when this portion is low, company may be unstable. (Baran 2006, 25)

The most common solvency ratios are following ones:

**The total debt** expresses the extent to which the property is covered by dept.

$$\text{The total debt} = \frac{\text{Short-term debt} + \text{Long-term debt}}{\text{Total assets}}$$

**The debt to equity ratio** indicates the portion between debt and equity. In a market economy, the value of this indicator should be moved from 0.3 to 1.0. The risk value is 1.0. Permanently higher value is allowed only in organizations with a secure and stable income.

$$\text{Debt to equity ratios} = \frac{\text{Total liabilities}}{\text{Shareholders´ equity}}$$

**The interest coverage ratio** reflects the ability to pay the price of outstanding debt – interests. The value should range from 2.0 to 3.0. (Baran 2006, 26)

$$\text{Interest coverage ratio} = \frac{\text{EBIT}}{\text{Interest expense}}$$

### 2.3.2 Liquidity ratios

Continued solvency is on of the fundamental conditions of success of an enterprise within the market. In connection with the ability to pay can be met the terms of solvency and liquidity. Usually defined as follows:

**Solvency** is a generic company’s ability to raise funds to cover their liabilities. It is a relative redundancy of asset’s value over the value of liabilities.

**Liquidity** is the ability to pay current debts. It is a measure of short-term or immediate solvency.

A typical indicator is the ratio of total current assets and current liabilities. It is also called **current ratio** or working capital ratio. This indicator shows the number of times current assets cover current liabilities which means how many times the company is able to satisfy his creditors when all assets will be turned in cash. The higher indicator value shows the ability to maintain the solvency. (Valach 2003, 108)

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

*"A very common rule of thumb suggests that a current ratio of 2 : 1 is about right for most businesses, because this proportion appears to permit a shrinkage of up to 50 percent in the value of current assets, while still providing enough cushion to cover all current liabilities. The problem with this concept is that the current ratio measures an essentially static condition and assesses a business as if it were on the brink of liquidation. The ration does not reflect the dynamics of a going concern, which should be the top priority of management. A lender or creditor looking for future business with a successful client should bear this in mind, and will likely turn to the type of cash flow analysis to judge the viability of the business as a client."* (Helfert 2001, 127)

The **quick ratio** (acid-test ratio) calculates only with the financies (in cash and bank accounts), short-term securities and receivables. The recommended value of this indicator would not fall under 1. (Sedláček 2001, 74)

$$\text{Quick ratio} = \frac{\text{Current assets - Inventory}}{\text{Current liabilities}}$$

The **cash ratio** shows the proportion between the most liquid parts of assets and current liabilities. By current liabilities are understood trade payables, short-term bank loans and other loans – all business debts with maturity within one year. The best part is, if the value of the indicator is in the range 0.9 to 1.0, which means that 90% to 100% of short-term liabilities of the company can be covered by its own financial assets. For companies engaged in production activity is acceptable interval of values from 0.2 to 0.6.

$$\text{Cash ratio} = \frac{\text{Cash equivalents + Cash}}{\text{Current liabilities}}$$

### 2.3.3 Profitability ratios

Profitability is a measure of ability to make a profit using the invested capital. Profitability ratios measure the effect of the result achieved by the business activities of the company. Company effectively manages its assets and capital would have higher value of profitability ratios. (Scholleová 2008, 161)

**The return on assets** indicates how difficult it can be to use assets of the company. The high value of the indicator may predicate that the company is working near full capacity. It may be difficult to expand production without an increase in invested capital. (Brealey, Myers 2003, 828)

$$\text{Return on assets} = \frac{\text{EBIT}}{\text{Total assets}}$$

**The return on equity** reflects the efficiency of reproduction of invested capital. This indicator tells how much net profit falls on one of the owners´ crown invested. (Scholleová 2008, 162)

$$\text{Return on equity} = \frac{\text{Net income}}{\text{Shareholder´s equity}}$$

**The return on sales** shows the firm´s ability to make a profit at a given level of sales which means how much effect can company produce on sales of CZK 1.
This indicator is also called the **profit margin**. In this case it is necessary to use net profit – after tax. (Růčková 2010, 56)

$$\text{Return on sales} = \frac{\text{EAT}}{\text{Sales}}$$

*“Because ROA and ROE are such commonly cited numbers, we stress that it is important to remember they are accounting rates of return. For this reason, these measures should properly be called return on book assets and return on book equity. In addition, ROE is sometimes called return on net worth. Whatever it´s called, it would be inappropriate to compare the result to, for example, an interest rate observed in the financial markets.”* (Ross, Westerfield, Jaffe 2008, 53)

### 2.3.4 Asset utilization ratios

The size and structure of property is related to technical and economical specifics of operating activities crucial for assets facilities. An important role falls on management and their ability to achieve the target output with the optimum deployment of assets. Indicators of activity give the possibility to express, quantify and, therefore, to analyze how efficiently, quickly and intensively company uses its assets. (Grünwald, Holečková 2008, 47)

The activity is characterized by two types of indicators of activity:

- Turnover
- Turnover period

**Turnover** expresses how often a particular item or group of items turns into sales or other item (groups of items) for a certain period.

**Turnover period** reflects the length of period which is necessary to make a turnover in the time (usually in days). (Holečková 2008, 81)

**The total assets turnover** shows how much crowns is generated in sales for every dollar in assets. The minimum recommended value of this indicator is 1. The low value of the indicator means inefficient use of assets.

$$\text{Total assets turnover} = \frac{\text{Sales}}{\text{Total assets}}$$

**The total assets turnover period** should be as short as possible.

$$\text{Total assets turnover period} = \frac{\text{Total assets x 360}}{\text{Sales}}$$

**The inventory turnover** is defined as sales divided by inventories and indicates the speed with which the company turns its inventory. High turnover of inventory is considered as manifestation of effectiveness. (Brealey, Myers 2000, 755)

The low number of turnaround times represents danger to the solvency of the company; it may be the result of poor purchasing policy, the accumulation of unwanted or unsalable inventory. If the value of indicators is better than averages, then it means that the company does not have redundant illiquid stocks, which would require extra funding. (Holečková 2008, 84)

$$\text{Inventory turnover} = \frac{\text{Sales}}{\text{Inventory}}$$

**The accounts receivable turnover period** ratio reflects the time period during which the company must wait on average before receiving payment from their customers. Longer average receivables collection period implies a greater need for loans and thus higher costs. (Pavelková, Knápková 2006, 81)

$$\text{Accounts receivable turnover period} = \frac{\text{Average account receivable x 360}}{\text{Annual credit sales}}$$

## 2.4 Market value measures

These indicators are not based on financial statements only, but they require data from the capital market. This results in a reduction in use, because not every company that has a double entry accounting have the legal form of joint-stock company and its shares are freely tradable on capital markets.

Using **earnings per share** indicator we find out how much of net income can be paid from the company´s profit per share as well as maximum amount of dividends.

$$\text{EPS} = \frac{\text{EAT}}{\text{Number of common shares}}$$

The **dividend yield** is the expected dividend as a percentage of the share price.

$$\text{Dividend yield} = \frac{\text{Annual dividend per share}}{\text{Price per share}}$$

The **price-earnings ratio** (P/E) can be interpreted as a payback period of capital invested in buying shares, on condition of a constant amount of earnings per share. For the P/E ratio is known a simple rule. The indicator is less (in time or in comparison with other stocks), the stocks are temporarily undervalued, which may mean good investment opportunity. (Valach 1999, 113)

$$\text{P/E ratio} = \frac{\text{Price per share}}{\text{Earnings per share}}$$

## 2.5 Cumulative indicators

These indicators present the overall financial characteristics and economic situation of the company by a single number.

