HKBM7008 Finance for Business Managers

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Module 1

Introduction of Corporate Finance

McGraw-Hill/Irwin

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Learning Outcome

- Research, apply and critically evaluate/discuss
  - Financial assessment techniques used to report upon a business's financial performance, identifying potential areas for further investigation which may improve its financial positions
  - Various techniques used in the management and control of financial resources

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Key Concepts and Skills

- Understand the basic types of financial management decisions and the role of the Financial Manager
- Know the financial implications of the various *forms of business organization*
- Know the *goal* of financial management
- Identify the *conflicts of interest* that can arise between owners and managers
- Recognize the various regulations that firms face

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Module Outline

1. What is Corporate Finance?

2 The Corporate Firm

3 The Importance of Cash Flows

4 The Goal of Financial Management

5 Agency Problem & Control of the Corporation Regulation

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1. What Is Corporate Finance?

Corporate Finance addresses the following three questions:

1. What long-term investments should the firm choose?
2. How should the firm raise funds for the selected investments?
3. How should short-term assets be managed and financed?

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Balance Sheet Model of the Firm

Total Value of Assets:

Current Assets

Non-current Assets

1 Tangible

2 Intangible

Total Firm Value to Investors:

Current Liabilities

Long-Term Debt

Shareholders' Equity

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The Capital Budgeting Decision

Current Assets

Non-current Assets

1 Tangible

2 Intangible

What long-term investments should the firm choose?

Current Liabilities

Long-Term Debt

Shareholders' Equity

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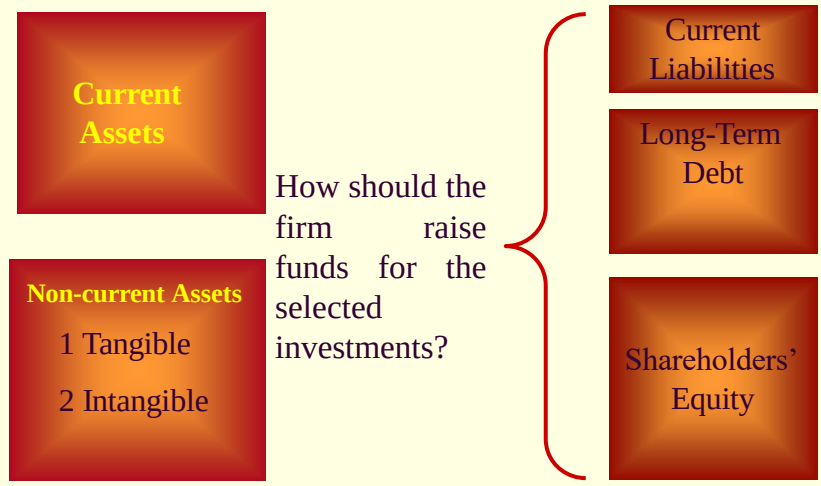
The Capital Structure Decision



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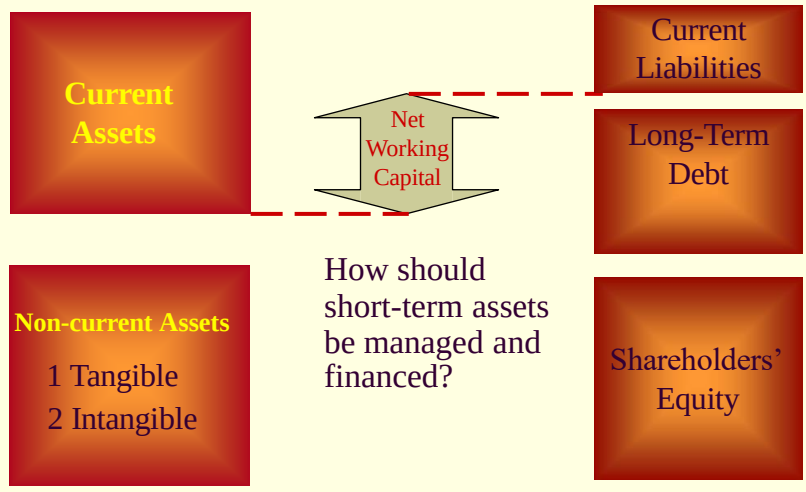
Short-Term Asset Management



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The Financial Manager

The Financial Manager's primary goal is to increase the value of the firm by:

1. Selecting value creating projects
2. Making smart financing decisions

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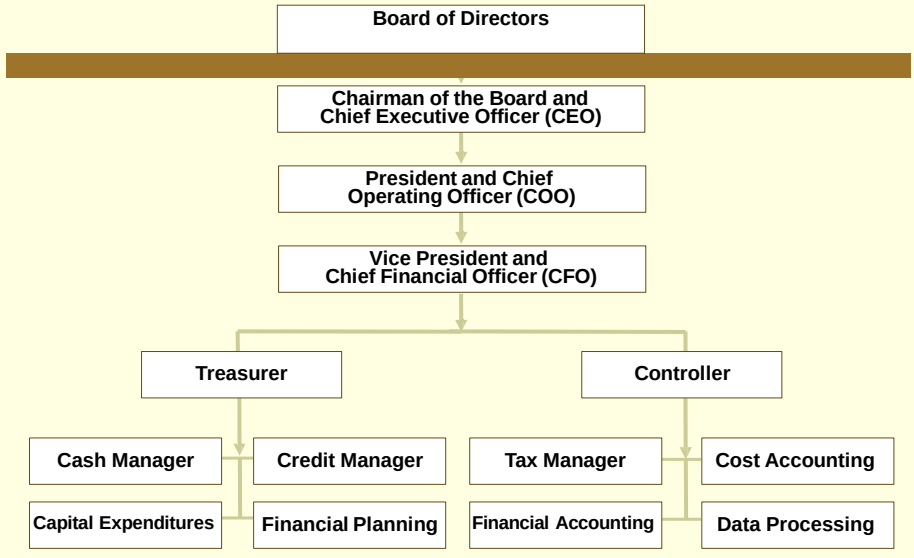
Hypothetical Organization Chart



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2 The Corporate Firm

- The corporate form of business is the standard method for solving the problems encountered in raising large amounts of cash.
- However, businesses can take other forms.

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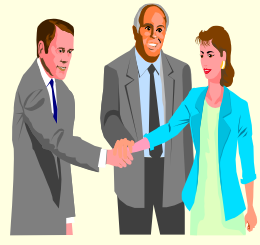
Forms of Business Organization

Sole Proprietorship

Partnership

Corporation

- General (Unlimited)
- Limited



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A Comparison

	Corporation	Partnership
Liquidity	Shares can be easily exchanged	Subject to substantial restrictions
Voting Rights	Usually each share gets one vote	General Partner is in charge; limited partners may have some voting rights
Taxation	Double	Partners pay taxes on distributions
Reinvestment and dividend payout	Broad	All net cash flow is distributed to partners
Liability	Limited liability	General partners may have unlimited liability; limited partners enjoy limited liability
Continuity	Perpetual life	Limited life

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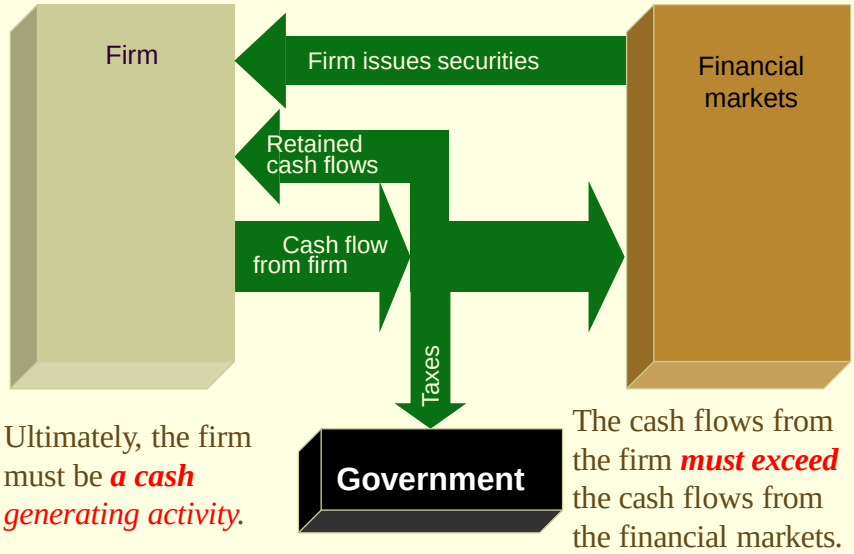
3 The Importance of Cash Flow



Ultimately, the firm must be ***a cash*** *generating activity*.

The cash flows from the firm ***must exceed*** the cash flows from the financial markets.

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4 The Goal of Financial Management

- What is the correct goal?
  - Maximize profit?
  - Minimize costs?
  - Maximize market share?
  - **Maximize shareholder wealth?**

What are other non-finance goals ?

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5 The Agency Problem

- Agency relationship
  - Principal hires an agent to represent his/her interest
  - Stockholders (principals) hire managers (agents) to run the company
- Agency problem
  - Conflict of interest between principal and agent

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Managerial Goals

- Managerial goals may be different from shareholder goals
  - Expensive bonus
  - Survival
  - Independence

- Increased growth and size are not necessarily equivalent to increase shareholder wealth

Management vs Shareholders

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Managing Managers

- Managerial compensation
  - Incentives can be used to align management and stockholder interests
  - The incentives need to be structured carefully to make sure that they achieve their intended goal
- Corporate control
  - The threat of a takeover may result in better management
- Other stakeholders

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5. Corporation Regulations

Generally Accepted Accounting Principles(GAAP)

Financial accounting practice is governed by concepts and rules known as generally accepted accounting principles (GAAP).

Relevant Information → Affects the decision of its users.

Reliable Information → Is trusted by users.

Comparable Information → Is helpful in contrasting organizations.

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Setting Accounting Principles

Financial Accounting Standards Board is the private group that sets both broad and specific principles.

The Securities and Exchange Commission is the government group that establishes reporting requirements for companies that issue stock to the public.

The International Accounting Standards Board (IASB) issues International Financial Reporting Standards that identify preferred accounting practices to create harmony among accounting practices of different countries.

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International Standards

The International Accounting Standards Board (IASB), an independent group (consisting of 16 individuals from many countries), issues International Financial Reporting Standards (IFRS) that identify preferred accounting

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Module 2

Financial Statements and Cash Flow

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Key Concepts and Skills

- Understand the information provided by financial statements
- Differentiate between book and market values
- Know the difference between accounting income and cash flow
- Calculate a firm's cash flow

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Chapter Outline

1 The Balance Sheet/Statement of Financial Position

2 The Income Statement / Statement of Comprehensive Income

3 Net Working Capital

4 Financial Cash Flow

5 The Accounting Statement of Cash Flows

6 Cash Flow Management

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1 The Balance Sheet

- An accountant's snapshot of the firm's accounting value at a specific point in time
- The Balance Sheet Identity is:

  Assets ≡ Liabilities + Stockholder's Equity

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1 The Balance Sheet (Content)

The Balance Sheet Identity is:

Assets ≡ Liabilities + Stockholder's Equity

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Balance Sheet Analysis

- When analyzing a balance sheet, the Finance Manager should be aware of three concerns:
  1. Liquidity
  2. Debt versus Equity
  3. Value versus Cost

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Liquidity

- Refers to the ease and quickness with which assets can be converted to cash—without a significant loss in value
- Current assets are the most liquid.
- Some fixed assets are intangible.
- The **more liquid** a firm's assets, the less likely the firm is to experience problems meeting short-term obligations.
- Liquid assets frequently have lower rates of return than fixed assets.

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Debt versus Equity

- **Creditors** generally receive the first claim on the firm's cash flow.
- Shareholder's equity is the residual difference between assets and liabilities.
- Assets − Liabilities ≡ Stockholder's Equity

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Value versus Cost

- Under Generally Accepted Accounting Principles (GAAP), audited financial statements of firms carry assets at cost.
- Market value is the price at which the assets, liabilities, and equity could actually be bought or sold, which is a completely different concept from historical cost.

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Assets ≡ Liabilities + Stockholder's Equity

Assets:The business owner or the control of valuable resources

Eg: Cash, office buildings, plant, equipment, the sale of inventory items, raw materials

Liabilities: for others' money in arrears

Eg: Bank Loan, Bank Overdraft, the supply of the goods, due to the Government's tax

Equities: Owner of the shares

Eg: Common Stock, Retained Earnings

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Accounting – Transactions

- Sources of transactions
- Recognize the transactions and post into the account

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Analyzing and Recording Process

Analyze each transaction and event from source documents

Record relevant transactions and events in a journal

Post journal information to ledger accounts

Prepare and analyze the trial balance

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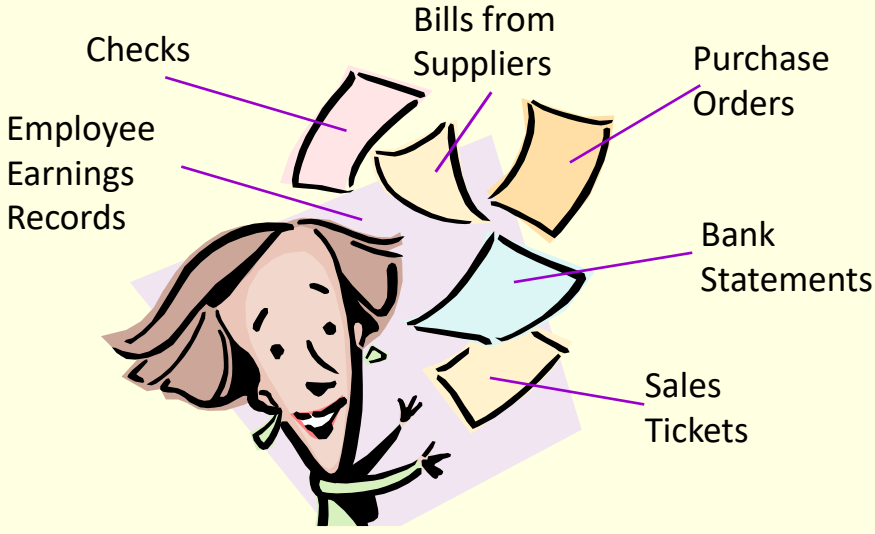
Source Documents



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Summary – Double Entry

- Balance Sheet: Asset = Liabilities + Equity.
- Every transactions will required 2 and more entries to full balance the account. Moreover, it reflects the total value of the transaction and flow of the transaction

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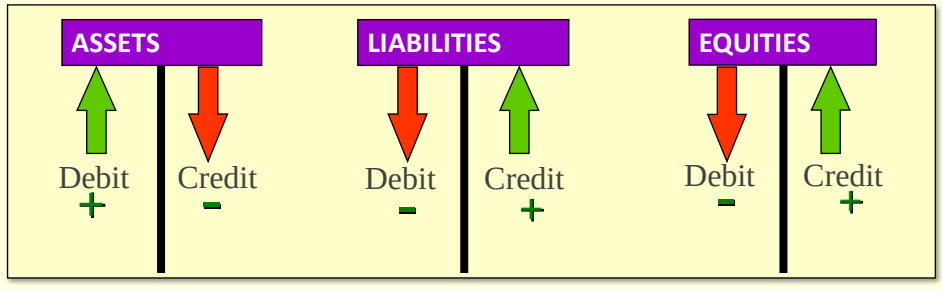
Double-Entry Accounting

Assets = Liabilities + Equity



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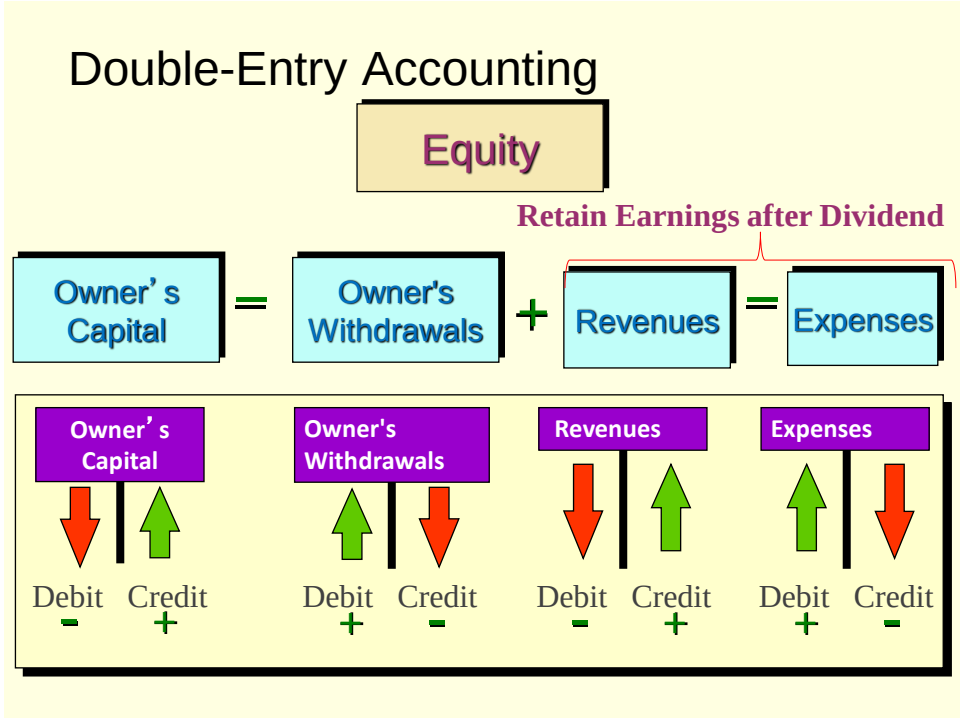

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Introduction – by Example

SMART – Construction Consultant Co. Ltd

Balance Account (Dual "double" entry)
– for all the transactions

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Original Investment

SMART invests $50,000 to SMART Ltd – common share

Account books :

(1) Cash （Asset)

(2) Equity (Equity)

1-65

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Original Investment

SMART - $50,000 invest as common share

	Asset			=	Liability		+ Equity
	CASH	Off Use	Equipt		A P	Long Debt	Equity
(1)	$ 50,000						$ 50,000
	$ 50,000	$ -	$ -		$ -	$ -	$ 50,000
		$ 50,000		=		$ 50,000	

1-66

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Purchase

Buy "goods" and pay $4,800 cash

Account :

(1) Cash (asset)

(2) Inventory (asset)

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Purchase

Buy "goods" and pay $4,800 cash

	Asset			=	Liability		+	Equity
	cash	off use	equipt		AR	L. Debt		Equity
(1)	$ 50,000							$ 50,000
(2)	(4,800)	$ 4,800						
	$ 45,200	$ 4,800	$ -		$ -	$ -		$ 50,000
		$ 50,000		=		$ 50,000		

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Purchase equipment

Buy equipment for $30,000 in cash

Account:

(1)cash (asset)

(2)equipment(asset)

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Buy equipment for $30,000 in cash

	Asset			=	Liabilities		+	Equity
	cash	off use	equipt		AP	L. Debt		Equity
(1)	$ 50,000							$ 50,000
(2)	(4,800)	$ 4,800						
(3)	(30,000)		$ 30,000					
	$ 15,200	$ 4,800	$ 30,000		$ -	$ -		$ 50,000
		$ 50,000		=		$ 50,000		

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Account Payable

Buy office use items $9,400, and settle 100% in 2 weeks。

Account:

(1) Inventory (Asset)

(2) Account Payable (Liabilities)

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Account Payable

Buy office use items $9,400, and settle 100% in 2 weeks。

	Asset			= Liabilities		+ Equity
	cash	Off Use	equipt	Account Payable	Long debt	Equity
(1)	$ 50,000					$ 50,000
(2)	(4,800)	$ 4,800				
(3)	(30,000)		$ 30,000			
(4)		9,400		$ 9,400		
	$ 15,200	$ 14,200	$ 30,000	$ 9,400	$ -	$ 50,000
		$ 59,400		=	$ 59,400	

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Accounting update

Update all the previous transactions

	Asset			=	Liabilities		+ Equity
	cash	off use	equipt		Acct payable	Long Debt	Equity
Bal	$ 15,200	14,200	30,000		9,400		$50,000
	$ 15,200	$ 14,200	$ 30,000		$ 9,400	$ -	$50,000
		$ 59,400		=		$59,400	

Proceed to other transactions

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Revenue

Consultant income$9,800 in cash

Account:

(1)Cash (Asset)

(2)revenue(Equity)

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Revenue 收入

Consultant income$9,800 in cash

	Asset			= Liabilities		+ Equity
	cash	off use	equipt	Acct Payable	Long Debt	Equity
Bal	$ 15,200	14,200	30,000	9,400		$ 50,000
(5)	9,800					9,800
	$ 25,000	$ 14,200	$ 30,000	$ 9,400	$ -	$ 59,800
		$ 69,200		=	$ 69,200	

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Payment Rent

Paid $2,800 as rental to rental company

Account:

(1) cash (asset)

(2) rental (equity)

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Paid $2,800 as rental to rental company

	Asset			= Liabilities		+ Equity
	Cash	Off use	Equipt	Acct Payable	Long Debt	Equity
Bal	$ 15,200	14,200	30,000	9,400		$ 50,000
(5)	9,800					9,800
(6)	(2,800)					(2,800)
	$ 22,200	$ 14,200	$ 30,000	$ 9,400	$ -	$ 57,000
		$ 66,400		=	$ 66,400	

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Pay worker salary

Salary payment $2,300.

Account :

(1) Cash (Asset)

(2) Salary pay (equity)

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Salary payment $2,300.

	Asset			= Liabilities		+ Equity
	Cash	Off use	Equipt	Acct Payable	Long Debt	Equity
Bal	$ 15,200	14,200	30,000	9,400		$ 50,000
(5)	9,800					9,800
(6)	(2,800)					(2,800)
(7)	(2,300)					(2,300)
	$ 19,900	$ 14,200	$ 30,000	$ 9,400	$ -	$ 54,700
		$ 64,100		=	$ 64,100	

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Account Receivable 应收账款

Overstock of office supplies, sold 10 unit to ABC for $3,400，ABC agrees to pay in 30 days

Account:

(1) AR (Asset) ↑

(2) Off Use (Asset) ↓

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AR 应收账款

Overstock of office supplies, sold 10 unit to ABC for $3,400，ABC agrees to pay in 30 days

	Asset				=	Liababilies +	Equity
	Cash	AR	Off Use	Equipt		Acct Payable	Equity
Bal	$ 19,900		14,200	30,000		9,400	$ 54,700
(8)		3,400	(3,400)				
	$ 19,900	3,400	$ 10,800	$ 30,000		$ 9,400	$ 54,700
		$ 64,100			=	$ 64,100	

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AR 应收账款

ABC Settled in 10 days

Account:

(1) Cash (Asset)

(2) AR (Asset)

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AR 应收账款

ABC Settled in 10 days

	Asset				=	Liabilities +	Equity
	Cash	AR	Off Use	Equipt		Acct Payable	Equity
Bal	$ 19,900	3,400	10,800	30,000		9,400	$ 54,700
(8)	3,400	(3,400)					
	$ 23,300	-	$ 10,800	$ 30,000		$ 9,400	$ 54,700
		$ 64,100			=	$ 64,100	

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SMART – Construction Consultant Co. Ltd
Trial Balance
MMM DD, YYYY

	Dr (HK$)	Cr (HK$)
Cash	23,300	
Office Use	10,800	
Equipment	30,000	
Account Payable		9,400
Capital Stock		50,000
Revenue		9,800
Rental Expense	2,800	
Salary Expense	2,300	
Total	$ 69,200	$ 69,200

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SMART – Construction Consultant Co. Ltd

Income Statement

for the year end MMM DD, YYYY

		HK$
Revenue		9,800
Expenses		
Rental Expense	2,800	
Salary Expense	2,300	
Total Expenses		5,100
Net Income		$ 4,700

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SMART – Construction Consultant Co. Ltd

Balance Sheet

as at MMM DD, YYYY

Fixed Assets		Current Liabilities	
		Account Payable	$ 9,400
Equipment	$ 30,000	Total Current Liabilities	$ 9,400
Total Fixed Asset	$ 30,000		
Current Assets			
Cash	$ 23,300	Total Liabilities	$ 9,400
Office Use	$ 10,800		
Total Current Asset	$ 34,100	Owner Equities	
		Capital Stock	$ 50,000
		Retained Earnings	$ 4,700
		Total Owner Equities	$ 54,700
Total Assets	$ 64,100	Total Liabilities and Owner Equities	$ 64,100

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2 The Income Statement

- Measures financial performance over a specific period of time
- The accounting definition of income is:

  Revenue – Expenses ≡ Income

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Income Statement Analysis

- There are three things to keep in mind when analyzing an income statement:
  1. Generally Accepted Accounting Principles (GAAP)
  2. Non-Cash Items
  3. Time and Costs

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GAAP

- The matching principle of GAAP dictates that revenues be matched with expenses.
- Thus, income is reported when it is earned, even though no cash flow may have occurred.

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Non-Cash Items

- Depreciation is the most apparent. No firm ever writes a check for "depreciation."
- Another non-cash item is deferred taxes, which does not represent a cash flow.
- Thus, net income is **not cash**.

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Time and Costs

- In the short-run, certain equipment, resources, and commitments of the firm are fixed, but the firm can vary such inputs as labor and raw materials.
- In the long-run, all inputs of production (and hence costs) are variable.
- Financial accountants do not distinguish between variable costs and fixed costs. Instead, accounting costs usually fit into a classification that distinguishes product costs from period costs.

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Financial accountants will concern

	Net Sales	$600,000
	Cost of Goods Sold	
Product Cost	variable costs	$120,000
Product Cost	fixed costs	$200,000
	Gross Profit 毛利	$280,000
	Operational Expenses:	
	selling and administrative expenses 銷售及行政開支	
Period Cost	variable expenses	$40,000
Period Cost	fixed expenses	$150,000
	Total Operational Expenses:	*$190,000*
	Net Profit	*$90,000*

Managerial accountants will concern

Net Sales	$600,000
Variable costs 可變成本	
Cost of Goods Sold	$120,000
Selling and Adm. Exp.	$40,000
Contribution Margin 貢獻	$440,000
Fixed costs 固定成本	
Cost of Goods Sold	$200,000
Selling and Adm. Exp.	$150,000
Total fixed Costs	$350,000
Net Profit	*$90,000*

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3 Net Working Capital

- Net Working Capital (NWC) ≡
  Current Assets – Current Liabilities

- NWC usually grows with the firm

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4 Financial Cash Flow

- In finance, the most important item that can be extracted from financial statements is the **actual** cash flow of the firm.
- Since there is no magic in finance, it must be the case that the cash flow received from the firm's assets must equal the cash flows to the firm's creditors and stockholders.

$$CF(A) \equiv CF(L) + CF(E)$$

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5 The Statement of Cash Flows

- There is an official accounting statement called the statement of cash flows.

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Purpose of the Statement of Cash Flows

How does a company obtain its cash?

Where does a company spend its cash?

What explains the change in the cash balance?

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Importance of Cash Flows

How did the business fund its operations?

Does the business have sufficient cash to pay its debts as they mature?

Did the business make any dividend payments?

Did the business borrow any funds or repay any loans?

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Classification of Cash Flows

The Statement of Cash Flows includes the following three sections:

- **Operating Activities**
- **Investing Activities**
- **Financing Activities**

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Format of the Statement
of Cash Flows

Company Name Statement of Cash Flows For Period Ended Date	
Cash flows from operating activities:	
[List of individual inflows and outflows]	
Net cash provided (used) by operating activites	$ #####
Cash flows from investing activities:	
[List of individual inflows and outflows]	
Net cash provided (used) by investing activites	#####
Cash flows from financing activities:	
[List of individual inflows and outflows]	
Net cash provided (used) by financing activites	#####
Net increase (decrease) in cash	$ #####
Cash (and equivalents) balance at beginning of period	#####
Cash (and equivalents) balance at end of period	$ #####

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6 Cash Flow Management

- Earnings can be manipulated using subjective decisions required under GAAP
- Total cash flow is more objective, but the underlying components may also be "managed"
  - Moving cash flow from the investing section to the operating section may make the firm's business appear more stable

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Importance of Cash Flow Statements

- Balance sheet, profit & loss account and cash flow statement
- Creative accounting and manipulation of profits
- Non-manipulation of cash

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RooHa Firm

A) Reducing balance depreciation at 40% p.a.

	£
Sales revenue	640,000
Depreciation (500,000x 40%)	200,000
All other expenses	390,000
Total expenses	590,000
Net profit	50,000

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(Continued)

B) Straight line depreciation over 5 years

	£
Sales revenue	640,000
Depreciation (500,000/5)	100,000
All other expenses	390,000
Total expenses	490,000
Net profit	150,000

NB: No physical change but profits tripled!!!

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Analyzing Cash Sources and Uses

Cash Flows of Competing Companies

all numbers in thousands	BMX	ATX	CAX
Cash provided (used) by operating activities	$ 90,000	$ 40,000	$ (24,000)
Cash provided (used) by investing activities:			
Proceeds from sale of operating assets			26,000
Purchase of operating assets	(48,000)	(25,000)	
Cash provided (used) by financing activities:			
Proceeds from issuance of debt			13,000
Repayment of debt	(27,000)		
Net increase (decrease) in cash	$ 15,000	$ 15,000	$ 15,000

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Module 3

An Introduction – Accounting
Balancing Account - Assets, Liability, Expenses, Profits

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Chapter Outline

- Transaction - impacts to Assets, Liability and Equity, and profitability
- Accounting / Operation - balance
- Relationship between Income statement and Balance sheet

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Accounting – Transactions

- Sources of transactions
- Recognize the transactions and post into the account

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Exercise : 20 mins

Company JJ – recognize the transactions and post onto :

-Balance Sheet

- Income statement

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May1, 20X4 – Wang families invested $8000 and register JJ Co as 800 common share @$10

JJ co
Balance Sheet
May 2, 20X4

Asset		Equity	
Cash	$ 8,000	Equity	$ 8,000
Total	$ 8,000	Total	$ 8,000

Asset = Liabilities + Equity
$8,000 = 0 + $8,000

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May 2, JJ purchased a cutting tool sets $2,500 cash .

JJ Co
Balance Sheet
May 2, 20X4

Asset		Equity	
Cash	$	Equity	$
Tools and Equip			
Total	$	Total	$

Asset = Liabilities + Equity

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May 8, JJ bought a lorry $15,000。JJ paid $2,000 cash, and a 30 day cheque $13,000

JJ Co
Balance Sheet
May 8, 20X4

Asset		Liabilities and Equity	
Cash	$	Liabilities	
Tools and Equipt		Acct Payable	$
Lorry		Total Equit	
		Equity	
Total	$	Total	$

Net Asset = Total Asset - Total Laibilities

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May 11, purchase Tools' components$300, on loan

JJ Co
Balance Sheet
May 11, 20X4

Asset		Liabilities and Equity	
Cash	$	Liabilities	
Tools/Equipt		Accout Payable	$
Lorry		AccountPayable1	
		Total Liabilities	$
		Total Equity	
		Equity	
Total	$	Total	$

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May 18, JJ sold $150 tools' components to ABC in 30 days credit。

JJ Co
Balance Sheet
May 18, 20X4

Asset		LBY + Equity	
Cash	$	Liabilities	$
Acct Receivable		Acct Payable	
Tools - Equipt		Acct Payable 1	
Lorry		**Total Liabilities**	$
		Total Equity	
		Equity	
Total	$	Total	$

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May 25, ABC paid JJ $75 for Tools' components

JJ Co
Balance Sheet
May 25, 20X4

Asset		LBY + Equity	
Cash	$	Liabilities	$
AR		Acct Payables	
Tools and Equipt		Acct Payables	
Lorry		**Total Liabilities**	$
		Total Equity	
		Equity	
Total	$	Total	$

1-93

90

May 28, JJ paid the Tools' component bill for $150。

JJ Co
Balance Sheet
May 28, 20X4

Asset		LBY + Equity	
Cash	$	Liabilities	
AR		Acct Payable	$
Tools and Equipt		Acct Payable 1	
Lorry		**Total Liabilities**	
		Total Equity	
		Equity	
Total	$	Total	$

1-94

91

May 29, JJ collect service revenue contract of $750 in cash.

JJ Co
Balance Sheet
May 29, 20X4

Asset		LBY + Equity	
Cash	$	Liabilities	
AR		Acct Payable	$
Tools and Equipt		Acct Payable 1	
Lorry		**Total Liabilities**	
		Total Equity	
		Equity	
		Retain Earning	
Total	$	Total	$

Asset = Liabilities + Equity + Earning

1-95

92

May 29, JJ in May

Revenue **$750**, paid in cash.

May 31, JJ purchase the fuel **$50** for cutting tool and lorry, paid in cash。

93

93

JJ's Consulting Company
Income Statement
20X4 May 31

Revenue	**$750**
Operating expenses -Fuel	**50**
Net Income	**$700**

94

94

Thanks

End

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Module 4

An Introduction
- Managerial Accounting Concepts and Principles

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1

Financial Accounting vs Managerial Accounting

Financial accounting provides general purpose financial information to those who are outside the organization.

Managerial accounting provides financial and non-financial information for managers of an organization and other decision makers

2

Nature of Financial and Managerial Accounting

	Financial Accounting	Managerial Accounting
1. Users and decision makers	Investors, creditors and other external users	Managers, employees and other internal users
2. Purpose of information	Making investment, credit and other decisions	Planning and control decisions
3. Flexibility of practice	Structured and often controlled by GAAP	Relatively flexible (no GAAP)
4. Timeliness of information	Often available only after audit is complete	Available quickly without need to wait for audit
5. Time dimension	Historical information with some predictions	Many projections and estimates
6. Focus of information	Emphasis on whole organization	Projects, processes and segments of an organization
7. Nature of information	Monetary information	Monetary and nonmonetary information

3

Types of Business

- 3 main categories of business:
  - Manufacturing,
  - Trading,
  - Service
  - How about pubs, restaurants, etc?
- Costs can be described as:
  - Manufacturing costs,
  - Trading costs,
  - Service costs

4

Manufacturing company

Manufacturing companies purchase materials and components and convert them into finished goods.

A manufacturing company must also develop, design, Market, and distribute its products.

5

Merchandising/Trading company

Merchandising /Trading companies purchase and then sell tangible products without changing their basic form.

6

Service-sector company

Service companies provide services or intangible products to their customers.

Labor is the most significant cost category.

7

Types of Inventory

Manufacturing-sector companies typically have one or more of the following three types of Inventories:

1. Direct materials inventory
2. Work in process inventory (work in progress)
3. Finished goods inventory

8

Types of Inventory

Merchandising-sector /trading-sector companies hold only one type of inventory – the product in its original purchased form.

Service-sector companies do not hold inventories of tangible products.

9

Classification of Manufacturing Costs

1.Direct materials costs

2.Direct manufacturing labor costs

3.Indirect manufacturing costs (Manufacturing factory)

10

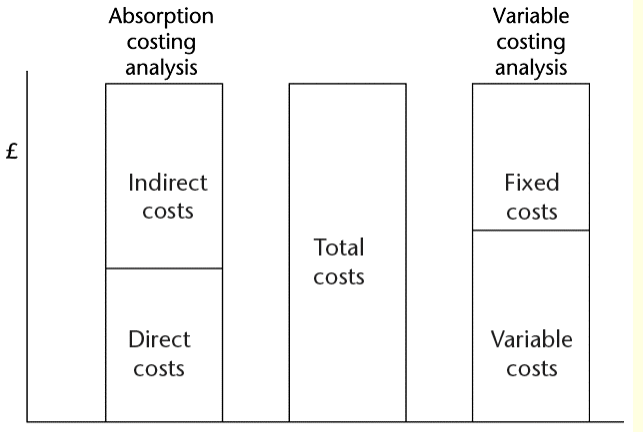
Concept of Cost

- Classification of cost
  - Closely related to product and process of production of goods and service
- Variable Cost, Fixed Cost, Combined cost (partly variable and some fixed cost)
- Eg. Product cost – all direct cost related to production of goods and services
  - Direct materials
  - Direct labour
  - Production cost
  - An other production related cost

1-6

11

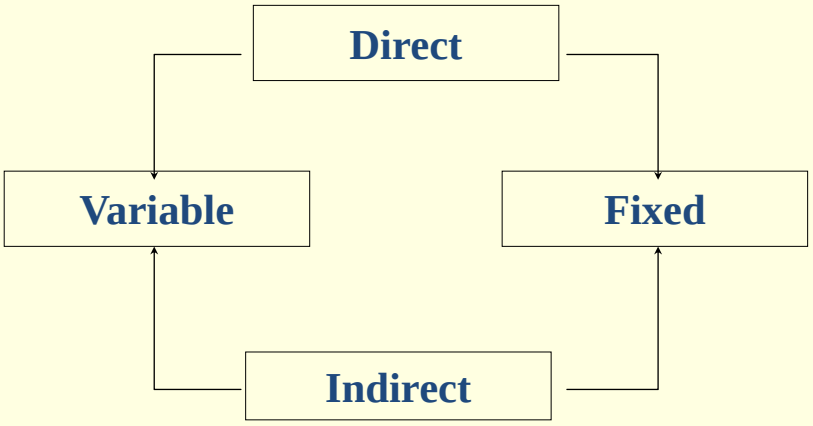
Comparison of Alternative Cost Analyses



N.B. Most direct costs are variable and most indirect costs are fixed, but there are exceptions, e.g. variable overheads.

12

Relationships of Types of Costs



13

Cost Behaviour: Variable Costing Analysis – Fixed and Variable Costs

- **Variable costs vary in direct proportion with activity**
(e.g. wood for furniture, fabric for garment)

- **Fixed costs remain constant over wide ranges of activity**
(e.g. rent and rates, depreciation, supervisor's salary)

14

Concept of Cost – Economical Value

- The nature of cost and business operation (volume) can be reflected as
- Relationship between Y (total cost) and fixed cost and the variable cost

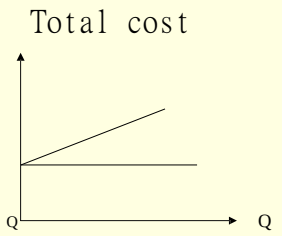
$$y = a + b\,x$$

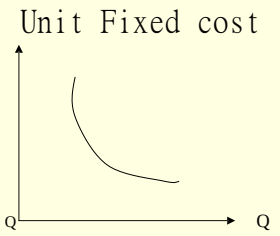
1-8

15

Concept of Cost – Economical Value

- Production cost can be separated into Fixed Cost and Variable Cost
- Fixed Cost
  - Total fixed cost: within a time limited, it will not increase
  - Unit fixed cost will decrease and Qty increases





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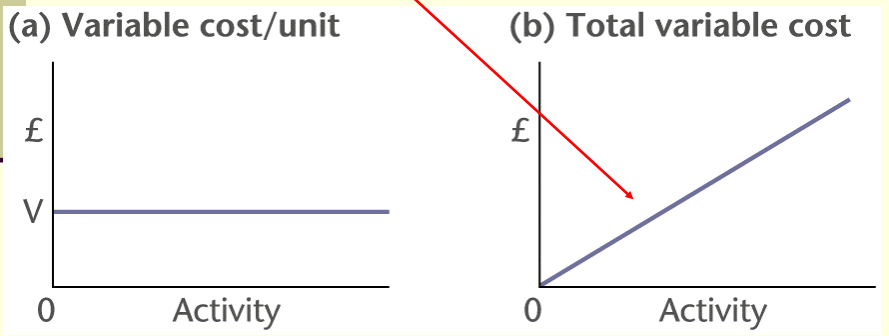
Variable and Fixed Costs

Cost behavior refers to how a cost will react to changes in the level of business activity.