### 2.5.1 Altman Z-Score

The Altman analysis represents one of the ways to comprehensively assess the financial health of the company. It is determined by a single number – the Z-Score which consists of five indicators and includes profitability, debt, liquidity and capital structure. The individual indicators are then assigned to their importance, based on extensive surveys.

Z-Score is given in two versions, one for evaluation of small firms and the other for the evaluation of companies traded on the stock market. The Z-Score estimates the impending bankruptcy of an enterprise about two years ahead with a relatively high reliability. (Scholleová 2008, 175)

**Altman Z-Score for companies that are not traded on stock market.**

$$Z = 0{,}717 \text{ x } X_1 + 0{,}847 \text{ x } X_2 + 3{,}107 \text{ x } X_3 + 0{,}42 \text{ x } X_4 + 0{,}098 \text{ x } X_5$$

Evaluation of the calculated Z-Score

- $Z > 2{,}9$ Company is financially healthy and in the foreseeable future is not threatened by bankruptcy
- $1{,}23 < Z < 2{,}89$ Band called “gray zone”, health of the firm can not be clearly determined
- $Z < 1{,}23$ Company is not financially healthy and it threatens bankruptcy

$X_1$ Net working capital/Total assets

$X_2$ Retained earnings/Total assets

$X_3$ EBIT/Total assets

$X_4$ Equity/Total liabilities

$X_5$ Net sales/Total assets

**Altman Z-Score for companies traded on stock market.**

$$Z = 1{,}2 \times X_1 + 1{,}4 \times X_2 + 3{,}3 \times X_3 + 0{,}6 \times X_4 + 1 \times X_5$$

- $Z > 2{,}99$ Company is financially healthy and in the foreseeable future is not threatened by bankruptcy
- $1{,}81 < Z < 2{,}99$ Band called "gray zone", health of the firm can not be clearly determined
- $Z < 1{,}81$ Company is not financially healthy and it threatens bankruptcy

$X_1$ Net working capital/Total assets

$X_2$ Retained earnings/Total assets

$X_3$ EBIT/Total assets

$X_4$ Market value of equity/Total liabilities

$X_5$ Net sales/Total assets (Scholleová 2008, 176)

The indicator cover only a portion of the spectrum of financial health, there is no indicator of solvency and no indication of cash flow (in 1986, when Altman made this method was the cash flow in its infancy). (Grünwald, Holečková 2007, 183)

### 2.5.2 Economic value added

Economic value added is frequently discussed topic amongst wider financial community. The surge in popularity of this concept was initiated by the consulting firm Stern Stewart & Co, who developed an accounting measure of economic value added and patented it as EVA.

The basics of this method can be found in microeconomics, which states that the purpose of business is to maximize profits. However, it is not the accounting profit (difference between revenues and costs), but the economic profit. The difference of economic against the accounting profit is that economic profit is the difference between income and economic costs, which means costs including the so-called opportunity costs. In practice, the opportunity costs are mainly interest on equity and rewards for risk. This indicates that the economic benefit arises only when it exceeds normal profit derived from an average capital cost expend on the lender (cost - interest) and the owners (opportunity cost). (Matyášová 2003, 1)

Currently, it is possible to identify two approaches to calculate EVA.

- The standard calculation in which the final index is called Eva entity. This is the original method of calculation reported primarily in foreign financial literature, based on US GAAP (Generally accepted accounting principles) or IRFS/IAS (International financial reporting standards). (Landa 2008, 106)

  $$EVA = NOPAT - Capital \times WACC$$

  $$EVA = NOPAT - NOA \times WACC$$

- An alternative calculation method according to the Ministry of Industry and Trade, the final index is called Eva equity.

  $$EVA = (ROE - r_e) \times Equity$$

Measuring financial profitability is a key point in assessing performance. Therefore, it is important to use EVA to complete the financial analysis. Financial Analysis do not take into account the risks and investors´ requirements. It is not able to distinguish the impact of different accounting rules and their application and ignores the time value of money.

# II. ANALYSIS

# 3 CHARACTERISTICS OF COMIT SERVICES S.R.O.

Company ComIT services s.r.o. has been registered in the commercial code in 24. 2. 2006. The company was established by two partners. Registered capital amounted to CZK 200,000 (100% paid). In 2007, two other companions entered. The shares are now equally divided between the four partners. The company is located in Znojmo and since 2007 has one branch office in Přerov. This strategic placement allows them to offer their services for almost the whole Moravia.

ComIT services s.r.o. focuses on supply of products and services in the field of computers. Company offers for customers professional and quality services performed by certified specialists with many years of experience in information technology.

List of business activities of ComIT services s.r.o.:

- Specialized retail sale
- Production, installation and repair of electrical machines and devices, electronic and telecommunication equipment
- Mediation of trade and services
- Provision of software, advice on information technologies, data processing, hosting and related services and web portals
- After-school education, organization of courses, trainings, including lecture services.

Despite the short duration of action on the market the company achieved certification, partnerships and expertise from leading companies operating in IT.

- Selected certified Cisco partner
- Triline premium partner
- HP Preferred Partner
- ESET Gold Partner
- Kerio Certified Partner

ComIT services s.r.o. belongs to the CZ NACE 62.0 – Activities in the field of information technology.

# 4 METHODS

Financial analysis is always based primarily on analysis of financial statements - balance sheet, income statement and statement of cash flows. The following is assessment of all components of financial stability - debt, liquidity, profitability and activity. This presupposes selection of appropriate financial ratios and comparing their values over time as well as comparing the situation with the industry to which the analyzed company belongs. Cumulative indicators can be used for complementarity.

## 4.1 Absolute indicators

The data from financial statements, which can be directly used, are helpful particularly for the analysis of trends (vertical analysis), and the percentage component analysis (vertical analysis). Absolute indicators provide the basic information about the property and financial situation of the company.

### 4.1.1 Vertical and horizontal analysis of balance sheet

*Table 1. Vertical analysis of the balance sheet - ComIT services s.r.o.*

| (in CZK thousand) | 2007 | | 2008 | | 2009 | |
|---|---|---|---|---|---|---|
| **TOTAL ASSETS** | **4 527** | **100%** | **4 814** | **100%** | **5 172** | **100%** |
| **Fixed assets** | **1 520** | **34%** | **1 277** | **27%** | **1 178** | **23%** |
| Intangible fixed assets | 0 | 0% | 0 | 0% | 0 | 0% |
| Tangible fixed assets | 1 520 | 34% | 1 277 | 27% | 1 178 | 23% |
| Long-term financial assets | 0 | 0% | 0 | 0% | 0 | 0% |
| **Current assets** | **2 974** | **66%** | **3 498** | **73%** | **3 959** | **77%** |
| Inventory | 297 | 7% | 306 | 6% | 809 | 16% |
| Long-term receivables | 0 | 0% | 9 | 0% | 0 | 0% |
| Short-term receivables | 2 470 | 55% | 2 429 | 50% | 2 318 | 45% |
| Short-term financial assets | 207 | 5% | 754 | 16% | 832 | 16% |
| **Other assets** | **33** | **1%** | **39** | **1%** | **35** | **1%** |
| **TOTAL LIABILITIES** | **4 527** | **100%** | **4 814** | **100%** | **5 172** | **100%** |
| **Equity** | **865** | **19%** | **1 100** | **23%** | **1 821** | **35%** |
| Registered capital | 200 | 4% | 200 | 4% | 200 | 4% |
| Capital funds | 0 | 0% | 0 | 0% | 0 | 0% |
| Reserve funds, indivisible fond and other retained earnings | 0 | 0% | 20 | 0% | 20 | 0% |
| Net profit or loss from previous year | 254 | 6% | 0 | 0% | 880 | 17% |
| Net profit or loss for the period | 411 | 9% | 880 | 18% | 721 | 14% |
| **Liabilities** | **3 646** | **81%** | **3 677** | **76%** | **3 330** | **64%** |
| Provisions | 10 | 0% | 0 | 0% | 0 | 0% |
| Long-term payables | 350 | 8% | 754 | 16% | 454 | 9% |
| Short-term payables | 2 821 | 62% | 2 613 | 54% | 2 721 | 53% |
| Bank loans and financial accommodations | 465 | 10% | 310 | 6% | 155 | 3% |
| - fixed bank loans | 465 | 10% | 310 | 6% | 155 | 3% |
| - short-term bank loans | 0 | 0% | 0 | 0% | 0 | 0% |
| - short-term accommodations | 0 | 0% | 0 | 0% | 0 | 0% |
| **Other liabilities** | **16** | **0%** | **37** | **1%** | **21** | **0%** |