- Total variable costs change in proportion to activity changes.



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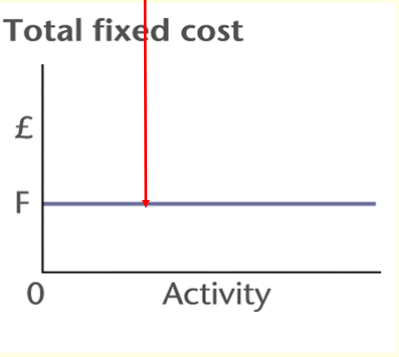
Variable and Fixed Costs

Cost behavior refers to how a cost will react to changes in the level of business activity.

- Total fixed costs do not change when activity changes.



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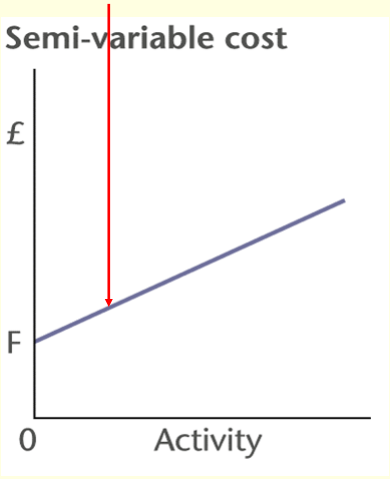
Variable and Fixed Costs

Cost behavior refers to how a cost will react to changes in the level of business activity.

- Mixed costs are combinations of fixed and variable costs.



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Analyze this cost into its fixed and variable elements:

Month	*Output(units)*	*Total cost($)*
Jan	120	6,237
Feb	134	6,269
Mar	140	6,280
Apr	126	6,256
May	110	6,220
Jun	119	6,234

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Answer: High–Low Method *question*

Highest output (March)	**140 units**	**$6,280**
Lowest output (May)	**110 units**	**$6,220**
Difference	**30 units**	**$ 60**

Variable cost per unit produced = $60/30 = $2

Variable cost of 140 units = 140 × $2 = $280

Fixed cost (at 140 units) = Total cost – Variable cost
= $6,280 – $280
= $6,000

*This can be checked by substituting these values in the other month:

In May,	$
Variable cost = 110 × $2	= 220
Fixed cost	= 6,000
Total cost	= 6,220

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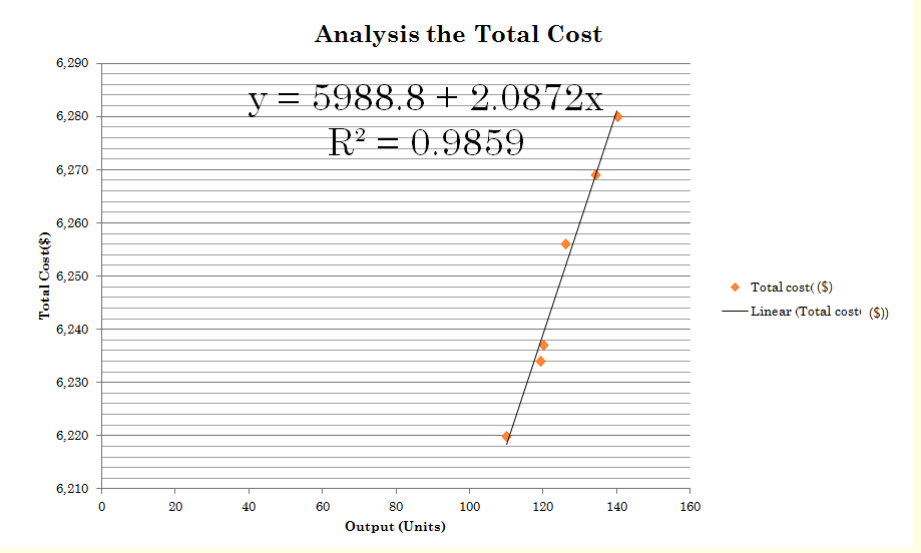
Regression Analysis



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Module 5

Cost-Volume-Profit and break-even analysis

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Key Concepts and Skills

- Understand about the relationship between cost, volume, and profit
- Understand the various forms of break-even analysis

1-1

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Chapter Outline

1 Relationship – Cost-Volume-Profit;

2 Break-even Analysis

1-2

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1 Relationship –

Cost-volume-Profit

1-3

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Cost Control– A key part of Management and control of Financial Resources

Profit = Sales – cost and expenses

- To increase profit and profitability %
- Increase sales Qty, Unit sales price
- Reduce cost and expenses

1-4

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"Cost-Volume-Profit" - CVP

- In a set condition, to understand the relationship between cost, volume and profit)
- Margin contribution increase, product sales profitability increase
- With limited resources, company should always drive and prioritize for highest margin contributed products first

1-11

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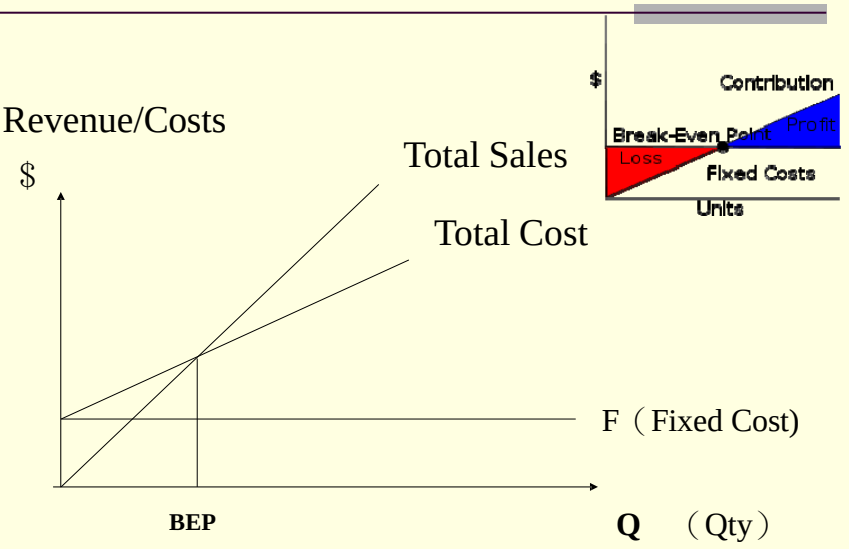
"Cost-Volume-Profit" - CVP



1-12

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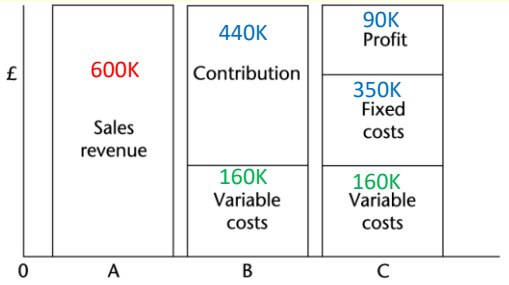
What is the difference between gross margin and contribution margin?

Net Sales	$600,000
Cost of Goods Sold	
variable costs	$120,000
fixed costs	$200,000
Gross Profit 毛利	$280,000
Operational Expenses:	
selling and administrative expenses 銷售及行政開支	
variable expenses	$40,000
fixed expenses	$150,000
Total Operational Expenses:	*$190,000*
Net Profit	*$90,000*

Net Sales	$600,000
Variable costs 可變成本	
Cost of Goods Sold	$120,000
Selling and Adm. Exp.	$40,000
Contribution Margin 貢獻	$440,000
Fixed costs 固定成本	
Cost of Goods Sold	$200,000
Selling and Adm. Exp.	$150,000
Total fixed Costs	$350,000
Net Profit	*$90,000*

30

Contribution Relationships



Columns A and B together illustrate the definition of contribution.

Contribution = Sales revenue – Variable cost

Columns B and C show the relationship between contribution, fixed costs and profit.

Total contribution = Total fixed costs + Profit

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"Cost-Volume-Profit" - CVP

- CVP analysis
  - Single product– Break-even point (BEP)
  - Total Contribution = Revenue – Variable Cost ----- (1)

    Total Contribution = Total Fixed Cost + Profit ----- (2)

If Profit = 0 和 (1) = (2); Revenue – Variable Cost = Total Fixed Cost

Qty $_{BEP}$ x Unit Price - Qty $_{BEP}$ x Unit variable cost = Total Fixed Cost

Qty $_{BEP}$ x(Unit Price – Unit variable cost) = Total Fixed Cost

Qty $_{BEP}$ = Total fixed cost / (Unit Price – Unit variable cost)

Qty $_{BEP}$ = Total fixed cost / Unit Contribution

1-13

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2 Single product - BEP

$$\text{Break-even point in units} = \frac{\text{Fixed costs}}{\text{unit Contribution}}$$

- BEP = Total fixed cost / (unit $ - unit variable cost)
- Eg. : IPAD (HK STORE)
  - Monthly total fixed cost : rental, salary + utilities/insurance = $5,000,000
  - IPAD : Unit sales price : $ 8,000
  - IPAD : Unit cost: $ 6,000
  - Each IPAD profit contribution : 8000-6000 = $2000
  - Monthly BEP Quantity :
    - 5,000,000 / (8000-6000)
    - 5,000,000 / 2,000
    - 2,500 unit IPAD

1-14

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Eg. Single product (BEP)

Causeway Bay – Hairy Crab specialty shop:
Monthly break-even Quantity (BEP Q)

Monthly fixed cost
- Monthly Rental:$720,000
- Monthly Employees salary with MPF: $110,000
- Monthly utility and insurance = $50,000

Crab (Large size) : Unit sales price :$ 150(each)
- Crab (Large) : Unit cost : $ 70(each)
- How many crab (L) need to sell to break-even ?

Fixed Cost=($720,000+$110,000+$50000)
BEP=$880,000/($150-70)per crab
= 11,000crab

1-15

34

Multiple products (BEP)

Causeway Bay – Hairy Crab specialty shop: Monthly break-even Quantity (BEP Q)

- Monthly fixed cost
  - Monthly Rental:$720,000
  - Monthly Employees salary with MPF: $110,000
  - Monthly utility and insurance = $50,000
- Crab (M) : Unit sales price :$ 50(each), cost $30
- Crab (S) : Unit sales price :$ 20(each), cost $10
- Assume 60% sales revenue from M, 40% from S
- How many crab (M) and Crab (S) need to sell to break- even ?

1-16

35

"Cost-Volume-Profit" Analysis Multiple products

- BEP Q
- = Total Fixed Cost / Combined Average marginal contribution
- Then, calculate the BEP Qty and BEP revenue, and profitability

1-17

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"Cost-Volume-Profit" Analysis Multiple products

- Combined Quantity approach
  - Work out the sales quantity proportion ratios
  - Establish unit price of each product,
  - Work out the unit variable cost and marginal unit contribution
  - BEP (combined):
    - Qty BEP (combined) = Fixed cost / (combined unit price – combined unit variable cost)
    - BEP (combined) in $ = Fixed cost / combined unit marginal contribution rate

1-18

37

Total fixed cost $880,000

	A (Med size crab)	B (Small size crab)
Total Sales Quantity available (given)	30,000	50,000
Unit price	$50	$20
Unit marginal contribution	$20=(50-30)	$10=(20-10)
Unit marginal contribution %	40% =$20/$50	50% =$10/$20

1-19

38

$$\text{Break-even point in dollars} = \frac{\text{Fixed costs}}{\text{Contribution margin ratio}}$$

- BEP＝Fixed cost /combined average marginal contribution rate
  - Product sales proportion：A=60%; B=40%
  - Combined average marginal contribution %
  - ＝40%*60%+50%*40%=44%
  - BEP=880,000/44%=2,000,000

1-20

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- BEPm=$2,000,000*60%=$1.2M
- BEPs=$2,000,000*40%=$0.8M

- Qa=1.2M/50=24,000 unit
- Qb=0.8M/20=40,000 unit

EBIT = $2,000,000x0.44=$880,000
just cover the fixed cost

1-21

40

- IF Target revenue : $3,000,000，
-

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Module 6

Financial Statements Analysis and Long-Term Planning

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Key Concepts and Skills

- Know how to standardize financial statements for comparison purposes
- Know how to compute and interpret important financial ratios
- Be able to develop a financial plan using the percentage of sales approach
- Understand how capital structure and dividend policies affect a firm's ability to grow

1-35

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Chapter Outline

1 Financial Statements Analysis

2 Ratio Analysis

3 The Du Pont Identity

4 Financial Models

5 Some Warnings Regarding Financial Planning Models

1-36

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1 Financial Statements Analysis

- Common-Size Balance Sheets
  - Compute all accounts as a percent of total assets
- Common-Size Income Statements
  - Compute all line items as a percent of sales
- Standardized statements make it easier to compare financial information, particularly as the company grows.
- They are also useful for comparing companies of different sizes, particularly within the same industry.

1-37

45

2 Ratio Analysis

- Ratios also allow for better comparison through time or between companies.
- As we look at each ratio, ask yourself:
  - How is the ratio computed?
  - What is the ratio trying to measure and why?
  - What is the unit of measurement?
  - What does the value indicate?
  - How can we improve the company's ratio?

1-38

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Categories of Financial Ratios

- Z-score – Predicting Bankruptcy
  - Insolvency for public list companies (manufacturers or non-manufacturer) (Bankruptcy ??)
- Short-term solvency or liquidity ratios
- Long-term solvency or financial leverage ratios
- Asset management or turnover ratios
- Profitability ratios
- Market value ratios

1-39

47

The Z-Score Model: Public-Manufacturers

- Credit scoring models provide a quick, objective way to evaluate creditworthiness.

Altman's Z-Score =

1.2*(NWC/Total Assets) + 1.4* (Accumulated RE / Total Assets) + 3.3*(EBIT/Total Assets) + .6*(MV Equity / BV Debt) + 0.999*(Sales/Total Assets)

- **Z-Score < 1.81 indicates high probability of bankruptcy**
- **Z-Score between 1.81 and 2.99 is a grey area**
- **Z-Score > 2.99 indicates a low probability of bankruptcy**

1-40

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Z-score Formula:

Z = l.2A + l.4B + 3.3C + 0.6D + 0.999E.

A = Working Capital/Total Assets
(Measures liquid assets in relation to the size of the company)

B = Retained Earnings/Total Assets
(Measures profitability that reflects the company's age and earning power)

C = Earnings Before Interest & Tax/Total Assets
(Measures operating efficiency apart from tax as being important to long-term viability)

D = Market Value of Equity/Total Liabilities
(Add market dimension that can show up market price fluctuation as possible a red flag.)

E = Sales/Total Assets. (Standard measure for total asset turnover)

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The Z-Score Model:
Private / Non-Manufacturers

Altman's Z-Score = 6.56*(NWC/Total Assets) + 3.26*(Accumulated RE / Total Assets) + 1.05* (EBIT/Total Assets) + 6.72* (BV Equity / Total Liabilities)

- Z-Score < 1.23 indicates high probability of bankruptcy
- Z-Score between 1.23 and 2.90 is a grey area
- Z-Score > 2.90 indicates a low probability of bankruptcy

1-41

50

Computing Liquidity Ratios

- Current Ratio = Current Assets / Current Liabilities
- = 4179.4 / 2003.565 = 2.09 times

  This ratio measures the short-term debt-paying ability of the company. A higher current ratio suggests a strong liquidity position.

- Quick Ratio = (Current Assets – Inventory) / Current Liabilities

  =(4179.4 – 143.9) / 2003.565= 2.01 times

This ratio is like the current ratio but excludes current assets such as inventories that may be difficult to quickly convert into cash.

- Cash Ratio = Cash / Current Liabilities

  = (2 8 6 0 . 2 + 7 8 1 . 5) / 2003.565 = 1.82 times

Cash ratio as payment liabilities of the foundation, but they are cash holdings by the management of the use of corporate assets effect a negative position, this ratio should not be too large, the relative Current ratio and quick ratio, this role is small. 1-42

51

Is an over-high current ratio (like 5:1) a good thing?

No, because this tells users that the business cannot use its **excess cash efficiently** to generate further income.

Excess cash means the amount of cash left over after settling all liabilities due within the next 12 months.

Businesses should **invest their excess cash** into investments, such as shares, term deposits, and etc to **earn interest**.

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Computing Leverage Ratios

- Total Debt Ratio = TD/TA = Total Liabilities/Total Assets
  =(2003.6 + 4117.8) / 8989.5=68% (smaller is better)
- =TD/(TD+TE) = (TA – TE) / TA

  Ratio of liabilities to assets that reflects the overall enterprise debt service capacity of important indicators, which liabilities and assets of the contrast, reflect the total assets of the business (how much is the debt?).
- Debt/Equity = TD / TE = Total Liabilities/Total equities
- =(2003.6 + 4117.8) / 2868.075 = 2.134
- Long Term Debt Ratio
- = Long Term Liabilities / Total equities
- =(1417 +1435.118+897.179) / 2868.075 = 131%
- Equity Multiplier (EM) = TA / TE = 1 + D/E
- =1+(2003.6 + 4117.8)/ 2868.075=3.134 =1+2.134

1-43

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Computing Coverage Ratios

- Times Interest Earned = EBIT / Interest
  - =1270.2 / 327 = 3.88 times

  It is a measure the ability of the corporate income to pay the interest expense.

- Cash Coverage
- = (EBIT + Depreciation + Amortization) / Interest
- = (1,270.22 + 113.812) / 327
- = 4.23 times

1-44

54

Computing Inventory Ratios

- Inventory Turnover = Cost of Goods Sold / Inventory = 865.721 / 143.9= 6.02 times

This ratio measures the number of times merchandise is sold and replaced during the year.

- Days' Sales in Inventory = 365 / Inventory Turnover
  - = 365 / 6.02 = 61 days

This ratio measures how many days, on average, it takes to sell the inventory.

1-45

55

Computing Receivables Ratios

- Receivables Turnover
- = Sales / Accounts Receivable
- = 2727 / 18.974 = 143.53 times

- **Average Collection Period**
- = 365 / Receivables Turnover
- = 365 / 143.53 = 2.54days=3 days

- **Normal average of around 45 – 75 days.**

This ratio measures, on average, how many days it takes to collect an account receivable.

1-46

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CREDITORS' RATIO/ PERIOD OF CREDIT RECEIVED FROM TRADE CREDITORS

Closing Trade Creditors x 365
Cost of Goods Sold

= 1144.77 x 365 /[7455.218 x (1 - 0.19) + 865.7] = 61 days

Where the period of credit is high compared with other businesses (or the average for the industry), and/or increasing over time, this indicates that the company is delaying paying its creditors.

It may adversely affect a company's credit rating, creditors may refuse to supply further goods on credit, and it could suggest financial weakness.