*Table 2. Vertical analysis of the balance sheet - Branch - Activities in the field of information technology*

| (in CZK thousand) | 2007 | | 2008 | | 2009 | |
|---|---|---|---|---|---|---|
| **TOTAL ASSETS** | **21 487 568** | **100%** | **31 434 696** | **100%** | **37 564 253** | **100%** |
| **Fixed assets** | **7 207 791** | **34%** | **13 741 535** | **44%** | **13 810 786** | **37%** |
| Intangible and tangible fixed assets | 6 896 523 | 32% | 11 771 141 | 37% | 11 753 395 | 31% |
| Long-term financial assets | 311 268 | 1% | 1 970 394 | 6% | 2 057 391 | 5% |
| **Current assets** | **13 734 143** | **64%** | **18 413 848** | **59%** | **20 344 681** | **54%** |
| Inventory | 1 531 743 | 7% | 704 206 | 2% | 1 520 042 | 4% |
| Long-term and short-term receivables | 10 070 813 | 47% | 14 870 685 | 47% | 14 880 772 | 40% |
| Short-term financial assets | 2 131 587 | 10% | 2 838 957 | 9% | 3 943 867 | 10% |
| **Other assets** | **545 634** | **3%** | **-720 687** | **-2%** | **3 408 786** | **9%** |
| **TOTAL LIABILITIES** | **21 487 568** | **100%** | **31 434 696** | **100%** | **37 564 253** | **100%** |
| **Equity** | **10 259 645** | **48%** | **15 687 940** | **50%** | **17 460 679** | **46%** |
| Registered capital | 3 599 405 | 17% | 3 850 867 | 12% | 3 850 696 | 10% |
| Retained earnings and other funds | 3 601 343 | 17% | 7 754 528 | 25% | 9 471 721 | 25% |
| Net profit or loss for the period | 3 058 897 | 14% | 4 082 545 | 13% | 4 138 262 | 11% |
| **Liabilities** | **10 911 333** | **51%** | **15 403 617** | **49%** | **13 111 053** | **35%** |
| Provisions | 546 848 | 3% | 558 905 | 2% | 1 079 962 | 3% |
| Long-term payables | 2 640 165 | 12% | 4 240 036 | 13% | 2 969 724 | 8% |
| Short-term payables | 6 726 881 | 31% | 10 041 665 | 32% | 8 437 159 | 22% |
| Bank loans and financial accommodations | 997 439 | 5% | 563 010 | 2% | 624 209 | 2% |
| - fixed bank loans | 245 010 | 1% | 134 342 | 0% | 179 804 | 0% |
| - short-term bank loans | 752 429 | 4% | 428 668 | 1% | 444 404 | 1% |
| **Other liabilities** | **316 590** | **1%** | **343 139** | **1%** | **6 992 522** | **19%** |

*Table 3. Horizontal analysis of the balance sheet - ComIT services s.r.o.*

| (in CZK thousand) | 2007 | 2008 | 2008/2007 | 2009 | 2009/2008 |
|---|---|---|---|---|---|
| **TOTAL ASSETS** | **4 527** | **4 814** | **6%** | **5 172** | **7%** |
| **Fixed assets** | **1 520** | **1 277** | **-16%** | **1 178** | **-8%** |
| Intangible fixed assets | 0 | 0 | 0% | 0 | 0% |
| Tangible fixed assets | 1 520 | 1 277 | -16% | 1 178 | -8% |
| Long-term financial assets | 0 | 0 | 0% | 0 | 0% |
| **Current assets** | **2 974** | **3 498** | **18%** | **3 959** | **13%** |
| Inventory | 297 | 306 | 3% | 809 | 164% |
| Long-term receivables | 0 | 9 | 0% | 0 | 0% |
| Short-term receivables | 2 470 | 2 429 | -2% | 2 318 | -5% |
| Short-term financial assets | 207 | 754 | 264% | 832 | 10% |
| **Other assets** | **33** | **39** | **18%** | **35** | **-10%** |
| **TOTAL LIABILITIES** | **4 527** | **4 814** | **6%** | **5 172** | **7%** |
| **Equity** | **865** | **1 100** | **27%** | **1 821** | **66%** |
| Registered capital | 200 | 200 | 0% | 200 | 0% |
| Capital funds | 0 | 0 | 0% | 0 | 0% |
| Reserve funds, indivisible fond and other retained earnings | 0 | 20 | 0% | 20 | 0% |
| Net profit or loss from previous year | 254 | 0 | -100% | 880 | 0% |
| Net profit or loss for the period | 411 | 880 | 114% | 721 | -18% |
| **Liabilities** | **3 646** | **3 677** | **1%** | **3 330** | **-9%** |
| Provisions | 10 | 0 | 0% | 0 | 0% |
| Long-term payables | 350 | 754 | 115% | 454 | -40% |
| Short-term payables | 2 821 | 2 613 | -7% | 2 721 | 4% |

| | | | | | |
|---|---|---|---|---|---|
| Bank loans and financial accommodations | 465 | 310 | -33% | 155 | -50% |
| - fixed bank loans | 465 | 310 | 50000% | 155 | -50% |
| - short-term bank loans | 0 | 0 | 0% | 0 | 0% |
| - short-term accommodations | 0 | 0 | 0% | 0 | 0% |
| **Other liabilities** | **16** | **37** | **131%** | **21** | **-43%** |

*Table 4. Horizontal analysis of the balance sheet - Branch - Activities in the field of information technology*

| (in CZK thousand) | 2007 | 2008 | 2008/2007 | 2009 | 2009/2008 |
|---|---|---|---|---|---|
| **TOTAL ASSETS** | **21 487 568** | **31 434 696** | **46%** | **37 564 253** | **19%** |
| **Fixed assets** | **7 207 791** | **13 741 535** | **91%** | **13 810 786** | **1%** |
| Intangible and tangible fixed assets | 6 896 523 | 11 771 141 | 71% | 11 753 395 | 0% |
| Long-term financial assets | 311 268 | 1 970 394 | 533% | 2 057 391 | 4% |
| **Current assets** | **13 734 143** | **18 413 848** | **34%** | **20 344 681** | **10%** |
| Inventory | 1 531 743 | 704 206 | -54% | 1 520 042 | 116% |
| Long-term and short-term receivables | 10 070 813 | 14 870 685 | 0% | 14 880 772 | 0% |
| Short-term financial assets | 2 131 587 | 2 838 957 | 33% | 3 943 867 | 39% |
| **Other assets** | **545 634** | **-720 687** | **-232%** | **3 408 786** | **-573%** |
| **TOTAL LIABILITIES** | **21 487 568** | **31 434 696** | **46%** | **37 564 253** | **19%** |
| **Equity** | **10 259 645** | **15 687 940** | **53%** | **17 460 679** | **11%** |
| Registered capital | 3 599 405 | 3 850 867 | 7% | 3 850 696 | 0% |
| Retained earnings and other funds | 3 601 343 | 7 754 528 | 115% | 9 471 721 | 22% |
| Net profit or loss for the period | 3 058 897 | 4 082 545 | 33% | 4 138 262 | 1% |
| **Liabilities** | **10 911 333** | **15 403 617** | **41%** | **13 111 053** | **-15%** |
| Provisions | 546 848 | 558 905 | 0% | 1 079 962 | 0% |
| Long-term payables | 2 640 165 | 4 240 036 | 61% | 2 969 724 | -30% |
| Short-term payables | 6 726 881 | 10 041 665 | 49% | 8 437 159 | -16% |
| Bank loans and financial accommodations | 997 439 | 563 010 | -44% | 624 209 | 11% |
| - fixed bank loans | 245 010 | 134 342 | -45% | 179 804 | 34% |
| - short-term bank loans | 752 429 | 428 668 | -43% | 444 404 | 4% |
| **Other liabilities** | **316 590** | **343 139** | **8%** | **6 992 522** | **1938%** |

An insight on balance sheet items gives us basic information about financial and property structure of company. Vertical analysis of financial and property structure of ComIT services s.r.o. and industry is presented in tables 1. and 2. The horizontal analysis of balance sheet is displayed in tables 3. and 4.

**Vertical**: Looking at table 1 we can see that current assets fill around 70% of total assets. This is a positive phenomenon from the perspective of creditors, because the property structure largely composed of current assets enhances liquidity. The largest share of current assets falls on short-term receivables. A slightly increasing total amount of assets can be observed, which is positive.

Compared to industry averages has the rated company a very similar proportion of fixes assets. Share of current assets is higher than the branch's average. As regards the financial structure, evaluated company uses a larger proportion of liabilities. In all analyzed years, the ratio of liabilities is 64 – 81 % while the sector average is 35 – 51 %.

**Horizontal:** Trends in items of property and financial structure of ComIT services s.r.o. are shown in table 3 and for comparison there are average trends of these items of the appropriate branch. Looking at the year on year changes there is visible that the total assets gradually increased, which was caused by increase of current assets, namely the increase in inventory and short-term financial assets.

When evaluating financial structure, it is clear that the line of equity is absolutely growing which, together with a constant amount of capital, means that company is consistently profitable. As for the branch, we can say that the development of the equity is similar; we can also observe a constant increase of capital.

### 4.1.2 Vertical and horizontal analysis of income statements

*Table 5. Vertical analysis of the income statement - ComIT services s.r.o.*

| (in CZK thousand) | **2007** | | **2008** | | **2009** | |
|---|---|---|---|---|---|---|
| Revenues from merchandise | 16 043 | 78% | 20 869 | 72% | 16 948 | 68% |
| Production | 2 202 | 11% | 3 917 | 14% | 4 119 | 17% |
| - Revenues from own product and services | 2 202 | 11% | 3 917 | 14% | 3 482 | 14% |
| - Changes in inventory of own products | 0 | 0% | 0 | 0% | 0 | 0% |
| Other revenues | 67 | 0% | 158 | 1% | 283 | 1% |
| **REVENUES** | **20 514** | **100%** | **28 861** | **100%** | **24 832** | **100%** |
| Cost of goods sold | 13 880 | 78% | 17 898 | 75% | 13 569 | 66% |
| Production consumed | 1 285 | 7% | 2 253 | 9% | 2 718 | 13% |
| Interest expenses | 47 | 0% | 69 | 0% | 25 | 0% |
| Depreciations of intangible and tangible assets | 830 | 5% | 760 | 3% | 773 | 4% |
| Personnel expenses | 1 569 | 9% | 2 697 | 11% | 3 191 | 16% |
| Changes in provisions and adjustments in operating activity and complex deferred expenses | 10 | 0% | -10 | 0% | 0 | 0% |
| Other costs | 117 | 1% | 138 | 1% | 145 | 1% |
| **COSTS** | **17 738** | **100%** | **23 805** | **100%** | **20 421** | **100%** |

*Table 6. Vertical analysis of the income statement - Branch (Activities in the field of information technology)*

| (in CZK thousand) | 2007 | | 2008 | | 2009 | |
|---|---|---|---|---|---|---|
| Revenues from merchandise | 4 881 813 | 13% | 5 346 614 | 13% | 6 481 020 | 14% |
| Production | 32 473 755 | 87% | 35 641 471 | 87% | 41 083 664 | 86% |
| - Revenues from own product and services | 32 498 956 | 87% | 35 629 465 | 87% | 40 902 227 | 86% |
| - Changes in inventory of own products | -72 033 | 0% | -110 194 | 0% | -22 524 | 0% |
| **REVENUES** | **37 355 568** | **100%** | **40 988 085** | **100%** | **47 564 684** | **100%** |
| Cost of goods sold | 3 916 223 | 12% | 4 270 876 | 12% | 4 706 421 | 12% |
| Production consumed | 18 279 581 | 56% | 19 329 111 | 54% | 22 951 795 | 57% |
| Interest expenses | 89 646 | 0% | 91 716 | 0% | 33 282 | 0% |
| Personnel expenses | 9 129 058 | 28% | 10 816 495 | 30% | 11 619 398 | 29% |
| Tax | 973 259 | 3% | 1 089 898 | 3% | 1 143 804 | 3% |
| **COSTS** | **32 387 767** | **100%** | **35 598 096** | **100%** | **40 454 700** | **100%** |

*Table 7. Horizontal analysis of the income statement - ComIT services s.r.o.*

| (in CZK thousand) | 2007 | 2008 | 08/07 | 2009 | 09/08 |
|---|---|---|---|---|---|
| Revenues from merchandise | 16 043 | 20 869 | 30% | 16 948 | -19% |
| Production | 2 202 | 3 917 | 78% | 4 119 | 5% |
| - Revenues from own product and services | 2 202 | 3 917 | 78% | 3 482 | -11% |
| - Changes in inventory of own products | 0 | 0 | 0% | 0 | 0% |
| Other revenues | 67 | 158 | 136% | 283 | 79% |
| **REVENUES** | **20 514** | **28 861** | **41%** | **24 832** | **-14%** |
| Cost of goods sold | 13 880 | 17 898 | 0% | 13 569 | 0% |
| Production consumed | 1 285 | 2 253 | 75% | 2 718 | 21% |
| Interest expenses | 47 | 69 | 47% | 25 | -64% |
| Depreciations of intangible and tangible assets | 830 | 760 | -8% | 773 | 2% |
| Personnel expenses | 1 569 | 2 697 | 72% | 3 191 | 18% |
| Changes in provisions and adjustments in operating activity and complex deferred expenses | 10 | -10 | -200% | 0 | -100% |
| Other costs | 117 | 138 | 18% | 145 | 5% |
| **COSTS** | **17 738** | **23 805** | **34%** | **20 421** | **-14%** |