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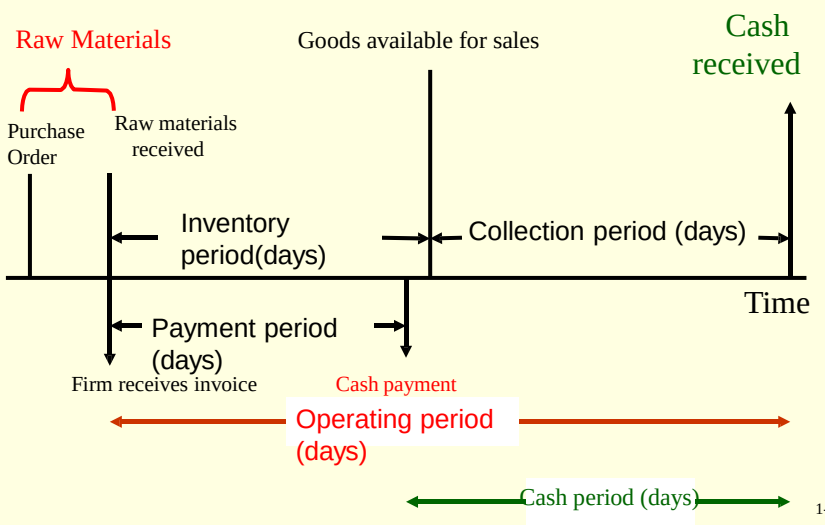
2Operating period and Cash period



1-61

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Operating period and Cash period

Operating period (days) = Inventory period (days) + Collection period (days)
= 61 days + 3 days = 64 days

Cash period (days) = Operating period (days) - Payment period (days)
= 64 – 61 days = 3 days

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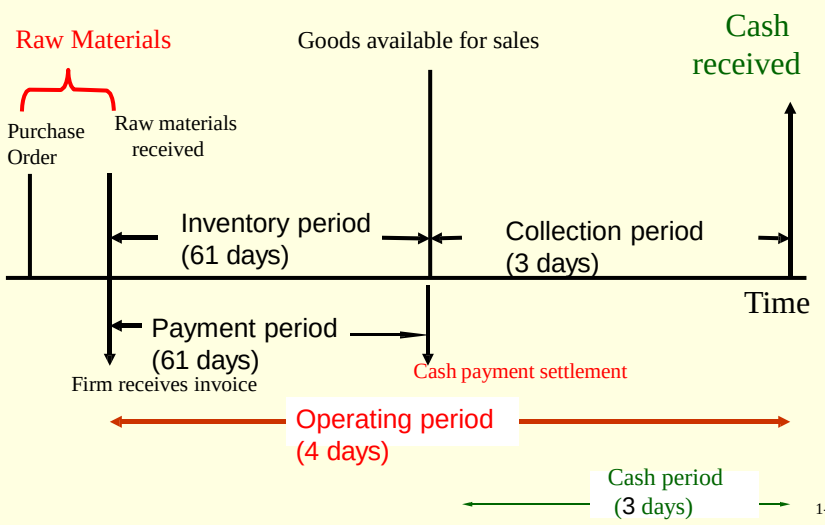
Operating period and Cash period



1-61

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Computing Total Asset Turnover

- Total Asset Turnover = Sales / Total Assets
  - = 2726.983 / 8989.465= 0.30 times
  - It is usual for TAT < 1, especially if a firm has a large amount of fixed assets.

1-47

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Computing Profitability Measures

Gross Profit Margin
= (Sales – Cost of Goods Sold) / Sales
= (2727-865.7) / 2727 = 68.3%

Net Profit Margin = Net Income after tax / Sales
= 727.801/ 2727 = 26.69%

- EBITDA Margin = EBITDA/Sales
- = (727.801 +326.966+215.451+ 113.812)/2727
- = 50.75 %

- Return on Assets (ROA after tax)
- = Net Income after Tax / Total Assets
- = 727.8 / 8989.5 = 8.1%

- Return on Equity (ROE after tax)
- = Net Income after Tax / Total Equity

= 727.8 / 2868.075 = 25.4%

It is used to measure per unit asset creation how much net profit.

The measure is corresponding to shareholders' equity investment in the company's index.

1-48

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Computing Market Value Measures

- Market Capitalization
- = $18.19/1.074 per share x 557219 000shares
- = 9.400 billion RMB

- PE Ratio = Price per share / Earnings per share
- = (18.19/1.074) / (727/557) = 16.94 / 1.31 = 13 times

Assessment Unit price level is reasonable Index.
(The bigger value = too expensive)

- Market-to-book ratio
  = market value per share / book value per share
- = (18.19 / 1.074)/(2868.1 /(557.219)) = 3.29 times

1-49

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Using Financial Statements

- Ratios are not very helpful by themselves: they need to be compared to something
- Time-Trend Analysis
  - Used to see how the firm's performance is changing through time
- Peer Group Analysis
  - Compare to similar companies or within industries

1-50

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Using Financial Statements

- Time-Trend Analysis(At least 3 years)
- Used to see how the firm's performance is changing through time
  - Compare the trend and changes (both in absolute and percentage)
  - Balance Sheet,
  - Income Statement
- Financial Ratios Trends – each of the factors/ratios should be analyzed and compared and identify the trend and the cause of the changes for better forecast the future and make proactive plan for improvement

1-51

65

Applicable – Balance sheet, Income statement, and ratios..

Firm, Peer

Firm, Peer

3 yr

	Amount	%	Amount	%
Current Asset				
Cash	$20,000	6.49	$35,000	15.48
AR	32,000	10.39	39,000	17.26
Inventory	72,000	23.38	50,000	22.12
Fixed Asset	200,000	64.94	100,000	44.25
: Depreciation	(24,000)	(7.79)	(10,000)	(4.42)
Other Asset	8,000	2.59	12,000	5.31
Total Asset	$308,000	100.00	$226,000	100.00
Current Liability	$11,600	3.77	$7,000	3.01
Acct Payable	58,400	18.96	42,000	18.58
Payables	80,000	25.97	-	-
Long term liability	$150,000	48.70	$49,000	21.59
Total liability	$132,000	42.86	$151,000	66.80
Equity	26,000	8.44	26,000	11.61
Retain earning	$158,000	51.30	$177,000	78.41
Total Equity	$308,000	100.00	$226,000	100.00
Liability + Equity				

1-52

66

Applicable – Balance sheet, Income statement, and ratios..

P/L
Or Ratios

Firm, Peer

3 Yrs

	Amount	%	Amount	%
Sales	$500,000	100.00	$550,000	100.00
COGS	(374,000)	(74.80)	(420,000)	(76.36)
Gross Profit	$126,000	25.2	$130,000	23.63
Operating Expense	(68,000)	(13.60)	(60,000)	(10.90)
Net Op Profit	$58,000	11.60	$70,000	12.72
Extraord. income	-	-	-	-
Extraord expense	(28,000)	(5.60)	(25,000)	(4.55)
EBT	$30,000	6.00	$45,000	8.2
Tax	(6,000)	(1.20)	(4,600)	(0.84)
EAT	$24,000	4.80	$40,400	7.35

1-53

67

Applicable – Balance sheet, Income statement, and ratios..

	2017 Amount	2017 %	2018 Amount	2018 %
Current Asset				
Cash	$20,000	6.49	$16,000	
AR	32,000	10.39	36,000	
Inventory	72,000	23.38	62,000	33.70
Fixed Asset	200,000	64.94	80,000	43.48
: Depreciation	(24,000)	(7.79)	(20,000)	(10.87)
Other Asset	8,000	2.59	10,000	5.42
Total Asset	$308,000	100.00	$184,000	100.00
Current Liability	$11,600	3.77	$4,000	2.17
Acct Payable	58,400	18.96	38,000	20.65
Payables	80,000	25.97	-	-
Long term liability	$150,000	48.70	$42,000	22.82
Total liability	$132,000	42.86	$120,000	65.22
Equity	26,000	8.44	22,000	11.96
Retain earning	$158,000	51.30	$142,000	77.18
Total Equity	$308,000	100.00	$184,000	100.00
Liability + Equity				

DROP
20%

1-54

68

Applicable – Balance sheet, Income statement, and ratios..

	2017		2018	
	Amount	%	Amount	%
Sales	$500,000	100.00	$470,000	100.00
COGS	(374,000)	(74.80)	(358,000)	(76.17)
Gross Profit	$126,000	25.2	$112,000	23.83
Operating Expense	(68,000)	(13.60)	(62,000)	(13.19)
Net Op Profit	$58,000	11.60	$50,000	10.64
Extraord. income	-	-	-	-
Extraord expense	(28,000)	(5.60)	(28,000)	(5.96)
EBT	$30,000	6.00	$22,000	4.68
Tax	(6,000)	(1.20)	4,600	(0.98)
EAT	$24,000	4.80	$17,400	

DROP 27.5%

1-55

69

Horizontal - Ratios

	2017		2018		Trend
	Amount	%	Amount	%	
Sales	$500,000	100.00	$550,000	100.00	1 0 %
COGS	(374,000)	(74.80)	(420,000)	(76.36)	1 2.3%
Gross Profit	$126,000	25.2	$130,000	23.63	
Operating Expense	(68,000)	(13.60)	(60,000)	(10.90)	
Net Op Profit	$58,000	11.60	$70,000	12.72	
Extraord. income	-	-	-	-	
Extraord expense	(28,000)	(5.60)	(25,000)	(4.55)	%
EBT	$30,000	6.00	$45,000	8.2	%
Tax	(6,000)	(1.20)	(4,600)	(0.84)	%
EAT	$24,000	4.80	$40,400	7.35	%

Sales Revenue increase by 10% (500 to 550),
but cost of sales increased 12.3% exceeded the sales growth (problems, reasons)
Gross profit (17-18) drops 1.6%, due to cost of sales grows 1.6%.
Net profit (17-18) – surprising increase 1.12% (good, why).
This Net Profit positive contribution can be identified as effective
due to tight cost control which drops 2.5% on operating cost

70

Using Financial Statements

- Peer Group Analysis (Total – min 3+1 = 4 companies)
- Compare to similar companies or within industries - SIC and NAICS codes (Peer Industry Average) – Alternative – you can use the larges 4 companies in your picked industry and project an industry average for comparison
- Mainly compare all the key financial ratios among the peer "selected" companies and compare their 3 years ratios, and the "selected" industry average
- Critically analysis the difference and trends, and then identify the cause of the changes, which can be macro or micro (internal) causes

1-57

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Using Financial Statements Peer Group - Comparison

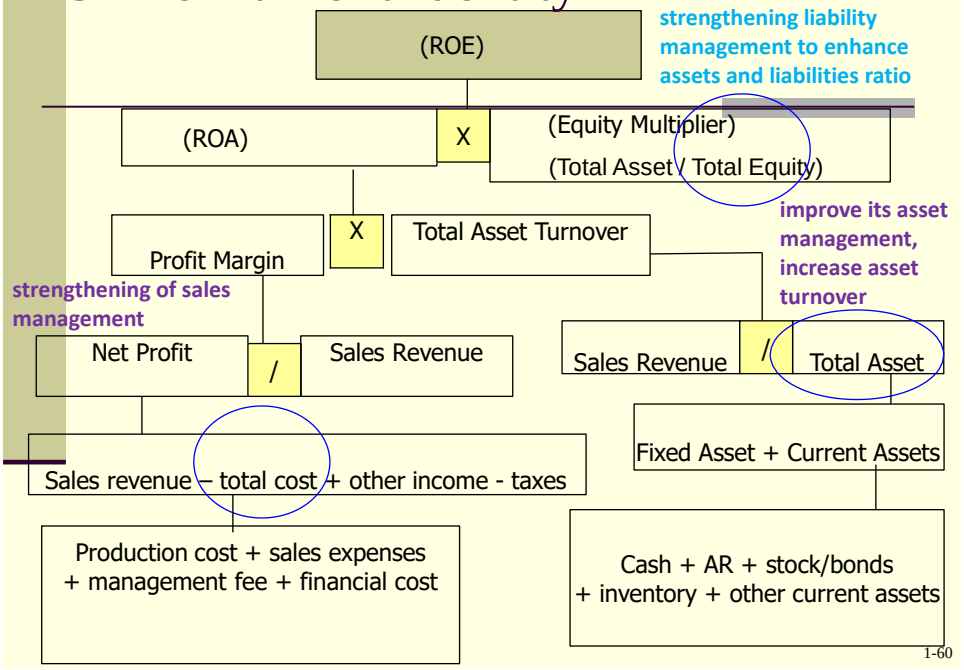
Quick Ratio (Times)	Co A	Co. B	Co. C	**Industry Average**
2018	1.4	2.2	3	**1.7**
2019	1.6	2	2	**1.8**
2020	1.7	1.4	1.1	**1.3**

Do this for each key financial ratios
Trends of Peers, comparing to CoA. Why ?

1-58

72

3 The Du Pont Identity



1-60

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3 The Du Pont Identity

- ROE = NI / TE
- Multiply by 1 and then rearrange:
  - ROE = (NI / TE) (TA / TA)
  - ROE = (NI / TA) (TA / TE) = ROA * EM
- Multiply by 1 again and then rearrange:
  - ROE = (NI / TA) (TA / TE) (Sales / Sales)
  - ROE = (NI / Sales) (Sales / TA) (TA / TE)
  - ROE = PM * TAT * EM

1-61

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Using the Du Pont Identity

- ROE = PM * TAT * EM
  - Profit margin (PM) is a measure of the firm's operating efficiency – how well it controls costs.
  - Total asset turnover (TAT) is a measure of the firm's asset use efficiency – how well it manages its assets.
  - Equity multiplier (EM) is a measure of the firm's financial leverage.

1-62

75

Calculating the Du Pont Identity

- ROA =727.8/8989.5 = 8.1% & EM = 3.13
  - ROE = 8.1% * 3.13 = 25.4%
- PM = 26.69% and TAT = 30.3
  - ROE = 26.69% * 30.3 * 3.13 = 25.4%

to measure of shareholders' equity investment returns indicators

ROE = 25.4

to measure how many assets per unit net profit

ROA after tax = 8.1 | X | EM =8989.5/2868.1=3.13

Profit Margin =727.8/2727=0.2669 | X | Total Asset Turnover = 30.3

The indicators reflect each of the dollar sales revenue brought the number of net profits.

1-63

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Potential Problems

- There is no underlying theory, so there is no way to know which ratios are most relevant.
- Benchmarking is difficult for diversified firms.
- Globalization and international competition makes comparison more difficult because of differences in accounting regulations.
- Firms use varying accounting procedures.
- Firms have different fiscal years.
- Extraordinary, or one-time, events

1-64

77

4 Financial Models

- Investment in new assets – determined by capital budgeting decisions
- Degree of financial leverage – determined by capital structure decisions
- Cash paid to shareholders – determined by dividend policy decisions
- Liquidity requirements – determined by net working capital decisions

1-65

78

The Sustainable Growth Rate

- The sustainable growth rate tells us how much the firm can grow by using internally generated funds and issuing debt to maintain a constant debt ratio.
- Using the Parkson Co.
  - Self-Sustainable Growth Rate
    = Retained Earning ÷ Equity
    = 2,731.1 ÷ 2,868.1
    = 95.2%

1-68

79

Determinants of Growth

- Profit margin – operating efficiency
- Total asset turnover – asset use efficiency
- Financial leverage – choice of optimal debt ratio
- Dividend policy – choice of how much to pay to shareholders versus reinvesting in the firm

1-69

80

5 Some Warnings

- Financial planning models do not indicate which financial polices are the best.
- Models are simplifications of reality, and the world can change in unexpected ways.
- Without some sort of plan, the firm may find itself adrift in a sea of change without a rudder for guidance.

1-70

81

Module 7

An Introduction

- Long term financing (stocks, bonds)

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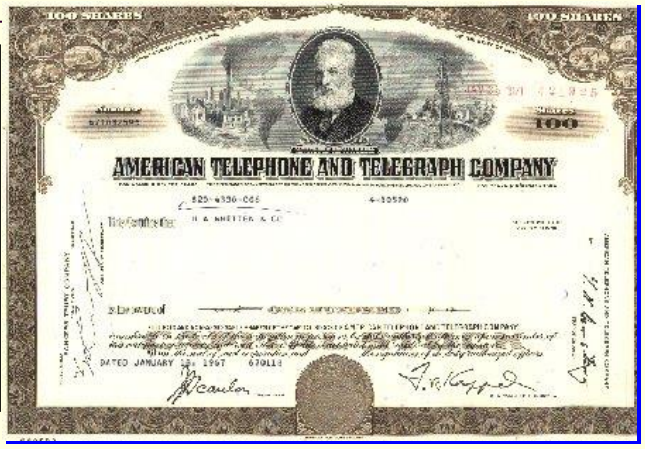
C 1

Stock Certificates and Transfer

Each unit of ownership is called a **share of stock**.

A stock certificate serves as proof that a stockholder has purchased shares.



When the stock is sold, the stockholder signs a **transfer endorsement** on the back of the stock certificate.

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Basics of Capital Stock

C 2

Total amount of stock that a corporation's charter authorizes it to sell.

Stockholders' Equity	
Common Stock, par value $0.01;	
authorized 250,000,000 shares;	
issued and outstanding 92,556,295 shares	$925,563

Total amount of stock that has been issued or sold to stockholders.

84

C 2

Basics of Capital Stock

Par value or Face value is an arbitrary amount assigned to each share of stock when it is authorized.

≠

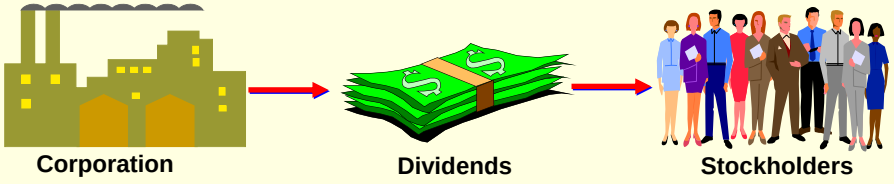
Market price is the amount that each share of stock will sell for in the market.

85

Cash Dividends

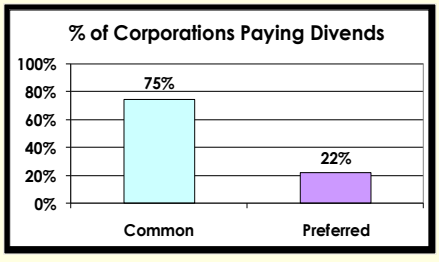
P 2

Regular cash dividends provide a return to investors and almost always affect the stock's market value.



To pay a cash dividend the corporation must have:

1. A sufficient balance in retained earnings and
2. The cash necessary to pay the dividend.



86

Accounting for Cash Dividends

P 2

Three important dates

Date of Declaration

Record liability for dividend.

Date of Record

No entry required.

Date of Payment

Record payment of cash to stockholders.

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Stock Dividends

A distribution of a corporation's own shares to its stockholders without receiving any payment in return.

Why a stock dividend?

- Can be used to keep the market price on the stock affordable.
- Can provide evidence of management's confidence that the company is doing well.

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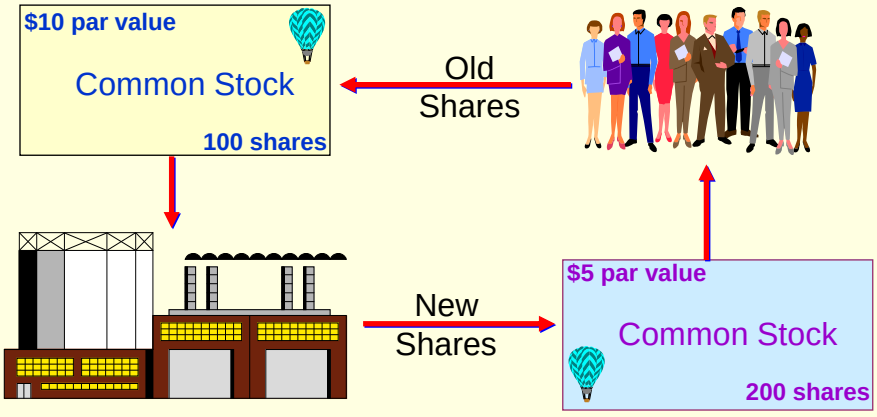
P 3

Stock Splits

A distribution of additional shares of stock to stockholders according to their percent ownership.



89

Stock Split

Assume a corporation has 5,000 shares of $1 par value common stock outstanding before a 2–for–1 stock split.