*Table 8. Horizontal analysis of the income statement - Branch (Activities in the field of information technology)*

| (in CZK thousand) | 2007 | 2008 | 08/07 | 2009 | 09/08 |
|---|---|---|---|---|---|
| Revenues from merchandise | 4 881 813 | 5 346 614 | 10% | 6 481 020 | 21% |
| Production | 32 473 755 | 35 641 471 | 10% | 41 083 664 | 15% |
| - Revenues from own product and services | 32 498 956 | 35 629 465 | 10% | 40 902 227 | 15% |
| - Changes in inventory of own products | -72 033 | -110 194 | 53% | -22 524 | -80% |
| **REVENUES** | **37 355 568** | **40 988 085** | **10%** | **47 564 684** | **16%** |
| Cost of goods sold | 3 916 223 | 4 270 876 | 9% | 4 706 421 | 10% |
| Production consumed | 18 279 581 | 19 329 111 | 6% | 22 951 795 | 19% |
| Interest expenses | 89 646 | 91 716 | 2% | 33 282 | -64% |
| Personnel expenses | 9 129 058 | 10 816 495 | 18% | 11 619 398 | 7% |
| Tax | 973 259 | 1 089 898 | 12% | 1 143 804 | 5% |
| **COSTS** | **32 387 767** | **35 598 096** | **10%** | **40 454 700** | **14%** |

Percentage analysis of profit and loss of ComIT services s.r.o. and the branch are shown in Table 5 and 6. In terms of revenues generated by company it is clear that the main income comes from sales of goods, since the proportion of revenues from merchandise in total revenue are on average 70 %. This greatly exceeds the average value in the branch. Revenues from own products and services represents approximately 12% of revenues. For branch, these items contribute to overall revenue at a much greater extent, approximately 87%. Trends in total costs of the company developed positively, year on year growth (a decrease in 2009) was less than the year on year increase/decrease in revenues. Thereby the firm maintains an annual profitability. There is also visible a relatively stable proportion of all types of costs to total costs. The biggest item is represented by the cost of goods sold, which were decreasing in the analyzed years from 78% to 66%. Another important item is personnel expenses, the proportion is steadily increasing and last reporting year reached the value 16%. Other type of costs participates to total costs insignificantly. The sector's share of the cost of goods sold is much lower, but share of personnel expenses is higher and reaches a stable lever of 29% of total costs. Unlike the analyzed company, in the branch analysis, there is great proportion of production consumed on total costs, approximately 56%.

In the Table 9 and Figure 1, there is summarized overview of the profit/loss development of ComIT services s.r.o. From this table and graph can be seen an economic growth between 2007 and 2008. Inn 2009 there was a slight decline in profit in connection with a decrease in sales of goods and services. In comparison to 2007, in 2008 the company achieved more than twice the profit. The cause was primarily the increase in the other revenues and the revenues of own products and services. Values in Table 9 demonstrate that ComIT services s.r.o. behaves in a profitable way.

*Table 9. Profit/loss 2007 - 2009 - ComIT services s.r.o.*

| (in CZK thousand) | **2007** | **2008** | **2009** |
|---|---|---|---|
| Operating profit/loss | 576 | 1 218 | 898 |
| Financial profit/loss | -64 | -98 | 3 |
| Extraordinary profit/loss | 30 | -1 | 0 |
| **Profit/loss for the current period** | **411** | **880** | **721** |
| Profit/loss before tax | 542 | 1 119 | 901 |
| Profit/loss before tax and interest costs | 589 | 1 188 | 926 |
| Interest costs | 47 | 69 | 25 |

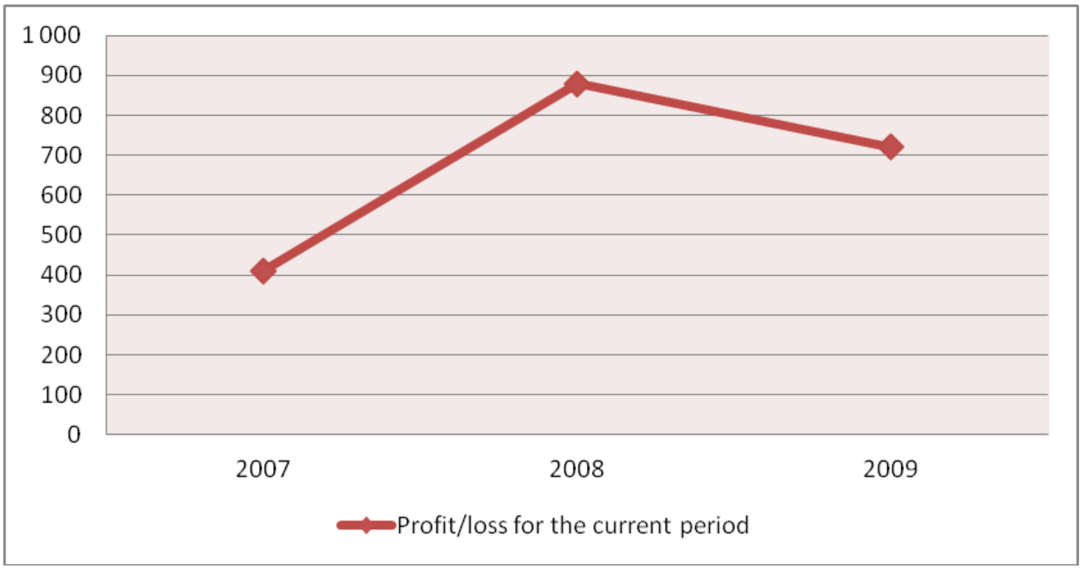
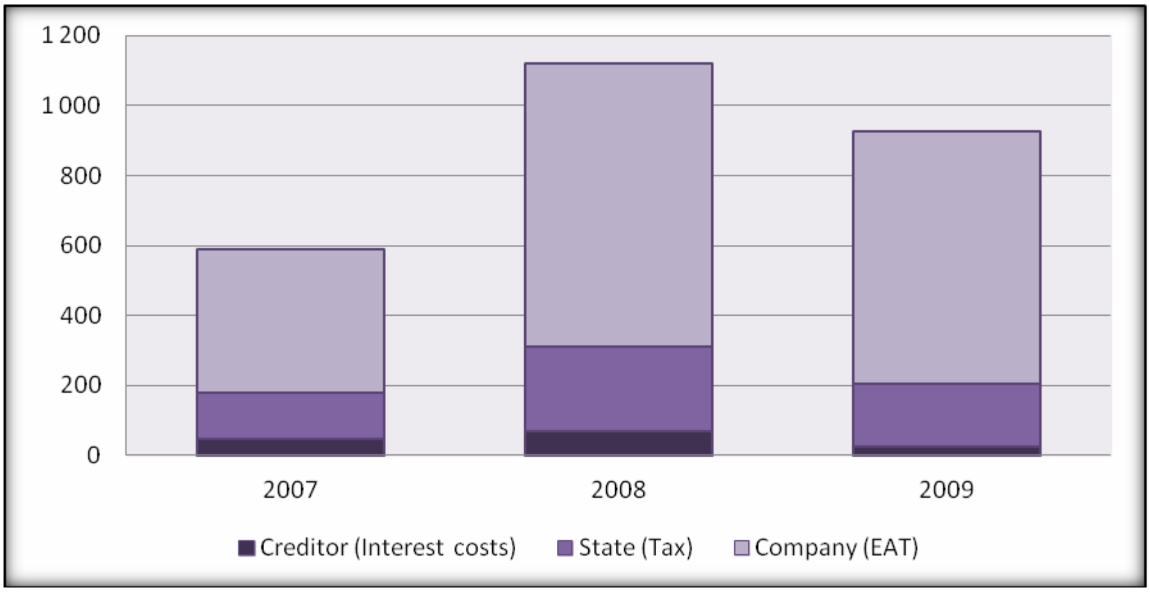