	Before Split	After Split	
Common Stock Shares	5,000	10,000	**Increase**
Par Value per Share	$ 1.00	$ 0.50	**Decrease**
Total Par Value	$ 5,000	$ 5,000	**No Change**

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Module 8

Discounted Cash Flow Valuation

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Key Concepts and Skills

- Be able to compute the future value and/or present value of a single cash flow or series of cash flows
- Be able to compute the return on an investment
- Be able to use a financial calculator and/or spreadsheet to solve time value problems

1-72

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Chapter Outline

1 Valuation: The One-Period Case
2 The Multiperiod Case
3 Compounding Periods
4 Simplifications
5 Loan Amortization
6 What Is a Firm Worth?

1-73

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1 The One-Period Case

- If you were to invest $10,000 at 5-percent interest for one year, your investment would grow to $10,500.

$500 would be interest ($10,000 × .05)
$10,000 is the principal repayment ($10,000 × 1)
$10,500 is the total due. It can be calculated as:

$$\$10{,}500 = \$10{,}000 \times (1.05)$$

- The total amount due at the end of the investment is call the *Future Value* (*FV*).

1-74

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Future Value

- In the one-period case, the formula for *FV* can be written as:

$$FV = C_0 \times (1 + r)$$

Where C_0 is cash flow today (time zero), and r is the appropriate interest rate.

1-75

95

Present Value

- If you were to be promised $10,000 due in one year when interest rates are 5-percent, your investment would be worth $9,523.81 in today's dollars.

$$\$9{,}523.81 = \frac{\$10{,}000}{1.05}$$

The amount that a borrower would need to set aside today to be able to meet the promised payment of $10,000 in one year is called the *Present Value* (*PV*).

Note that $10,000 = $9,523.81×(1.05).

1-76

96

Present Value

- In the one-period case, the formula for *PV* can be written as:

$$PV = \frac{C_1}{1+r}$$

Where C_1 is cash flow at date 1, and

r is the appropriate interest rate.

1-77

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Net Present Value

- The Net Present Value (*NPV*) of an investment is the present value of the expected cash flows, less the cost of the investment.
- Suppose an investment that promises to pay $10,000 in one year is offered for sale for $9,500. Your interest rate is 5%. Should you buy?

1-78

98

Net Present Value

$$NPV = -\$9{,}500 + \frac{\$10{,}000}{1.05}$$

$$NPV = -\$9{,}500 + \$9{,}523.81$$

$$NPV = \$23.81$$

The present value of the cash inflow is greater than the cost. In other words, the Net Present Value is positive, so the investment should be purchased.

1-79

99

Net Present Value

In the one-period case, the formula for *NPV* can be written as:

$$NPV = -Cost + PV$$

If we had *not* undertaken the positive *NPV* project considered on the last slide, and instead invested our $9,500 elsewhere at 5 percent, our *FV* would be less than the $10,000 the investment promised, and we would be worse off in *FV* terms :

$$\$9{,}500 \times (1.05) = \$9{,}975 < \$10{,}000$$

1-80

100

2 The Multiperiod Case

- The general formula for the future value of an investment over many periods can be written as:

$$FV = C_0 \times (1 + r)^T$$

Where

C_0 is cash flow at date 0,

r is the appropriate interest rate, and

T is the number of periods over which the cash is invested.

1-81

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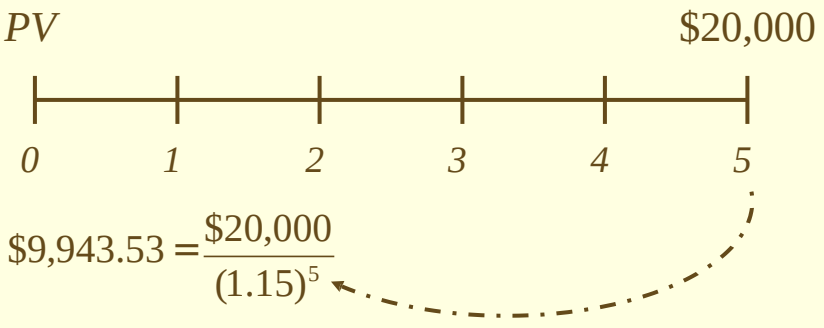
3. Present Value and Discounting (compounding)

- How much would an investor have to set aside today in order to have $20,000 five years from now if the current rate is 15%?



$$\$9{,}943.53 = \frac{\$20{,}000}{(1.15)^5}$$

1-85

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What Rate Is Enough?

Assume the total cost of a college education will be $50,000 when your child enters college in 12 years. You have $5,000 to invest today. What rate of interest must you earn on your investment to cover the cost of your child's education?

About 21.15%.

$$FV = C_0 \times (1+r)^T \qquad \$50{,}000 = \$5{,}000 \times (1+r)^{12}$$

$$(1+r)^{12} = \frac{\$50{,}000}{\$5{,}000} = 10 \qquad (1+r) = 10^{1/12}$$

$$r = 10^{1/12} - 1 = 1.2115 - 1 = 0.2115$$

1-87

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Multiple Cash Flows

- Consider an investment that pays $200 one year from now, with cash flows increasing by $200 per year through year 4. If the interest rate is 12%, what is the present value of this stream of cash flows?
- If the issuer offers this investment for $1,500, should you purchase it?

Calculation NPV (+ or -) ?

1-89

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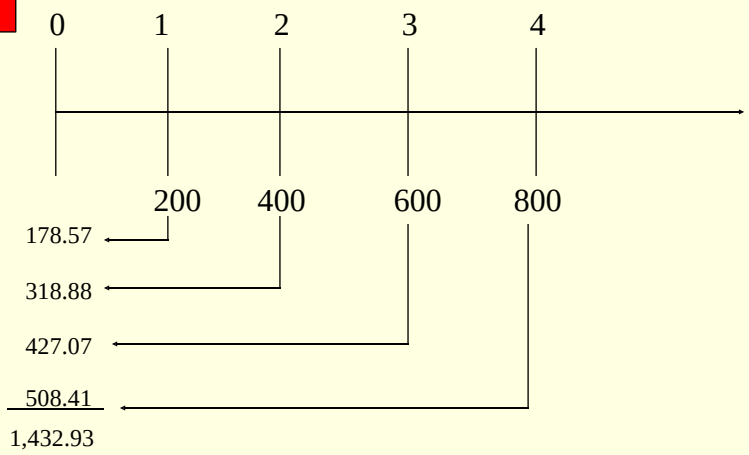
Multiple Cash Flows

Worth 1500 ?



Present Value < Cost → Do Not Purchase

1-90

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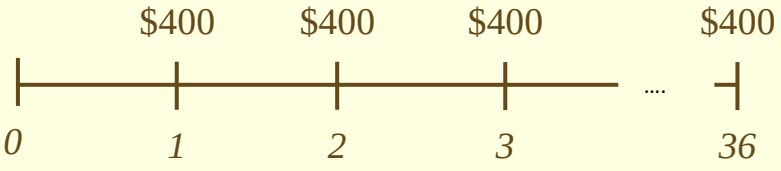
Annuity: Example

If you can afford a $400 monthly car payment, how much car can you afford if interest rates are 7% on 36-month loans?



$$PV = \frac{\$400}{.07/12}\left[1 - \frac{1}{(1+.07/12)^{36}}\right] = \$12{,}954.59$$

1-103

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Geometric Series

$T(1)+T(2) + T(3) +T(4) +\ldots+T(n)$

$$\boxed{S(n) = \frac{a(R^n - 1)}{R-1}} \quad (R > 1) \qquad or \qquad \boxed{S(n) = \frac{a(1-R^n)}{1-R}} \quad (R < 1)$$

a = 400/(1+0.07/12)
R=1/(1+0.07/12)
n=36

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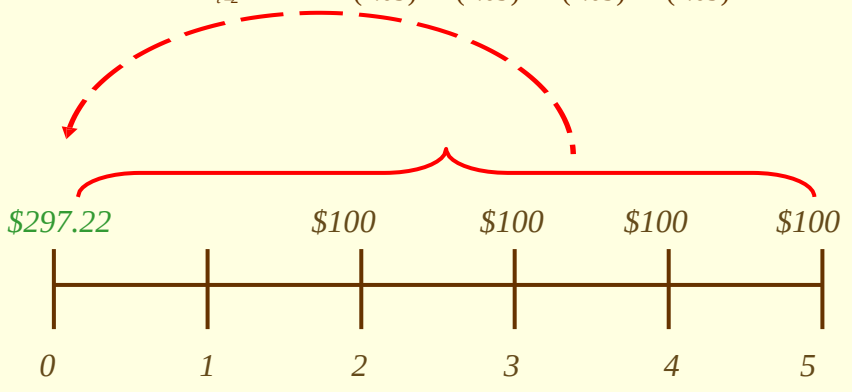
4 Simplifications

What is the present value of a four-year annuity of $100 per year that makes its first cash inflow two years from today if the discount rate is 9%?

$$PV_0 = \sum_{t=2}^{5} \frac{\$100}{(1.09)^t} = \frac{\$100}{(1.09)^2} + \frac{\$100}{(1.09)^3} + \frac{\$100}{(1.09)^4} + \frac{\$100}{(1.09)^5} = \$297.22$$



2-104

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5 Loan Amortization

- Amortized Loans require repayment of principal over time, in addition to required interest.

1-108

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Amortized Loan with Fixed Principal Payment

- Consider a $50,000, 10 year loan at 8% interest. The loan agreement requires the firm to pay $5,000 in principal each year plus interest for that year.
- Click on the Excel icon to see the amortization table

1-111

110

Year	Beginning Balance	Interest Payment	Principal Payment	Total Payment	Ending Balance
1	50,000	4,000	5,000	9,000	45,000
2	45,000	3,600	5,000	8,600	40,000
3	40,000	3,200	5,000	8,200	35,000
4	35,000	2,800	5,000	7,800	30,000
5	30,000	2,400	5,000	7,400	25,000
6	25,000	2,000	5,000	7,000	20,000
7	20,000	1,600	5,000	6,600	15,000
8	15,000	1,200	5,000	6,200	10,000
9	10,000	800	5,000	5,800	5,000
10	5,000	400	5,000	5,400	0

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Amortized Loan with Fixed Payment

- Each payment covers the interest expense plus reduces principal
- Consider a 4 year loan with annual payments. The interest rate is 8% ,and the principal amount is $5,000.
  - 4 Number of years
  - 8 % interest
  - 5,000 PV
  - PMT = -1,509.60
- Click on the Excel icon to see the amortization table

1-113

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Year	Beginning Balance	Total Payment	Interest Paid	Principal Paid	Ending Balance
1	5,000.00	1,509.60	400.00	1,109.60	3,890.40
2	3,890.40	1,509.60	311.23	1,198.37	2,692.03
3	2,692.03	1,509.60	215.36	1,294.24	1,397.79
4	1,397.79	1,509.60	111.82	1,397.78	0.01
Totals		6,038.40	1,038.41	4,999.99	

Note: The ending balance of .01 is due to rounding. The last payment would actually be 1,509.61.

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6 What Is a Firm Worth?

- Conceptually, a firm should be worth the present value of the firm's cash flows.
- The tricky part is determining the size, timing, and *risk* of those cash flows.

1-115

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Thanks

END

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Module 9

Net Present Value and Other Investment Rules

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1

Key Concepts and Skills

- Be able to compute payback and discounted payback and understand their shortcomings
- Be able to compute the internal rate of return and profitability index, understanding the strengths and weaknesses of both approaches
- Be able to compute net present value and understand why it is the best decision criterion

2

Chapter Outline

1 Why Use Net Present Value?
2 The Payback Period Method
3 The Internal Rate of Return (IRR)
4 Problems with the IRR Approach
5 The Profitability Index
6 The Practice of Capital Budgeting

1-118

3

Pizza Wagon

Introduction

- Olive is made redundant at the age of 57.
- She cannot draw her pension until she is 60.
- She decides to run her own business for 3 years.
- This will be a catering service.
- She intends to sell pizzas for £4 each.
- Ingredients will cost £1 each.
- She intends to buy a parcel van (£ 19,500) and convert it to a mobile kitchen and sales facility.
- It will be called 'The Pizza Wagon'.
- Her business plan income and expenditure are shown in the next slide.

6

4

Pizza Wagon (Continued)

	Year 1	*Year 2*	*Year 3*	*3-Year Period*
No. of pizzas sold	15,000	20,000	25,000	60,000
	£	£	£	£
Sales revenue	60,000	80,000	100,000	240,000
Cost of ingredients	15,000	20,000	25,000	60,000
Gross profit	45,000	60,000	75,000	180,000
Van depreciation	6,500	6,500	6,500	19,500 (straight-line)
Van running costs	9,000	9,000	9,000	27,000
Site fees	11,000	14,000	19,000	44,000
Advertising	5,000	4,000	4,000	13,000
Administration	3,500	3,500	3,500	10,500
Total overheads	35,000	37,000	42,000	114,000
Net profit	10,000	23,000	33,000	66,000

7

5

Details of Van Payment

- Olive has no business track record.
- She is unable to buy van on credit terms.
- She needs to use £19,500 cash to pay for the van at the start of year 1.

8

6

Owner's Point of View

- Olive is satisfied with budget projections.
- £10,000 is much less than her current income of about £15,000. But if she is careful, she believes she can survive her first year by living simply.
- Years 2 and 3 look considerably better compared to her current income.

However, Olive is shocked at end of year 1 that she is running short of working capital!!! Can you see why?

9

7

Conversion of Profit to Cash Flow

	Year 1	Year 2	Year 3	3-Year Period
	£	£	£	£
NET PROFIT	10,000	23,000	33,000	66,000
ADJUSTMENT*	–13,000	+6,500	+6,500	–
NET CASH FLOW	– 3,000	+29,500	+39,500	+66,000

*Calculation of adjustment

Depreciation	6,500	6,500	6,500	19,500
Less: van payment	19,500	–	–	19,500
	–13,000	+6,500	+6,500	–

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8

What is Capital Investment Appraisal (CIA)?

Capital Investment Appraisal is about deciding, which fixed assets to acquire or which long-term projects to invest in, e.g. factories, machinery, offices, etc.

Typically,

- large amounts of money are involved over long periods of time.
- the cost of reversing a CIA decision is very high.

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Capital Investment Appraisal (CIA)

ARR = Accounting Rate of Return

PBP = Payback Period

Profit-based

NPV = Net Present Value

IRR = Internal Rate of Return

Cash-flow based

10

Accounting Rate of Return

This method expresses the expected average annual profits as a percentage of the initial investment.

$$ARR = \frac{\text{average annual profit}}{\text{initial investment}} \times 100$$

Companies using ARR may have a predetermined threshold percentage below which projects will not be accepted.

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Accounting Rate of Return

- Depreciation may be calculated several ways.
- Income may vary from year to year.
- Time value of money is ignored.

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Accounting Rate of Return

Reconsider the $16,000 investment being considered by FasTek. The annual after-tax net income is $2,100. Compute the accounting rate of return.

$$\text{Accounting rate of return} = \frac{\$2{,}100}{\$16{,}000} = 13.13\%$$

Cash flow	$ 4,100
Depreciation	2,000
Income	$ 2,100

Depreciation = ($16,000 - 0) ÷ 8 years

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Limitations of ARR

- Profits are based on subjective opinions.
- Profits depend on depreciation method used.
- Profits can be manipulated by creative accounting.

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1 Why Use Net Present Value?

- Accepting positive NPV projects benefits shareholders.
  - •NPV uses cash flows
  - •NPV uses all the cash flows of the project
  - •NPV discounts the cash flows properly

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The Net Present Value (NPV) Rule

- Net Present Value (NPV) =
  Total PV of future CF's + Initial Investment
- Estimating NPV:
  1. Estimate future cash flows: how much? and when?
  2. Estimate discount rate
  3. Estimate initial costs
- Minimum Acceptance Criteria: Accept if NPV > 0
- Ranking Criteria: Choose the highest NPV

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Calculating NPV with Spreadsheets

- Spreadsheets are an excellent way to compute NPVs, especially when you have to compute the cash flows as well.
- Using the NPV function:
  - The first component is the required return entered as a decimal.
  - The second component is the range of cash flows *beginning with year 1.*
  - Add the initial investment after computing the NPV.

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Year	0	1	2	3
Cash Flows	-165000	63120	70800	91080
Required Return	0.12			
NPV - Incorrect	$11,274.48			
NPV - Correct	$12,627.41			

NPV (12%, Y1, Y2, Y3) + (165000)
= 12,627.41

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Net Present Value

❶ Discount the future net cash flows from the investment at the required rate of return.
❷ Subtract the initial amount invested from sum of the discounted cash flows.

FasTek is considering the purchase of a conveyor costing $16,000 with an 8-year useful life with zero salvage value that promises annual net cash flows of $4,100. FasTek requires a 12 percent compounded annual return on its investments.

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Net Present Value with Equal Cash Flows

Present value factors for 12 percent

Year	Annual Net Cash Flows	Present Value of $1 Factor	Present Value of Cash Flows
1	$ 4,100	0.8929	$ 3,661
2	4,100	0.7972	3,269
3	4,100	0.7118	2,918
4	4,100	0.6355	2,606
5	4,100	0.5674	2,326
6	4,100	0.5066	2,077
Total	$ 32,800		$ 20,367
Amount to be invested			(16,000)
Net present value of investment			$ 4,367

A positive net present value indicates that this project earns more than 12 percent on the investment.

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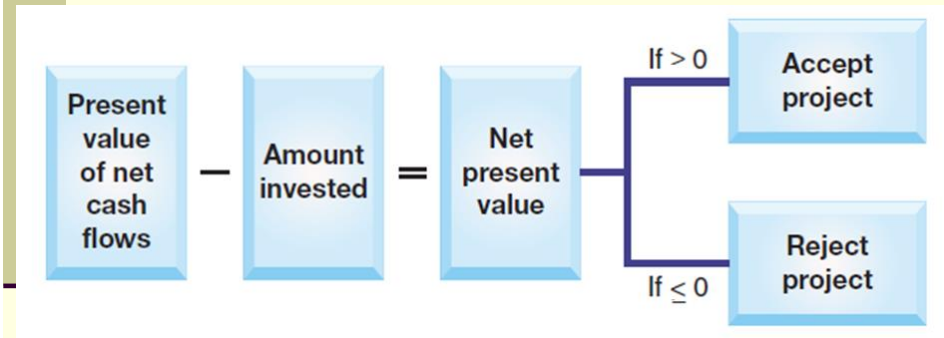
NPV rule:



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Net Present Value with Uneven Cash Flows

	Net Cash Flows			Present Value of 1 at 10%	Present Value of Net Cash Flows		
	A	B	C		A	B	C
Year 1	$ 5,000	$ 8,000	$ 1,000	0.9091	$ 4,546	$ 7,273	$ 909
Year 2	5,000	5,000	5,000	0.8264	4,132	4,132	4,132
Year 3	5,000	2,000	9,000	0.7513	3,757	1,503	6,762
Totals	$15,000	$15,000	$15,000		12,435	12,908	11,803
Amount invested					(12,000)	(12,000)	(12,000)
Net present value . . .					$ 435	$ 908	$ (197)

Although all projects require the same investment and have the same total net cash flows, project B has a higher net present value because of a larger net cash flow in year 1.

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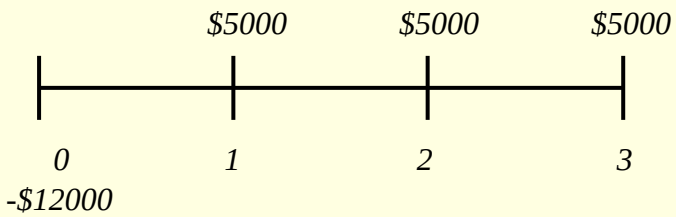
NPV: Example

Consider the following project:



The rate of NPV for this project is 10%

$$NPV = -12000 + \frac{\$5000}{(1+R)} + \frac{\$5000}{(1+R)^2} + \frac{\$5000}{(1+R)^3}$$

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2 Payback Period

The payback period of an investment is the time expected to recover the initial investment amount.