*Figure 1. Profit/loss 2007 – 2009 – ComIT services s.r.o.*

*Table 10. Subdivision of EBIT 2007 – 2009 – ComIT services s.r.o.*

| (in CZK thousand) | **2007** | **2008** | **2009** |
|---|---|---|---|
| **EBIT** | **589** | **1 118** | **926** |
| Creditor (Interest costs) | 47 | 69 | 25 |
| State (Tax) | 131 | 239 | 180 |
| Company (EAT) | 411 | 810 | 721 |

*Figure 2. Subdivision of EBIT 2007 – 2009 – ComIT services s.r.o.*




## 4.2 Subtractive indicators

*Table 11. Net working capital – ComIT services s.r.o.*

| (in CZK thousand) | 2007 | 2008 | 2009 |
|---|---|---|---|
| **NWC** | 153 | 885 | 1 238 |

*Table 12. Net working capital - Branch (Activities in the field of information technology)*

| (in CZK thousand) | 2007 | 2008 | 2009 |
|---|---|---|---|
| **NWC** | 7 007 262 | 8 372 183 | 11 907 522 |

Net working capital has a significant impact on the solvency of the company. Looking at progress of net working capital in ComIT services s.r.o. we can see increasing valuations which is positive because it means that current assets exceed short-term liabilities. Another positive phenomenon is huge increase of NWC in 2008. ComIT services s.r.o. has enough sources to cover unexpected liabilities.

Focusing on the values of NWC in branch - Activities in the field of information technology, we can see increase of values every year as well as in the analysed company.

## 4.3 Ratio analysis

### 4.3.1 Solvency ratios

*Table 13. Solvency ratios – ComIT services s.r.o.*

| | 2007 | 2008 | 2009 |
|---|---|---|---|
| Total debt | 80,54% | 76,38% | 64,39% |
| Debt rate | 4,22 | 3,34 | 1,83 |
| Long term liabilities/Liabilities | 22,35% | 28,93% | 18,29% |
| Long term liabilities/Long term capital | 48,51% | 49,17% | 25,06% |
| Equity/Fixed assets | 0,57 | 0,86 | 1,55 |
| Long term capital/Fixed assets | 1,11 | 1,69 | 2,06 |
| Interest coverage | 12,53 | 16,20 | 37,04 |

*Table 14. Solvency ratios - Branch (Activities in the field of information technology)*

| | 2007 | 2008 | 2009 |
|---|---|---|---|
| Total debt | 50,78% | 49,00% | 34,90% |
| Debt rate | 1,06 | 0,98 | 0,75 |
| Long term liabilities/Liabilities | 26,44% | 28,40% | 24,02% |
| Long term liabilities/Long term capital | 21,95% | 21,80% | 15,28% |
| Equity/Fixed assets | 1,42 | 1,14 | 1,26 |
| Long term capital/Fixed assets | 1,82 | 1,46 | 1,49 |
| Interest coverage | 45,98 | 57,40 | 159,71 |

The total debt ratio of ComIT s.r.o. is greater than the total debt ratio of analysed branch. However this indicator has decreasing trend in years. The company benefited from a relatively small number of long-term liabilities and the values for branch is very similar.

In all the years the company managed to keep so-called golden rule of financing – its fixed assets covered by long-term capital. The branch meets this criterion in the analysed year as well. Since the rate of interest coverage should always show a minimum value of 1, we can say that the company covers several fold interest earnings. The recommended value of interest coverage is 5, which was met in all years.

### 4.3.2 Liquidity ratios

*Table 15. Liquidity ratios – ComIT services s.r.o.*

| | 2007 | 2008 | 2009 | Advised numbers of MIT |
|---|---|---|---|---|
| Current ratio | 1,05 | 1,34 | 1,45 | 1,5 - 2 |
| Acid-test ratio | 0,95 | 1,22 | 1,16 | 1,00 |
| Cash flow liquidity ratio | 0,07 | 0,29 | 0,31 | 0,20 |
| NWC/Current assets | 5,14% | 25,30% | 31,27% | |
| NWC/Total assets | 3,38% | 18,38% | 23,94% | |

*Table 16. Liquidity ratios - Branch (Activities in the field of information technology)*

| | 2007 | 2008 | 2009 | Advised numbers of MIT |
|---|---|---|---|---|
| Current ratio | 1,84 | 1,76 | 2,29 | 1,5 - 2 |
| Acid-test ratio | | | | 1,00 |
| Cash flow liquidity ratio | 0,28 | 0,27 | 0,44 | 0,20 |
| NWC/Current assets | 51,02% | 45,47% | 58,53% | |
| NWC/Total assets | 32,61% | 26,63% | 31,70% | |

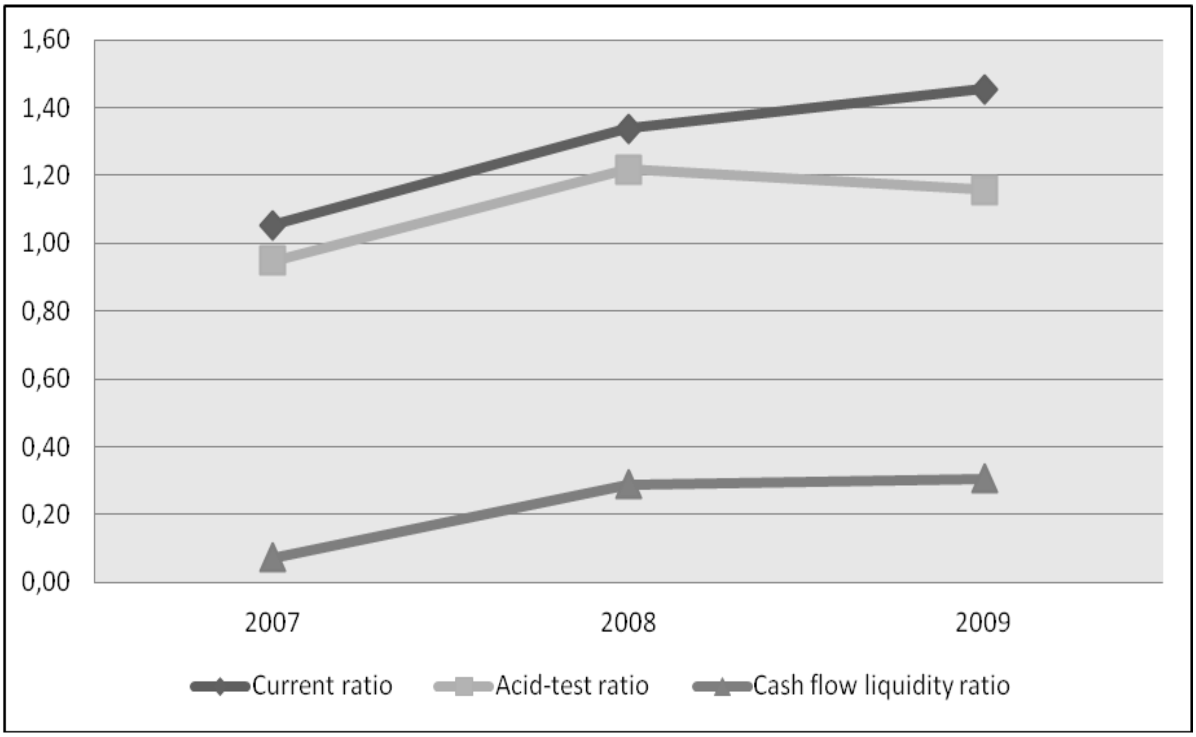



*Figure 3. Liquidity ratios 2007 – 2009 – ComIT services s.r.o.*

A necessary condition for long-term existence of the company is its liquidity, the ability of company to pay its obligations. Liquidity ratios compare the most liquid funds with short-term liabilities and determine the firm's ability to pay these obligations.