Managers prefer investing in projects with shorter payback periods.

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Payback period

- Disadvantages:
  - Ignore Time Value
  - Ignore later the cash inflow
  - bias the long-term project
- Advantages:
  - Easy to understand
  - Use cashflow instead

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Computing Payback Period with Even Cash Flows

FasTek is considering buying a new machine that will be used in its manufacturing operations. The machine costs $16,000 and is expected to produce annual net cash flows of $4,100. The machine is expected to have an 8-year useful life with no salvage value.

Calculate the payback period.

$$\text{Payback period} = \frac{\text{Cost of Investment}}{\text{Annual Net Cash Flow}}$$

$$\text{Payback period} = \frac{\$16{,}000}{\$4{,}100} = 3.9 \text{ years}$$

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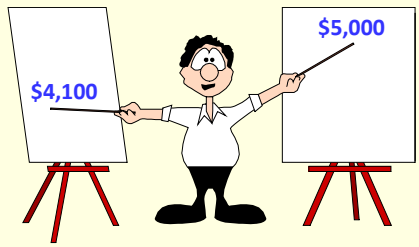
Computing Payback Period with Uneven Cash Flows

In the previous example, we assumed that the increase in cash flows would be the same each year. Now, let's look at an example where the cash flows vary each year.



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Computing Payback Period with Uneven Cash Flows

FasTek wants to install a machine that costs $16,000 and has an 8-year useful life with zero salvage value. Annual net cash flows are:

Payback is about 4.2 years.

Year	Annual Net Cash Flows	Cumulative Net Cash Flows
0	$ (16,000)	$ (16,000)
1	3,000	(13,000)
2	4,000	(9,000)
3	4,000	(5,000)
4.2 4	4,000	(1,000)
5	5,000	4,000
6	3,000	7,000
7	2,000	9,000
8	2,000	11,000

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Using the Payback Period

The payback period has two major shortcomings:

- It ignores the time value of money; and
- It ignores cash flows after the payback period.

Consider the following example where both projects cost $5,000 and have five-year useful lives:

Year	Project One Net Cash Inflows	Project Two Net Cash Inflows
1	$ 2,000	$ 1,000
2	2,000	1,000
3	2,000	1,000
4	2,000	1,000
5	2,000	1,000,000

Would you invest in Project One over Project Two just because it has a shorter payback period?

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3 The Internal Rate of Return

- IRR: the discount rate that sets NPV to zero
- Minimum Acceptance Criteria:
  - Accept if the IRR exceeds the required return
- Ranking Criteria:
  - Select alternative with the highest IRR
  - Reinvestment assumption:
  - All future cash flows are assumed to be reinvested at the IRR

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Internal Rate of Return (IRR)

The interest rate that makes . . .

❶ **Present value of cash inflows = Present value of cash outflows**

❷ The net present value equals zero.

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Internal Rate of Return (IRR)

- Disadvantage:
  - IRRs
  - Problems with mutually exclusive investments
- Advantage:
  - Easy to communicate

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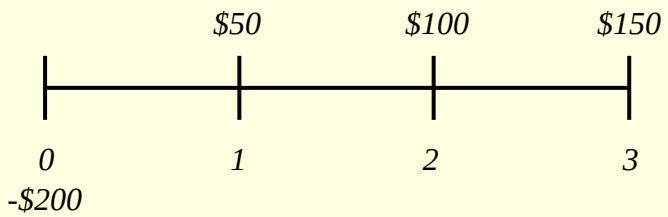
IRR: Example

Consider the following project:



The internal rate of return for this project is 19.44%

$$NPV = 0 = -200 + \frac{\$50}{(1+IRR)} + \frac{\$100}{(1+IRR)^2} + \frac{\$150}{(1+IRR)^3}$$

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4 The Profitability Index (PI)

$$\text{PI} = \frac{\text{Total PV of Future Cash Flows}}{\text{Initial Investment}}$$

- Minimum Acceptance Criteria:
  - Accept if PI > 1
- Ranking Criteria:
  - Select alternative with highest PI

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The Profitability Index

- Disadvantages:
  - Problems with mutually exclusive investments
- Advantages:
  - It can be useful if the investment limited capital
  - It is very easy to understand and communication

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5 The Practice of Capital Budgeting

- Varies by industry:

  Some firms use payback, others use accounting rate of return
  (ARR=Average Net Income after tax/Initial investment).

Common methods are IRR or NPV.

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Example of Investment Rules

Compute the IRR, NPV, PI, and payback period for the following two projects. Assume the required return is 10%.

	Net Cash Flows			Present Value of 1 at 10%	Present Value of Net Cash Flows		
	A	B	C		A	B	C
Year 1	$ 5,000	$ 8,000	$ 1,000	0.9091	$ 4,546	$ 7,273	$ 909
Year 2	5,000	5,000	5,000	0.8264	4,132	4,132	4,132
Year 3	5,000	2,000	9,000	0.7513	3,757	1,503	6,762
Totals	$15,000	$15,000	$15,000		12,435	12,908	11,803
Amount invested					(12,000)	(12,000)	(12,000)
Net present value					$ 435	$ 908	$ (197)

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Summary – Discounted Cash Flow

- NPV
  - Consider time value of money
  - Accept the project if the NPV is positive
- IRR
  - Discount rate that makes NPV = 0
  - Take the project if the IRR is greater than the required return
  - Same decision as NPV with conventional cash flows
  - IRR is unreliable with non-conventional cash flows非傳統現金流(-, +, +, +, -, + or alternatively +, -, -, +, -)
- PI
  - Benefit-cost ratio
  - Take investment if PI > 1
  - May be used to rank projects in the presence of capital rationing

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Summary – Payback Criteria

- Payback period
  - Length of time until initial investment is recovered
  - Take the project if it pays back in some specified period
  - Does not account for time value of money, and there is an arbitrary cutoff period

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Thanks

End

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《表格六》七匹狼服装公司财务比率公式及代码表

财务结构							
1	固定资产占长期资金比	Fixed Asset to LTL/Equity Ratio	= 固定资产 / 长期负债＋所有者权益	FA / LTL＋Equity	FA		
2	流动负债对资产净值比	Current Liabilities to Net Asset Ratio	= 流动负债 / 资产净值	CL / NA = (TA - CL - LTL)			
3	流动负债对存货比	Current Liabilities to Stock Ratio	= 流动负债 / 存货	CL / Stock			
偿债能力及变现能力		Short Term Solvency and Liquidity Measure					
	短债	Short term Solvency					
4	流动比率	Current Rato	= 流动资产 / 流动负债	CA / CL			
5	速动比率	Quick Ratio (Acid-test Ratio)	= 速动资产 / 流动负债	= CA - Stock / CL	流动资产－存货 / 流动负债		
6	存货信赖	Stock Credit Index	= 流动负债－速动资产 / 存货	CL-(CA-stock) / stock			
7	现金比率	Cash Ratio	= 现金 / 流动负债	Cash / CL			
	长债	Long Term Liquidity Measure					
8	资产负债比率	Total Debt Ratios	= 总负债 / 总资产	TL / TA			
9	产权比率	LT Debt / Equity Ratio	= 长期负债 / 所有者权益	LTL / Equity			
10	槓桿比率	Long Term Debt Ratio	= 长期负债 / 长期负债＋所有者权益	LTL / LTL + Equity			
11	有形资产负债率	Total Debt / Fixed Asset Ratio	= 总负债 / 有形资产	= TL / FA	总负债 / 固定资产		
12	利息保障倍数	Time Interest earned ratio	= 息税前收益 / 贷款利息	EBIT / I			
营运能力							
13	净值周转率	Net Asset Turnover	= 销售 / 净值	Sales / NA = (TA - CL - LTL)			
14	营运资金周转率	Working Capital Turnover	= 销售 / 营运资金	= Sales / WC	Sales / CA - CL		
15	存货周转率	Inventory Turn	= 銷貨成本 / 存货	COS / Stock	流动资产－流动负债		
16	存货周转日	Day's Sales in Inventory	= 365 / 存货周转率	365 / Inventory Turn			
17	应收帐周转率	Receivables Turnover	= 销售 / 应收帐	Sales / AR			
18	应收帐周转日	DSO - Days Sales Receivable (outstanding)	= 365 / 应收帐周转率	365 / Receivable Turnover			
19	应付帐周转率	Payable Turnover	= 销售成本 / AP	COS / AP			
20	应付帐周转日	Days of Payables Outstanding	= 365 / 应付帐周转率	365 / Payable Turnover			
21	固定资产周转率	Fixed Asset Turnover	= 销售 / 固定资产	Sales / FZ			
22	流动资产周转率	Current Asset Turnover	= 销售 / 流动资产	Sales / CA			
23	总资产周转率	Total Asset Turnover	= 销售 / 总资产	Sales / TA			
24	存货对营运资金比	Stock to WC Ratio	= 存货 / 营运资金	= Stock / WC	Stock / CA - CL		

代码	名称
AR	应收帐
CA	流动资产
CE	占用资本
Cash	现金
CL	流动负债
COS	销售成本
EAT	税后收益
EBT	税前收益
EBIT	息税前收益
Equity	所有者权益
FA	固定资产
GP	毛利
I	贷款利息
IC	投入资本
LTL	长期负债
NA	资产净值
NP	净利
ROA	资产滙报率
ROBA	经营资产息税前回报率
ROCE	占用资本回报率
ROE	权益回报率
ROI	投资回报率
ROIC	投入资本回报率
RONA	资产净值回报率
ROTA	总资产回报率
STL	短期负债
Sales	销售
Stock	存货
TA	总资产
TL	总负债
WC	营运资金
WCR	营运资金需求

Remark for 3: Indicates reliance on the available inventory for payment of short-term debt.

《表格六》七匹狼服装公司财务比率公式及代码表（续前）

获利能力

25 毛利率	Gross Profit Margin	$= \frac{毛利}{销售}$	$= \frac{GP}{Sales}$	$\frac{销售－销售成本}{销售}$	
26 净利率	Net Profit Margin (ROS)	$= \frac{净利}{销售}$	$\frac{NP}{Sales}$	销售回报率(return on Sales, ROS)	
27 淨值收益率	RONA	$= \frac{淨利}{資產淨值\ (NA)}$	$= \frac{NP}{TA - CL - LTL}$	$\frac{淨利}{总资产－流动负债－长期负债}$	
28 营运资金收益率	ROWC	$= \frac{净利}{营运资金}$	$= \frac{NP}{WC}$	$\frac{淨利}{流动资产－流动负债}$	
29 总资产收益率（税后）	ROA	$= \frac{净利}{总资产}$	$= \frac{NP}{TA}$	资产回报率（Return on Asset，ROA）＝Return on Investment， ROI）	
又称为“杜邦等式（Dupont Formula）”			=	销售利润率 x 总资产周转率	
			=	$\frac{EAT}{SALES} \times \frac{SALES}{TA}$	
30 总资产回报率（息税前）	ROTA	$= \frac{EBIT}{TA}$	=	Return on Total Assets，ROTA	
31 经营资产息税前回报率	ROBA	$= \frac{EBIT－利息收入}{投入资本－现金}$	$= \frac{EBIT - Interest\ gain/loss}{Invested\ Capital - Cash}$	Return on Business Assets，ROBA	
32 投入资本回报率	ROIC	$= \frac{EBIT}{投入资本}$	$= \frac{EBIT}{Invested\ Capital}$	Return on Invested Capital，ROIC	
			=	营业利润率X资本周转率（Capital Turnover） 或资产净值周转率（Net Asset Turnover）	
			=	$\frac{EBIT}{SALES} \times \frac{SALES}{IC}$	
（若投入资本＝资产净值＝占用资本或资本运用）			=	资产净回报率（Return on Net Asset， RONA）	
			=	占用资本回报率（Return on Capital Employed,ROCE）	
33 权益回报率（税后）	ROE (After Tax)	$= \frac{EAT}{所有者权益}$	$\frac{EAT}{Equity}$	Return on Equity，ROE（After Tax）	
		[杜邦比率(Dupont Ratio)]	=	$\frac{EAT}{SALES} \times \frac{SALES}{TA} \times \frac{TA}{Equity}$	
			=	$\underbrace{销售利润率 \times 总资产周转率}_{ROA \times 权益乘数 =} \times 权益$	
			=	ROA x 权益乘数 ＝ ROA x 1/（1－资产负债比率）	
			=	$\frac{EBIT}{SALES} \times \frac{SALES}{IC} \times \frac{EBT}{EBIT} \times \frac{IC}{Equity} \times \frac{EAT}{EBT}$	
			=	$\underbrace{\underbrace{营业利润率 \times 资本周转率}_{ROIC} \times \underbrace{借贷成本比率 \times 财务结构比率}_{财务杠杆乘数} \times 税收效应}_{税前营业获利能力、方针\ (Financial\ Leverage\ Multiplier)} = (1-税率)$	
				权益回报率（税前）ROE（Before Tax）	

增长能力

34 留存收益率	Retain Earning Ratio	$= \frac{留存收益}{EAT}$	$\frac{Retain\ Earning}{EAT}$		
35 自我维持增长率	Self-Sustainable Growth Rate	$= \frac{留存收益}{所有者收益}$	$= \frac{Earning\ Earning}{Equity}$	Self-sustainable Growth Rate, SGR=衡量公司增長力的指標(不靠向外借款)	
			=	$\frac{EAT}{所有者权益} \times \frac{留存收益}{EAT} = ROE = 留存收益率$	
			=	$\underbrace{营业利润率 \times 资本周转率}_{反映公司营业方针} \times \underbrace{财务杠杆乘数 \times 留存收益率}_{反映公司筹资政策 = (1- 税率)} \times 税收效应$	
市值和股份回报 36 每股盈余	Market Value / Earning Measure EPS	$\frac{净利}{发行股份数量}$	$\frac{NP}{Total\ issued\ common\ shares}$		
37 市价－盈余比率	PE Ratio	$\frac{每股价}{每股盈余}$	$\frac{Share\ Price}{EPS}$		

Executive Summary

The study will be Hong Kong listed company Parkson Retail Group Limited (3368) Financial Resources Management. This will be divided into six parts, 1) introduced the basic situation public Division such as business scope, corporate structure and market environment; 2) by the calculation Financial Ratios to analyze the firm's operating table , and the main competitors and a comparison 3) on which the Company internal controls and risk management; 4) assessment program this year the newly-opened the benefits Jinan shops and whether it is worthwhile investment, 5) List of funds collected and analyzed the pros and cons methods; 6) to provide operational efficiency audit programs to enable companies operating efficiency achieve the desired goal.

The first chapter is on Parkson Retail Group Limited 's background and its business conditions, and introduce 3 types of companies with Golden Eagle Retail Group Limited (3308), the Intime Retail (Group) Company Limited (1833) and Springland International Holdings Limited (1700) as the comparison and analysis counterparts.

Chapter 2 through the various financial ratio, from different dimension analysis Parkson Retail Group Limited while in the financial structure and debt-servicing capacity through performed better than the other listed companies and insolvency index tests, but its operating capacity, profitability and growth capacity has been a recession behind counterparts and water. Although the investors' point of view its shares still able to give dividend rate of return stability, but Parkson Retail Group Limited necessary improvement programs to keep its operations.

Chapter 3 mentioned Parkson Retail Group Limited 's corporate governance issues: the study shows that they must be at its core team, internal control, trading position transparency and credit risk management in for a change, to the multi overall operating performance and improve the operational capability and competitiveness.

Chapter 4 is assessed this year Jinan shop item the effectiveness and investment value. Calculated through cash flow, net present value, return more than the rate of investment returns and found that new projects on Parkson Retail Group Limited 's business and financial position better financial benefits, it is proposed public Division project development and utilize its internal resources to pay for their liquidity needs.

The chapter 5 is to study to the Jinan shop has invested funds the feasibility financing analysis and to make the enterprises financial situation of the best recommendation. Analyzed by 5 different Financing Program, the reports recommendations Parkson Retail Group Limited adopt the bank 5-year loan program for Jinan shop the RMB378 million for funding.

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Chapter 6 of Parkson Retail Group Limited for this year's operational efficiency audit planning, the proposed management needed in the concession counters sales ratio, other operating costs with revenue turnover ratio and operational cost-effectiveness that three areas are going to be audited.

In the final conclusion, we recommend that Parkson Retail Group Limited should grasp the financial structure still be preferable to peer level of lease machine, take decision action from the reform its corporate governance, and enhance its operational efficiency the corporate profitability and growth rates to go back on track, and try to eliminate the risk to face the crisis.

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1. Introduction

1.1 Company Background

Parkson Retail Group Limited ("Parkson") is The Lion Group, Malaysia in China's retail business department, The Lion Group's actual control are well-known local Chinese entrepreneurs Cheng Heng Jem. Parkson in 1994, China's retail market presence market, the Beijing opened the first homestores, was the first running a fashion in China which is department store chain enterprises in China, and now has become China's largest, still Department store, with covering China 30 major cities of the most extensive distribution network (E-Finet, 2008).

In November 2005, the Lion group to mainland China's Parkson distribution in Hong Kong Stock Exchange Listing Success (Stock code: 3368). Parkson first IPO through issuing 165.6 million shares, which 110.4 million shares of the new shares, 90 percent to the Placing, the remaining 10 percent in Hong Kong Public Offer. For each share 9.8 Hong Kong Dollar Listed Price guidelines points, the highest fund-raising 1,623million Hong Kong Dollar. Retail investors partly offer of the 44.7 times over-subscribed, the International Offering Shares as over-subscribed. Issued after the deduction and related costs, Parkson finally proceeded fund-raising net of 1,034 million Hong Kong Dollar. Their mainland retail business the total market value of 54,100 million Hong Kong dollar (the initial 55,200 million shares). IPO completed, Parkson's direct major shareholders holding shares PRG 70 per cent, public shareholding 30 per cent (QQ Finance, 2005).

Upto Year 2011 as 16 May, Parkson's stock price at 11.78 Hong Kong dollar, authorised share capital of 7,500 million, issued share capital of 2,810,490,250 shares. The market value of approximately 33,100 million Hong Kong dollar (Yahoo Hong Kong financial network, 2011). The growth of market value in Year 2011 compare to Year 2005 is five times.

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1.2 Operating Business Overview (products and services and the sales market)

Parkson's business model is divided into two, the first is chartered counters mode, the company of specific retail area counters for licensing operating (mainly the brand clothing), the licensing franchise operations need to be the sales percentage (known as point deduction rate) to give department Stores, as commission, and the need to pay for the salary of sales. The second model is the direct sales, department stores procurement of goods in department store sales to consumers, such goods to Home Supplies and fresh foods. Finally, the company is also let some retail area to third parties are operating, but this part of the proportion are rarely, rental income accounted for only 2010 turnover of the 4.4 percent (Parkson, 2011).

Parkson currently in China 30 major urban management 47 branches, of which 40 are self-shop, and the remaining 7 home is a management shops, (The company is not real ownership of the substore and receive only an annual management fees) (see Appendix 1). Self-store retail sale area of 1,250,000 square meters, together with the remaining management store retail sale area 219,000 square meters, total retail area of about 1,470,000 square meters (see Table 2) (Parkson, 2011).

The company to take each department store of standards readjust commodity distribution traveling, brand portfolio and business space to better for the operation in the cities in high-end goal consumer services. Parkson provides a series of international brands fashion and lifestyle commodities, such goods can be divided into four categories, namely "fashion apparel and clothing" and "cosmetics and accessories" and "home supplies and electrical" and "food and fresh". The special for a youth and trendy fashion of communities (Parkson, 2011).