The indicators of current liquidity of ComIT services s.r.o. are slightly below the recommended values of MIT, whereas emergency liquidity indicators meet the recommended values in 2008 and 2009. Pleasing is the fact that values are rising year by year. The cash flow liquidity ratio of ComIT services s.r.o. follows the advised rates in 2008 and 2009. The branch follows the advised rates in all analyzed years. For company these rates are very positive, because it means that there is small possibility that the company will not have enough money to pay its customers. But on the other hand having too much money in cash does not bring any incomes. As a recommendation can be provide investing money in profitable investments or in a risky business which is connected with a higher profit.

### 4.3.3 Profitability ratios

*Table 17. Profitability ratios – ComIT serives s.r.o.*

| | 2007 | 2008 | 2009 |
|---|---|---|---|
| Return on sales | 19% | 22% | 21% |
| Return on income | 3% | 4% | 4% |
| Return on assets | 13% | 23% | 18% |
| Return on equity and interest-bearing liabilities | 44% | 79% | 47% |
| Return on equity | 48% | 80% | 40% |

*Table 18. Profitability ratios - Branch (Activities in the field of information technology)*

| | 2007 | 2008 | 2009 |
|---|---|---|---|
| Return on sales | 9% | 11% | 10% |
| Return on income | 11% | 13% | 11% |
| Return on assets | 19% | 17% | 14% |
| Return on equity and interest-bearing liabilities | 37% | 32% | 29% |
| Return on equity | 30% | 26% | 24% |

The profitability ratios indicate that the company has been consistently profitable in the analyzed years. For business owners or shareholders is important to monitor return on equity. When analyzing ComIT services s.r.o. we can see high values of this indicator. Even much higher than those values in the branch.

*Table 19. Multiplicator – ComIT services s.r.o.*

| | 2007 | 2008 | 2009 |
|---|---|---|---|
| EBT/EBIT | 0,92 | 1,00 | 0,97 |
| Total assets/Equity | 5,23 | 4,38 | 2,84 |
| **Multiplicator** | **4,82** | **4,38** | **2,76** |

Effect of debt to return on equity reflects two factors – the reduction of income by interest and so-called financial leverage, these two factors act contradictory.

The value of the equity multiplier of ComIT services s.r.o. is greater than 1 in all analyzed years (Table 19), which means that increasing of the share of external sources in the capital structure would have a positive impact on the profitability of shareholders' equity. The indicator greater than 1 means that future indebting of the company makes sense, because owing to the divergence of interest which reducing profits, and financial leverage the increase of the share of foreign sources show a positive effect on return on equity. On the other hand, increasing the share of foreign sources is usually accompanied by a rise in interest which reduce the share of profits intended for investors and causing a decrease in indicators of profit reduction by interest and thereby a decrease in return on equity.

### 4.3.4 Asset utilization ratios

*Table 20. Asset utilization ratios – ComIT services s.r.o.*

| | 2007 | 2008 | 2009 |
|---|---|---|---|
| Total assets turnover | 4,03 | 5,15 | 4,07 |
| Total assets turnover (revenues) | 4,53 | 6,00 | 4,80 |
| Days in inventory | 5,86 | 4,44 | 13,82 |
| Average collection period | 48,74 | 35,28 | 39,61 |
| Days in liabilities | 62,57 | 48,90 | 54,26 |
| Receivables turnover | 7,39 | 10,20 | 9,09 |
| Liabilities turnover | 5,75 | 7,36 | 6,64 |

*Table 21. Asset utilization ratios - Branch (Activities in the field of information technology)*

| | 2007 | 2008 | 2009 |
|---|---|---|---|
| Total assets turnover | 1,51 | 1,13 | 1,09 |
| Total assets turnover (revenues) | 1,74 | 1,30 | 1,27 |
| Days in inventory | 14,76 | 6,19 | 11,50 |
| Average collection period | 97,05 | 130,61 | 112,63 |
| Days in liabilities | 90,27 | 125,44 | 86,33 |
| Receivables turnover | 3,71 | 2,76 | 3,20 |
| Liabilities turnover | 3,99 | 2,87 | 4,17 |

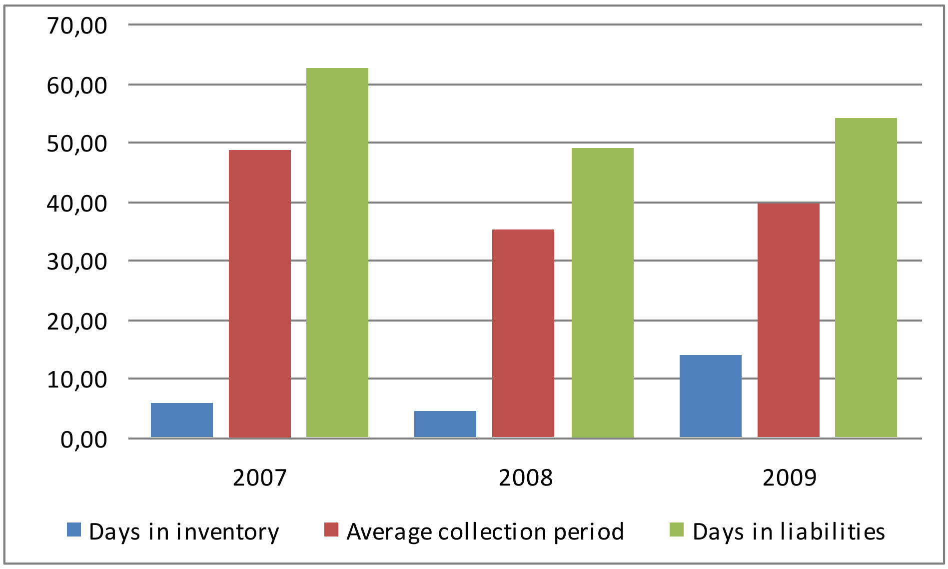



*Figure 4. Asset utilization ratios 2007 – 2009 – ComIT services s.r.o.*

Asset utilization ratios demonstrate how efficiently the company manages its assets, if there is more of them than is necessary, it created unnecessary costs. If they are few, company may lose potential sales. These ratios are expressed in two forms – either as an indicator of turnover or indicators of turnover time. In this group of indicators it is necessary to assess their value and development in comparison with the branch. Asset utilization ratios of ComIT services s.r.o. are calculated in Table 20 and Figure 4, values for the branch - activities in the field of information technology are shown in Table 21.

If the total asset turnover is calculated from sales, it reaches 4.5 in average and if the turnover of total assets is calculated from revenues, it reaches around 5.5. This fact demonstrates that sales occupy a substantial portion of revenues. Total asset turnover of ComIT services s.r.o. is significantly higher than the required minimum value of 1 (1CZK from assets should be achieved in sales of at least CZK1) and it is also higher than the total assets turnover achieved by the branch. This indicates the high ability to an effective use of their assets.

Days in inventory of ComIT services s.r.o. reach lower value than the branch, which is quite satisfactory.

The average collection period in 2008 decreased rapidly and in 2009 reached the value 39.61. Compared with the industry the company has almost three times lower values. Ratio average collection period should be put into context with the days in liabilities. Comparing these two indicators in all analyzed years, it is visible that average collection period is shorter than the days in liabilities. This phenomenon is positive because the company did not have to use other sources for financing their activities. Companies in the industry have shorter days in liabilities than average collection period, thus getting company into position of lender.

# 5 ASSESSMENT AND RECOMMENDATIONS

Financial performance of ComIT services s.r.o. will be evaluated on the basis of previous results and possible recommendations will be suggested.

Throughout the period 2007 – 2009, which was subject to evaluation, the company reported profits, which is one indicator of the health of analyzed company. In 2008 profits showed an increasing tren (114% growth compared to 2007), which positively affected the economic situation of the company. This was cause mainly by establishing of new branch in Prerov in 2007.

The subtractive analysis of indicator shows that the company has positive outcome of net working capital in all analyzed years, which has to be evaluated positively. An increase in 2008 was primarily due to and increase in the short-term financial assets. Into coming years I suggest to keep a sufficiently large NWC, which represents free capital and the ability to cover unexpected events.

In terms of solvency ratios we observe a decrease value of the total debt indicator. This phenomenon can be viewed as positive. In the last reporting year, the total value of the debt was already approaching the upper limit of recommended values. Despite the positive development I recommend to focus on reducing long-term and mainly short-term payables. On the contrary, an enterprise should continue in the effective use of bank loans. The positive fact also is that in all years company managed to keep the golden rule of financing and fixed assets covered its long-term capital. In terms of interest coverage, the situation is very satisfactory, since the interest coverage exceeds several times the recommended value of 5 every year, so for the company would not be a problem to pay interest on any further loans.

Liquidity indicators are growing. The coefficient of current liquidity for the years 2008 and 2009 moves to the lower limit of recommended values. Company could be satisfied with the Acid-test ratio, since the value of reached the recommended values. The results of Cash-flow liquidity ratio demonstrate that the company in 2008 and 2009 effectively uses the financial resources. I again propose to focus on reducing short-term liabilities, since their amount significantly affect liquidity.

According to the profitability, we can say that the company was in all analyzed years profitable. The best result was achieved in the return on equity in 2008 – 80%. ROA indicator, which shows the return on total assets invested in the company, also showed positive results. The significance of this indicator is that there is used EBIT in calculation, which means that the embedded assets are measured by profit and interest. Even if the company does not face any serious problems with profitability, I recommend regular monitoring of this indicator.

The use of property is measured by total asset turnover, which has in analyzed company higher values than in the industry. This phenomenon pointing to ability of effective utilizing of assets. In terms of average collection period is appropriate to compare this indicator with days in liabilities. The average collection period should be shorter than the days in liabilities. ComIT services s.r.o. met this rule without exception. If the average collection period need to be shorten in the coming years I suggest to use the discount for early payment, volume discounts or to focus on more solvent customers. The number of days in inventory should be as short as possible. ComIT services s.r.o. has these values quite satisfactory, but in the last reporting year, this time slightly increased. Therefore, my recommendation for management is keep this value as low as it was in analyzed years and do not forget trying to prevent further growth of days in inventory. Generally, an effective inventory management can influence the choice of correct and reliable supplier. This eliminates unnecessary costs.

# CONCLUSION

When processing my bachelor thesis I proceeded according to the assignment. I dealt with the financial statements and their reporting ability for the management of ComIT services s.r.o.

The aim of this thesis was to examine and evaluate the reporting ability of individual financial statements and then on their basis make financial analysis of chosen company.

The theoretical part embodies the main features and characteristics of financial statements and their users. Another section focuses on explaining the principle and function of financial analysis as well as the methods and procedures of each calculation.

At the beginning of the second part, I briefly introduced analyzed company ComIT services s.r.o. The content of the practical part is financial analysis calculated by using methods characterized in the theoretical part. Then I evaluated individual indicators and with the help of graphs and tables I expressed development in the period.

In the last part I made a summary of important findings and conclusions, which I found out during the processing of my thesis and I proposed some recommendations to improve the current situation.

I believe that the work met the objective, which was set out in the beginning and I hope that it will be beneficial for the management of ComIT services s.r.o. and provide them useful information.

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# LIST OF ABBREVIATIONS

| | |
|---|---|
| EAT | Earnings after taxes |
| EBIT | Earnings before interest and taxes |
| EPS | Earnings per share |
| NWC | Net working capital |
| ROA | Return on assets |
| ROE | Return on equity |
| ROI | Return on income |
| WACC | Weighted costs of capital |

# LIST OF FIGURES

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# APPENDICES

# APPENDIX P I: BALANCE SHEET – COMIT SERVICES S.R.O.

| (in CZK thousand) | 2007 | 2008 | 2009 |
|---|---|---|---|
| **TOTAL ASSETS** | **4 527** | **4 814** | **5 172** |
| **Fixed assets** | **1 520** | **1 277** | **1 178** |
| Intangible fixed assets | 0 | 0 | 0 |
| Tangible fixed assets | 1 520 | 1 277 | 1 178 |
| Long-term financial assets | 0 | 0 | 0 |
| **Current assets** | **2 974** | **3 498** | **3 959** |
| Inventory | 297 | 306 | 809 |
| Long-term receivables | 0 | 9 | 0 |
| Short-term receivables | 2 470 | 2 429 | 2 318 |
| Short-term financial assets | 207 | 754 | 832 |
| **Other assets** | **33** | **39** | **35** |
| **TOTAL LIABILITIES** | **4 527** | **4 814** | **5 172** |
| **Equity** | **865** | **1 100** | **1 821** |
| Registered capital | 200 | 200 | 200 |
| Capital funds | 0 | 0 | 0 |
| Reserve funds, indivisible fond and other retained earnings | 0 | 20 | 20 |
| Net profit or loss from previous year | 254 | 0 | 880 |
| Net profit or loss for the period | 411 | 880 | 721 |
| **Liabilities** | **3 646** | **3 677** | **3 330** |
| Provisions | 10 | 0 | 0 |
| Long-term payables | 350 | 754 | 454 |
| Short-term payables | 2 821 | 2 613 | 2 721 |
| Bank loans and financial accommodations | 465 | 310 | 155 |
| - fixed bank loans | 465 | 310 | 155 |
| - short-term bank loans | 0 | 0 | 0 |
| - short-term accommodations | 0 | 0 | 0 |
| **Other liabilities** | **16** | **37** | **21** |

# APPENDIX P II: INCOME STATEMENT - COMIT SERIVCES S.R.O.

| (in CZK thousand) | 2007 | 2008 | 2009 |
|---|---|---|---|
| Revenues from merchandise | 16 043 | 20 869 | 16 948 |
| Production | 2 202 | 3 917 | 4 119 |
| - Revenues from own product and services | 2 202 | 3 917 | 3 482 |
| - Changes in inventory of own products | 0 | 0 | 0 |
| Other revenues | 67 | 158 | 283 |
| **REVENUES** | **20 514** | **28 861** | **24 832** |
| Cost of goods sold | 13 880 | 17 898 | 13 569 |
| Production consumed | 1 285 | 2 253 | 2 718 |
| Interest expenses | 47 | 69 | 25 |
| Depreciations of intangible and tangible assets | 830 | 760 | 773 |
| Personnel expenses | 1 569 | 2 697 | 3 191 |
| Changes in provisions and adjustments in operating activity and complex deferred expenses | 10 | -10 | 0 |
| Other costs | 117 | 138 | 145 |
| **COSTS** | **17 738** | **23 805** | **20 421** |