1.3 Today's Business Environment

Chinese retail are in high-speed growth, because income per capita enhances consumption rose to power, economic development from export to domestic demand. Chinese society 2010 total retail sales last year RMB 1.55 billion compare to last year the growth rate at 18.4 percent and higher than 10.3 percent of the economic growth in consumer goods in the type, especially in the luxury products fastest-growing, such as the gold and silver jewelry growth 46 percent, furniture growth 37.2 percent, electrical growth 27.7 percent. Parkson sales of major sales of four major types of goods precisely comply with the trend (China Statistical Information Network, 2011).

China Retail is a high dispersion and market competition, and engaged in the retail operations which can be divided into department store, supermarket chain group and clothing brands specialized stores, home appliances store, health care stores and general small shop 6 major categories. Parkson 2010 retail sales in RMB13,300 million for only national retail 0.09 percent of the market share. And in 2010, China Chain 100 strong" a survey in which Parkson total ranked 28; and in major chain in department stores operations ranked 8 (see Table 3) (eFuture, 2011).

1.4 Company Structure

Parkson offering document (2005) disclosed corporate structure apart from the Board, and management, and the main 8 divisions composition : procurement, design/Engineering, advertising and promotion, operation, management and administration, information technology, human resources, accounting and finance. In 2005 company employees of the 5,161; the 2010 increase at the end to 6,705.

1.5 Research comparison company information

This study is used of three comparison of Golden Eagle Retail Group Limited (3308), the Intime Retail (Group) Company Limited (1833) and Springland International Holdings Limited (1700). The above 3 businesses have the same nature of business with Parkson, and the size of the enterprise and market share are very close to each other (see to the following table). Therefore, we can from the above 4 companies the financial management of the equally comparative analysis.

Company Name	Parkson	Golden Eagle	Intime	Springland
(Stock number)	(3368)	(3308)	(1833)	(1700)
Business Nature	Department Store,Shopping Mall and Supermarket			
Market value*1 (HKD)	33,720 million	39,480 million	23,900 miilion	17,380 million
PE*1	28.83	34.86	27.23	33.24
Market area	In China 30 major cities	Jiangsu, Anhui, Shaanxi	Zhejiang, Shaanxi, Hubei 3 province and Beijing	Yangtze River Delta
Number of Stores*2	40	19	30	30

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Note1: Stock market colsing date on 18 May 2011 (Source: Yahoo)

Note2: Enterprise 2010's annual report for the self-shop in terms of the number (Source: the enterprise 2010 Annual Report)

2. Parkson's financial analysis

In this we through Parkson's financial reports analysis, of its financial structure, the repayment and realized capacity, operating capacity, profitable capacity, growth capacity and market value and shares returns for six areas with industrial average and three Industry Companies for comparison studies; on data as a result of the findings and risk assessment, and references for the financial statements (Table 4 - Balance Sheet/ Income Statement and Schedule 5-financial ratio analysis table) (Anthony, 2010).

2.1 Listed companies of bankruptcy index Z-Score analysis

Z-Score mainly used to examin bankruptcy rate, when Z-Score greater value, insolvency of the less likely, Financial Ratios more sound. The Altman (1968), the when Z < 1.8 , are located in bankruptcy; when 1.8≤ Z <2.99, are located in gray area; when Z≧2.99 is located at the Security Zone. Four companies the Z-Score values are as follows:

(Company Name)	Parkson				Golden Eagle	Intime	Springland
(RMB in million)(Yr)	2007	2008	2009	2010	2010		
NET CURRENT ASSETS	2,175.9	1,874.0	480.9	1,281.6	-1,009.1	-474.9	21.8
Total Assets	8,989.5	9,834.1	11,074.1	12,591.3	7,979.3	12,289.5	6,710.9
Retained earnings	2,731.1	3,388.5	3,581.1	4,172.9	3,482.7	5,310.5	3,764.6
EBIT	1,270.2	1,457.9	1,541.8	1,682.2	1,633.9	1,150.9	663.9
Stock value(HKD)*1	18.79	8.58	13.52	11.96	19.1	11.48	6.25
RMB/HKD ex rate*1	1.074	1.128	1.139	1.182	1.182		
Number of Stock (Million shares)	557.2	2,797	2,807	2,810	1,945	1,913	2,500
Total Liabilities	6,121.4	6,306.8	7,082.0	8,002.2	4,299.1	6,978.8	2,924.7
Sales	2,727.0	3,137.4	3,461.3	3,819.4	2,450.4	2,288.8	2,990.0

Note 1 : Dec 31 closing value by dividend and stock split adjustment

Zscore：$Z=1.2A+1.4B+3.3C+0.6D+0.999E$；

A = Working Capital/Total Assets ; B = Retained Earnings/Total Assets ; C = EBIT / Total Assets ;
D = [(Stock value x Total number of stocks)/RMB&HKD ex rate]/Total Liabilities; E = Sales/Total Assets

(Company Name)	Parkson				Golden Eagle	Intime	Springland
(RMB in million)(Yr)	2007	2008	2009	2010	2010		
A	0.24	0.19	0.04	0.10	(0.13)	(0.04)	0.00
B	0.30	0.34	0.32	0.33	0.44	0.43	0.56
C	0.14	0.15	0.14	0.13	0.20	0.09	0.10
D	7.71	3.39	4.71	3.55	7.31	2.66	4.52
E	0.30	0.32	0.31	0.30	0.31	0.19	0.45
Z Score	2.44	**3.55**	**4.10**	**3.46**	**5.83**	**2.65**	**4.27**

Listed companies insolvency index analysis: Parkson 4 years of Z-Score are safe-area and to demonstrate its financially sound.

2.2 Financial structure

(Company Nmae)	Parkson				Parkson	GE	Intime	SL	4 companies
(Year)	2007	2008	2009	2010	2007-2010 (4 years average)				
Fixed Asset to Long term Liability Ratio	0.12	0.21	0.37	0.40	0.28	1.08	0.46	1.67	0.87
Current Liabilities to Net Asset Ratio	0.70	0.68	1.00	1.30	0.92	1.33	0.72	2.06	1.26
Current Liabilities to Stock Ratio	13.9	12.8	22.3	25.6	18.7	24.0	35.5	8.19	21.6

Fixed Asset to Long term Liability Ratio

For Fixed Asset to Long term Liability Ratio as an example, fixed assets are for the long-term finance source. If the rate is lower, source of funds is more stable; and that "Fixed Asset to Long term Liability Ratio" has lower value, the company financial crises in the lower chances (Zhou and Lo, 2007). Parkson in 2005 after listing obtain sufficient funds to support enterprise expansion; with increased number of their branches. The "Fixed Asset to Long term Liability Ratio" also from 2007 0.12 rose to the 2010 0.4 (increase 230 per cent). but relatively 4 companies four years on average 0.87 , Parkson's long-term funds are very stable to show their strong competitive edge.

Current Liabilities to Net Asset Ratio

Parkson's "Current Liabilities to Net Asset Ratio" from 2007 the 0.7 climbed to the 2010 1.3, the Corporation of the four years liabilities of the flow rate is increasing much faster than 85 percent assets mainly because accounts payable at an annual increase of 10 per cent in 2010 as well as the new bank loans . Meet money raised as the result Parkson's business expansion for the sale proceeds (GSP) by the 200 7 years of people dollar 9,000 million RMB to 2010 14,100 million RMB(see Figure 6). Its 2010 still in the ratio between industry average 1.26, current liabilities of the problem is not serious.

Current Liabilities to Stock Ratio

The Parkson with the rest of three enterprises department store business for the operation license model (high as 90 per cent, see the chapter 2.3 operating capacity Analysis Section, the inventory is for direct sales only for the part of the business. China's stock is high in proportion because of its business supermarket business is in the heavy rate. Looking back at the rate department store industry 21.6, Parkson's "Current Liabilities to inventory ratio"18.7 is at a reasonable level.

Financial structure analysis: After overall analysis, Parkson in the above the ratio is better than the industrial standard level.

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2.3 Paying debt ability

(Company Name)	Parkson				Parkson	GE	Intime	SL	4 companies
(Year)	2007	2008	2009	2010	2007-2010 (4 年平均值)				
Current Ratio (%)	209%	178%	112%	121%	155%	87%	78%	60%	95%
Quick Ratio (%)	201%	170%	108%	117%	149%	82%	75%	47%	88%
Stock Credit Index	(14.12)	(10.97)	(3.67)	(6.48)	(9.31)	0.09	0.18	0.27	-2.2
Cash Ratio (%)	182%	152%	96%	87%	129%	76%	36%	36%	69%
Total Debt Ratio (%)	68%	64%	64%	64%	65%	59%	51%	67%	60%
Debt / Equity Ratio	1.31	0.76	0.67	0.35	0.69	0.15	0.18	0.38	0.35
Long Term Debt Ratio	0.57	0.43	0.40	0.26	0.40	0.10	0.14	0.19	0.21
Total Debt / Fixed Asset Ratio	7.48	4.83	2.90	3.21	4.60	1.23	2.01	1.10	2.23
Time Interest cover ratio	3.88	4.39	4.85	4.75	4.47	73.6	10.8	4.8	23.4

Current Ratio /quick ratio - the department store in the franchising license sales to obtain large quantities of cash, the cash-flow generally very healthy. And the Parkson mobile and quick ratio from 2007 of 2.1 times and 2 times the dropped to 2010 1.21 times and 1.17 times. The reason is that there is a 1,300 million long-term debt due to be credited (for 10 years current liabilities 21.7 percent). And the Parkson the flow and quick ratio, are better than the industrial level 0.95 and 0.88 because its cash levels are sufficient (The following mentioned).

Stock Credit Index – Parkson 4 years of inventory confidence of the market has been negative because of its current assets/liabilities long-term is poor. Parkson industry because their own inventory level is low, therefore, this index department store industry is not that important.

Cash ratio - the ratio of Year 07 182 percent to 10 years 87 percent; Parkson's cash level while fell, however, mainly due to an increase of bank loans due current liabilities (rose 61 per cent). But the ratio is higher than the industrial level 69 percent.

Equity and Debt Ratio – Parkson in the two rates higher than industry (0.69 than 0.35 and 0.4 than 0.21) because, in its positive financial policy, interest in recent years more favorable in using long-term loans to expand the company business. In the last four years of indicators decline is due to repay the due, in the long- term loan (reduction of 40 percent) and Owner rights increased by 60 per cent. With the current Parkson now yield far higher than the assets liabilities cost rate (2010 the 19.2 percent 9.3 per cent) and favorable to their additional profits; its indicators also trend downward,-2010 are very close to the industrial level 0.35 and 0.21 level, and therefore its long- term loan repayment capacity is sound.

Total Debt / Fixed Asset Ratio – Parkson financial policy adopted a low fixed assets to increase policy liquidity, and hence their fixed assets than with similar size of the industry low by half (2010 fixed assets: Parkson of 24,900 million RMB, and the remaining three enterprise average value of 35,400 million RMB) the lead to higher than in the indicators industry more than double standard. In view of its gearing ratio and peer similar (60 percent) and its realized capacity while not high but the company itself future development there is no negative effects.

Time Interest cover ratio – except that Golden Eagle (73.6 times) due to its liabilities is higher than standard level (23.4 times), Parkson to this indicators (5 times) are satisfactory and that while close Golden Eagle, three companies indicators (6.7 times).

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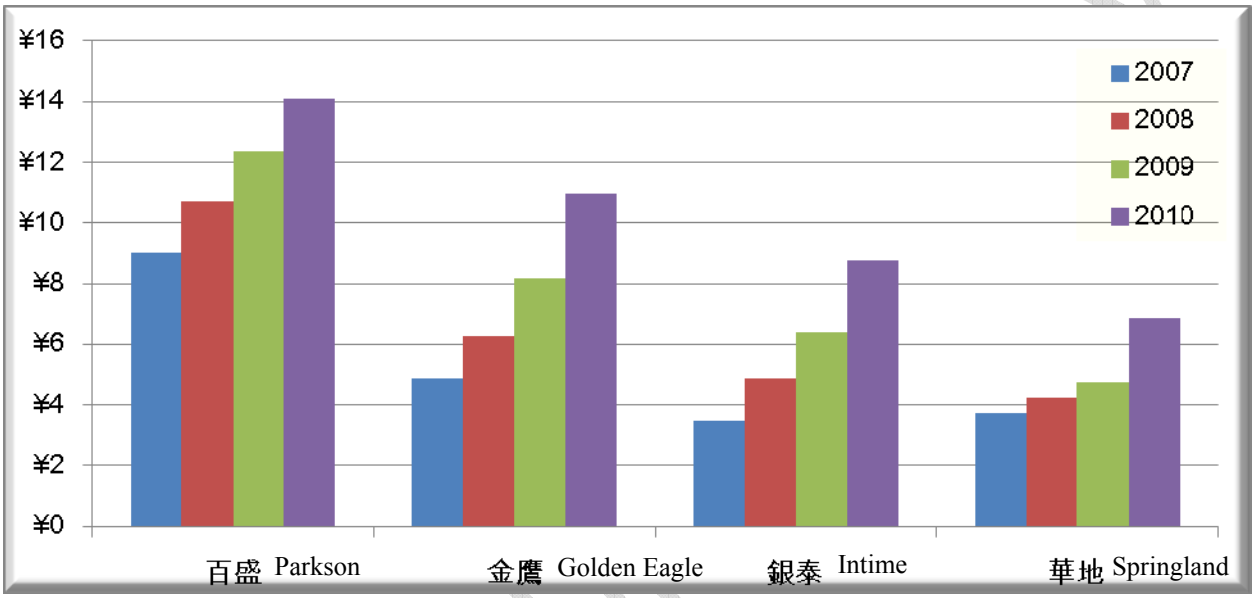
Paying debt ability－ Parkson in the capacity of outstanding, not only its cash ratio, the study also found its financial strategy used effectively leverage ratio of enterprises the additional profits; although fixed assets are not too many so not affecting the overall ability.

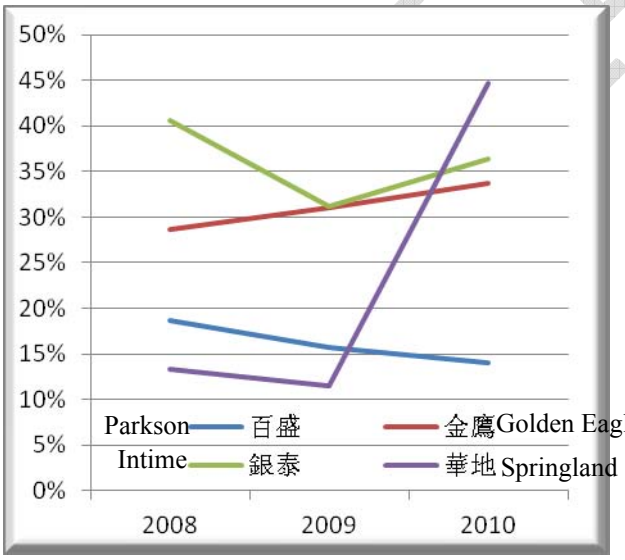
2.4 Operational ability

Parkson's total sales proceeds (Licensing counters 特許專櫃 sales revenue, direct marketing, the rent, management fees, and miscellaneous income) in the past four years each year, increased, from 2007 of 9,000 million RMB to 2010 the 14,100 million RMB, 2010, a growth rate of 14.1 percent, of which 11.4 percent of sales growth, and the remaining from 2009/10 two-year opening shop. The following the Parkson and Golden Eagle (3308), the Intime (1833) and Springland (1700), the three companies' department store performance of comparison.

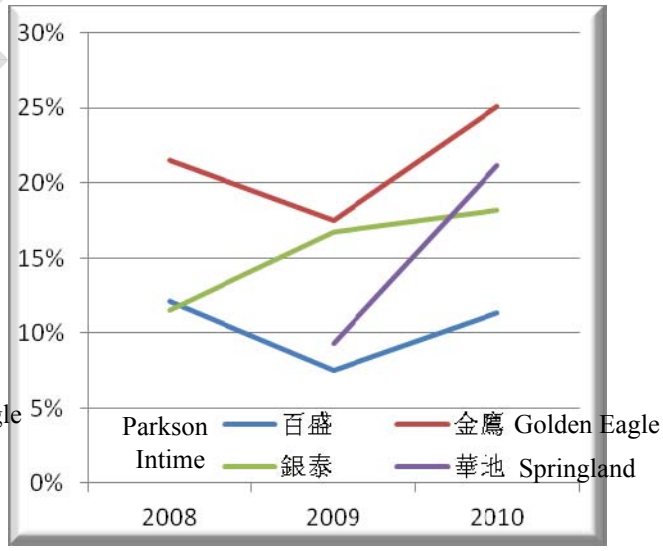
Sales (Unit：1 billion RMB) (Source: the enterprise Annual Report, 2007-2010)



Sales Process R ate

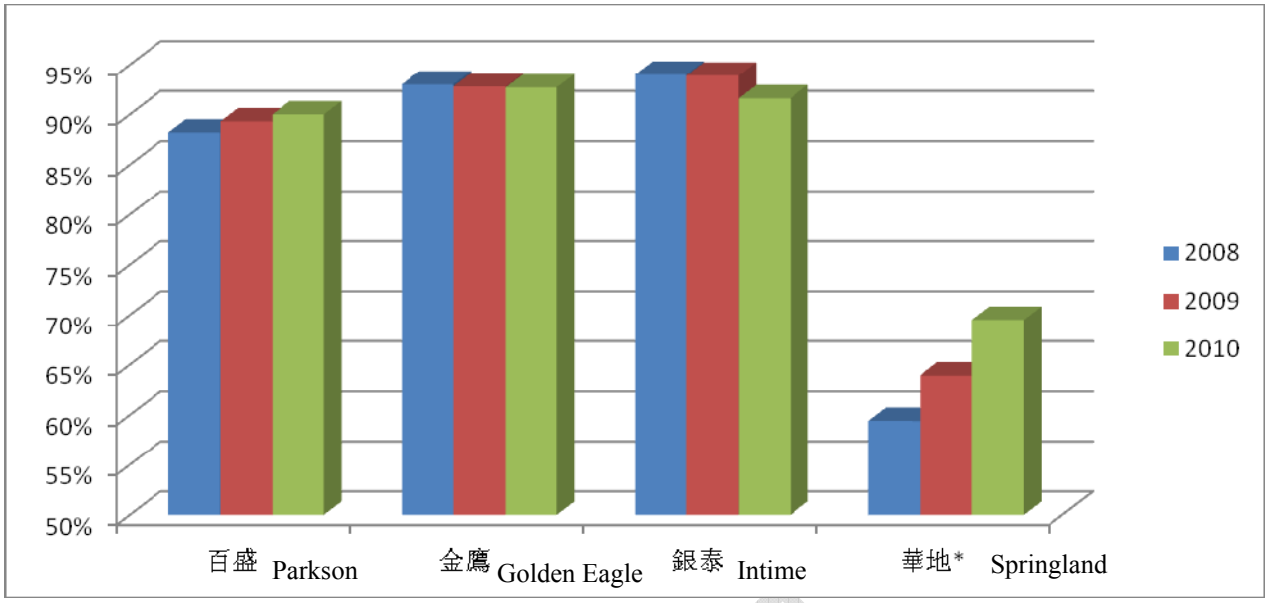


Sales Growth Rate



Sales process and sales growth ratio - The data was shown, the Parkson remains four department store company sales in the highest (14,000 million, compare to the second higher position Golden Eagle over 3,000 million) but in recent years growth rate (14.1 per cent) were less than competitors (average 32.1 percent).

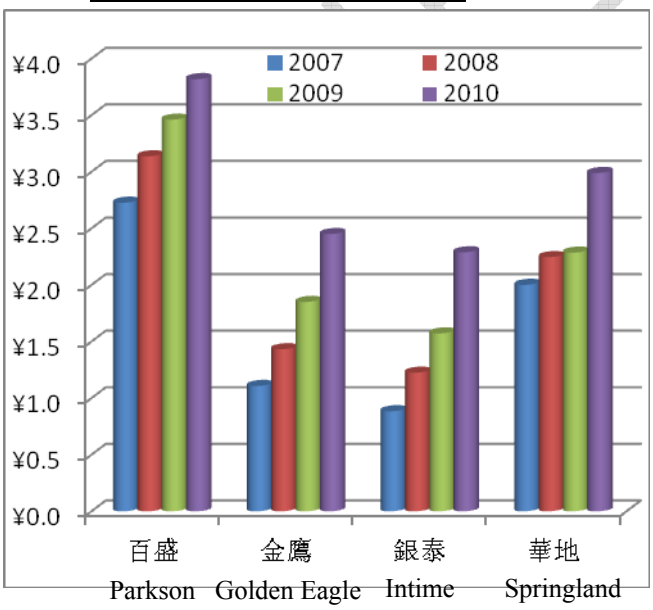
Licensing Counters 特許專櫃 Sales Ratio



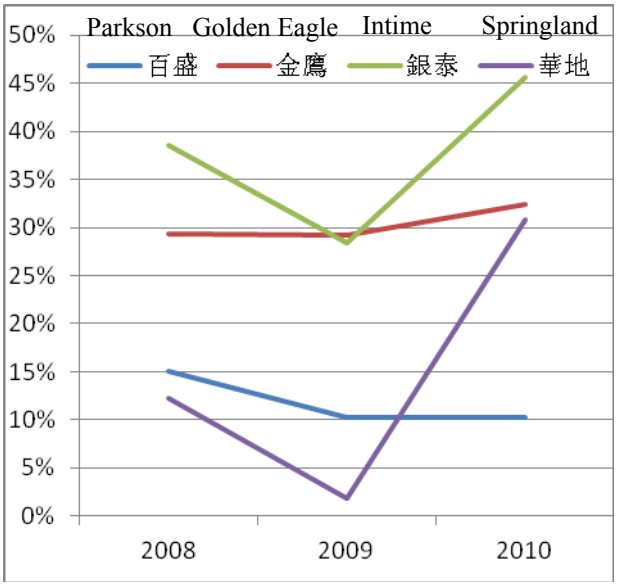
**The lowest ratio of Springland exclusive supermarket revenue*

The licensing counters another importance profit margins, and rate of return is more direct sales, Parkson 2010 counters license the deduction rate point to 19.2 percent, direct sales are higher than the 19 percent gross profit margin, direct sales operations should be deducted the profits salesmen' s salary and stock is also involved procurement and management, resulting low rate of return. The Parkson's license counters less than opponent turnover (Chartered counters commissions, direct sales income and rental income and miscellaneous income) growth and low in industry (below Figure) (the enterprise Annual Report, 2007-10).

Sales (Unit：10 billion RMB)



Sales Growth Rate



Operating expenses - Parkson company's operating expenses including rental expenses, expenditure on their salaries, depreciation and other operating expenses (including electricity and water, promotion and pre-opening cost.) Using turnover as the based amount, Parkson and peer operating expenses total turnover than as an example.

	Parkson					Golden Eagle	Intime	Springland	
(Company Name)	百盛					金鷹	銀泰	華地	4 Average
(Year)	2007	2008	2009	2010	4 yrs avg	2007-2010 (4 years average)			
employee costs	9.8%	8.4%	8.0%	9.4%	8.9%	9.1%	13.1%	9.8%	10.4%
Depreciation and amortization	4.2%	4.9%	4.8%	4.7%	4.7%	5.0%	10.4%	6.8%	6.7%
Rental expenses	11.9%	12.1%	14.5%	15.1%	13.4%	3.6%	13.1%	1.5%	8.3%
Other expenses	17.3%	17.5%	17.2%	18.8%	17.7%	14.5%	18.4%	11.3%	15.8%

From the data analysis to show Parkson the rental expenses above industry average (61 percent higher) because, in the company is more a shop is a rental property model of operation. Depreciation and amortization expenditures were lower than industry 29.8 percent, show department store a deterioration, is installed repair the capital expenditure has been completely depreciated. As for the other operating expenses is higher than the industrial standard 12 percent of the opening branches in recent years economic benefits unsatisfactory.

(Company Name)	百盛					金鷹	銀泰	華地	4 average
(Year)	2007	2008	2009	2010	4 yrs avg	2007-2010 (4 yrs average)			
Total assets turnover	30.3%	31.9%	31.3%	30.3%	31.0%	30.7%	18.6%	49.0%	32.2%
Average Collection Period	3	2	3	2	2.5	7	3	1	3.3
Days' Sales in Inventory (1)	61	70	63	78	68	148	98	83	102
Payment period(1)	66	59	59	58	59.3	57	63	51	57.8

Note 1：In department store of the industry, the method of calculation:the inventory and accounts payable turnover periods should be the most imortance： Days' Sales in Inventory = main business cost/ stock

Accounts Payable turnover days = Accounts Payable / [Concessionaire Sales x (1 –扣點率) + goods cost of sales] x 365

特許專櫃扣點率 （Parkson，2010）*1

Total Assets Turnover – Parkson's total assets turnover of 4 years are maintained to the stable level around 31%. And this targets are also relatively peer average level of 32.2 percent.

Accounts Payable Turnover days - department store's transactions are cash and credit card, there is no bad debts risks, the Parkson debtors turnover days is close to zero which is same as the peer group.

Inventory Turnover days - Parkson's the inventory turnover days are on rising trend (4 years growth 27 per cent) because, in the newly opening period should need additional procurement of goods, but the overall level is still below the industry 3.75 .

Accounts payable turnover days - the Parkson generated counters payment license, the accounts payable including the license return counters the sale and direct sales of suppliers arrears, Parkson accounts payable turnover days maintaining a stable some 60 days, and close to 58 days (peer group).

Operating Capacity Analysis – Parkson's business growth slowdown is mainly the license counters less than the peer group, with the increasing operating costs and lead to net profit margin behind industry.

2.5 Profitability

	Parkson	Golden Eagle	Intime	Springland	
(Company Name)	百盛	百盛	金鷹	銀泰	華地	4 Average

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(Year)	2007	2008	2009	2010	2007-2010 (4 yr*1 及 3 y r *2 Average)				
Net profit*1 (1 million RMB)	727.8	841	911	992	855	552	472	266	536
Net profit growth*2	n.a.	15.6%	8.3%	8.9%	13.8%	94.0%	25.6%	21.7%	38.8%
Gross profit margin*1	68.3%	68.7%	69.9%	71.2%	69.5%	78.3%	79.3%	40.2%	66.8%
Net Profit Margin*1	26.7%	26.8%	26.3%	26.0%	26.0%	32.6%	33.3%	11.0%	25.7%

Gross profit margin - because Parkson's business is not directly product sales, and therefore its high profit margin of the Trade characteristics. The gross profit margin in four years license with counters rate 3 per cent of the improvement 71.2 per cent, but in comparison with Golden Eagle and Intime average of the 78.8 per cent are less 7.6 per cent. The differences are mainly because the license Parkson counters ratio and Golden Eagle and Intime also 2 ~ 3 per cent discrepancy.

Net profit margin - if comparison Golden Eagle and Intime's average net profit margins 33 per cent, Parkson's 26% obviously low (Springland's net profit margins of supermarket business' impact, the other enterprises different). The main reason is Parkson turnover growth (the 07/08 15 % to 09/10 years of 10.3 per cent), plus operating expenses with increasing number of their branches (07 years of 17.3% to 10 years of 18.8 percent) thus the net profit margin is less than others.

(Company Name	百盛				金鷹	銀泰	華地	4 間企業
(Year)	2007	2008	2009	2010	2010			
Total Assets Turnover	30.3%	31.9%	31.3%	30.3%	30.7%	18.6%	44.6%	31.1%
Leverage ratio*1	3.1	2.9	2.8	2.8	2.2	2.3	1.8	2.3
Return on Equity (after tax)*2 (%)	25.4%	24.9%	23.5%	22.3%	25.1%	11.9%	18.6%	19.9%

Note 1: Leverage ratio = Total assets/Equity Note 2: DuPont Financial Analysis on Schedule 7

Total Assets Tuenover – Parkson's four years average 30.3 per cent, as the industry 31.1 per cent.

Leverage ratio/ Return on Equity (after-tax) - Parkson's Return on Equity a slight decline (2010 - 2007 rate of return less of 3.1 percent, dropping for 12%). The main reason is falling of profit margins due to the increasing expenditure (07 years of 17.3% to 10 years of 18.8 percent); assets turnover in industry, is the level of excellence, and leverage ratio (07 years 3.2 down to 10 years of 2.8) is the cause Return on Equity fell by the one of the reasons. Compared with counterparts, Parkson's return on equity has remained at a relatively high level 22.3 percent, right after Golden Eagle 25.1 percent.

Profitability analysis – in this capability analysis of indicators that can be found Parkson's been ability more industry inferior. Recommendation Parkson should be increasing number of counters to improve net profit rate, as well as by leverage to raise return on equity.

2.6 Growth ability

	Parkson	Golden Eagle	Intime	Springland		
(Company Name)	百盛	百盛	金鷹	銀泰	華地	4 Average

SAMPLE - FOR ONLY

(Year)	2007	2008	2009	2010	2007-2010 (4 years average)				
Retained yield (times)	3.8	3.9	3.8	4.1	3.9	5.0	8.6	6.0	5.9
Self-sustainable Growth Ratio (%)	95.2%	96.1%	89.7%	90.9%	93%	91%	100%	100%	96%

Retained yield - Parkson by retained earnings and after-tax for four years in a proportion (07-10 years, retained earnings growth 52 per cent, after tax profit growth 41 per cent) and the indicators have been in 4.0 times over the industry than average 5.9 times, the belief in Parkson need to pay dividend to shareholder in order to gain their supports; also needs to maintain a certain amount of reserves to develop business. Looking over their retirement yield very steady, we can see that it has been both the appropriate balance way. In the past four years Parkson's sales proceeds from the total for 56.6 percent rise, 4.0 times the rate of return is retained at reasonable levels.

Self-sustaining growth - four years Owner rights increase (60 percent) of more than retained earnings increase (52 per cent) led by Parkson self-sustaining growth rate of 5 percent. Relative industry average of 96 percent, Parkson with need to increase retained yield to maintain their self-sustaining growth rate in intra-industry level, otherwise, for its sustainable development to be affected.

Growth Capacity Analysis – Parkson's business growth capacity levels behind its peer group which is necessary to get an improvement.

2.7 Stock Market Prospects Analysis

	Parkson				Golden Eagle	Intime	Springland		
(Company Name)	百盛				百盛	金鷹	銀泰	華地	4 average
(Year)	2007	2008	2009	2010	2007-2010 (4 年平均值)				
Earning per share (HK$)	1.31*1	0.34	0.37	0.42	0.35*1	0.34	0.31	0.21	30.3
Price-earning Ratio (Times)	13.89*1	35.98	33.13	29.20	36.28*1	70.6	0	0	
Dividend yield (%)	45.7%	48.0%	46.2%	45.3%	46.3%	55.1%	37.4%	32.9%	43.2%

Note 1: Parkson in 2007 Shares will be demolished 1 split in 5, the average to 1 demolition before the split calculation.

Parkson P/E ratio the four years down the 62 percent to 2010 the 36.28 times, and the dividend rate has been maintained at about 46% water Ping. Although the average dividend less than rate Golden Eagle, the pursuit of dividends return stability while Parkson is better (Golden Eagle to 08/09 years dividend rate up to 80% and 90 percent, however, 10 years then dropped to 30 percent). In the present P/E RATIO, Parkson are the similar level of the industry about 30 times, showing that price fully reflected its value.

Stock Market Prospects Analysis – Parkson's dividend stable returns to investors, its stock is at a reasonable level.

3. Parkson's Corporate Governance assessment

Chapter 2 from the financial assessment analysis, we understand that Parkson's appearance growth slowdown and operating costs, and so, and direct affect for its enterprise development in the future and the shareholders' interests. We in this will explore Parkson of corporate governance of its financial performance of the hill and, in its internal control and risk management to check their existing mechanism has insufficient, to make appropriate recommendations.

3.1 Corporate Governance of business organization and its impact and importance

Since 1998 Asian financial turmoil and 2002 a series of international business scandal events (such as the Enron, the World Telecommunications, the Eurasian agriculture, serious impact on the stock market investors to lose the confidence for fund-raising; and begin to understand that if a company's own governance is not well, if Enron International enterprises, they can easily collapse. Therefore, Governments also focused on the tightening supervision regulations.

The Ho and Li (2008) pointed out that corporate governance is how an organization can have decision-making powers and responsibilities assigned to owners (shareholders), Board of Director (policy makers) and high-level managers (managements) three main people, and determine their interrelationship, including how authorization, mutual monitor, incentive and accountability. The ultimate promotion bodies performance and long-term sustainable value, protection of shareholders and other stakeholders' rights and interests.

Ho (2003) quoted McKinsey consulting company in 01 to global more than 200 institutional investors of research, which stated over 80 percent to "Corporate Governance" good corporate pay premium; in Asia, premium the proportion of 20 percent to 27 percent. Corporate Governance sound enterprises can attract more funds to get higher returns, with a more competitive strength.

3.2 Parkson existing Corporate Governance

Parkson from the Lion group in Malaysia, although the 05 years the initial independent of the Lion group, but in fact Golden Lion and Parkson President is the same Chung Ting-sum; therefore to a certain extent Parkson is Golden Lion family-controlled business. Parkson in a high percentage of shares (direct large shareholders holding shares PRG 70 percent) Representative major shareholders also the directors and senior management level, direct control over the board of directors.

Although the shareholders directly management does not mean low corporate performance, and, conversely has its advantages such as the Acting lower-cost, decision-making high efficiency, an initiative, and loyalty and market flexibility. From Xu (2008) proposed by the return on assets into account (ROE), total assets yield (ROA) to measure the company performance, in general its performance is still in the industry.

(Company Name)	百盛				百盛	金鷹	銀泰	華地	4 間企業
(Year)	2007	2008	2009	2010	2007-2010 (4 年平均值)				
ROA (after tax) (%)	8.1	8.9	8.5	8.1	8.4	9.7	5.8	5.3	7.3
ROE (after tax) (%)	25.4	24.9	23.5	22.3	24.0	25.1	11.9	18.6	19.9

But we find Parkson in the following several aspects of corporate governance, there is relative unbalanced status, may have directly damaged on the economic efficiency for the enterprises:

Lack of transparency on operation - Lion group operations are numerous, Parkson in its scope of business partners within the number of the lion group is connected business in its annual report has not fully disclosed. In addition, Parkson under the present the directors and managing director of Chung Wing Chun has with the Group of Companies directors. The related connected operation did not disclose. If a Parkson's Lien camp Company "Shanghai 9 Sea Lion property management, how many Parkson's business is to the Company has not been documented examination.

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Connected transactions through the minority shareholders' interests – ...

Monitor Board of Director failure – ...

Credit Risk - ...

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3.3 Suggestions for improvement

We recommend that Parkson pay attention to these issues, further consider the following suggestions for improvements:

1. The directors and management team members of the separation – management team is separated from members of the Board under the supervision and appointment, but too many of directors serve in the management team, restrictions on the independence of the management team.
2. Back to the independent directors monitor efficiency - strengthening the board of directors credibility and the public and small shareholders of the confidence.
3. Strengthening on transparency of enterprises - open more with the connected up operating transaction information to release small shareholders' worries in public
4. Tighten the internal control - the internal controls and responsibilities to unclear, unable to play monitoring whether the departments effective trading. The strengthening of the Centralize Internal Control Panel's functions, the irregular spot checks to confirm departments at any time waiting is to smooth the operation.
5. Credit Risk Management - the internal self-credit rating assessment, improving the company operations to the financial institutions in the public for the target ratings in order to improve the financing costs of the company.

4. Investment Project Appraisal

Parkson plan this year in Jinan opening of a new department store, an area of 33,800 square meters, the company program buying property for long-term use, the property used for 50 years. The funds 378 million RMB (for 2010 turnover 38,900 million RMB for 9.7 percent.) We will use a different financial ratios, including net present value measure (Greenwald, Kahn & Sonkin, 2005) for an investment assessment.

4.1 Project items basic information

Project Costs		Remarks
Mall area (square meters)	33,800	(Existing Jinan 濟南Project's Branch area)*1
Building price (人民幣/平方米)	10,000	(Exisitng Jinan濟南Project's Branch-Parkson purchase price) *1
Department store (1 million RMB)	338	
Decoration (1 million RMB)	40	(Parkson-cost in the past, about every square meters 1200 RMB computing) *1
Total Cost (1 million RMB)	378	
Remaining basic information		**Remarks**
Parkson Building depreciation years	50	(China's accounting legislation)
Decoration period (years)	5	(Parkson regular approach) *1
Sales growth rate	12%	(Parkson 2007-2010 average) *1
ultimate growth rate	3%	(assume long-term investment growth)
EBITDA (%) 利潤率	38%	(Parkson 2010) *1
Operating period (days)	10	(Parkson 2010) *1

Note 1：Source from Parkson 2007-10 Annual reports

4.2 The first year calculation of sales

Project items		Remarks
Sales per square meter (RMB)	10,000	(Parkson 2010) *1
Counters 特許專櫃sales ratio	90%	(Parkson 2010) *1
Direct Sales Ratio	10%	(Parkson 2010) *1
Total Sales (1 million RMB)	338	濟南Branch area 33,800 square meter x RMB10,000/sq. m.
特許專櫃扣點率	19%	(Parkson 2010) *1
Counters 特許專櫃commission (1 m RMB)	57.8	總銷售額 x 特許專櫃比率 x 扣點率
Direct Sales (1 m RMB)	33.8	總銷售額 x 直接銷售比率
Sales (1 million RMB)	91.6	

Note 1：Source from Parkson 2007-10 Annual reports

4.3 Computing Tax Cost

Items (Unit: 1 million RMB)	1 Yr	2 Yr	3 Yr	4 Yr	5 Yr
Sales = Last Year Sales x (1+Growth rate)	91.6	102.6	114.9	128.7	144.1
EBITDA	34.8	39.0	43.7	48.9	54.8

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Depreciation = -(Building cost/50+Decoration/5)	-14.8	-14.8	-14.8	-14.8	-14.8
EBIT:	20.0	24.2	28.9	34.1	40.0
Tax cost (Standard tax rate: 25%)	-5.0	-6.1	-7.2	-8.5	-10.0
Profit:	15.0	18.2	21.7	25.6	30.0

4.4 Cashflow calculation

Items (Unit: 1 million RMB)	Initial cost	1 Y r	2 Y r	3 Y r	4 Y r	5 Y r
EBITDA		34.8	39.0	43.7	48.9	54.8
Expenditures*1		(0.9)	(1.0)	(1.2)	(1.3)	(1.5)
Expenditures*2		(8.0)	(8.0)	(8.0)	(8.0)	(8.0)
Tax expense		(5.0)	(6.1)	(7.2)	(8.5)	(10.0)
Cashflow*3:	-378.0	20.9	23.9	27.3	31.1	35.3

Note 1)Working capital the first year calculation => annual direct sales x operating cashflow period/365=33.8mX(10/365)=0.93m

Working capital for the rest calculation =>the previous year working capital x(1+Sales growth rate)

Note 2) assumption for expenditure to pay for the annual decoration cost, about 40 million/5 year = 8 million per year

Note 3) Cashflow after 5 years, using the assumption the ultimate growth (Appendix 8)

4.5 ARR and NPV calculation

ARR	
Total income for 50 years*1	2,971.2 m
Average ARR(A)	59.4 m
Initial cost(B)	378.0 m
ARR (A/B):	15.7%

Note 1) Appendix 8 "Tax expense" , "Profit"—Total amount for 50 years

NPV :

r = 10.5% (2011 Parkson ROA)

t year = cashflow at t th year/$(1+r)^t$

Year	Cashflow	PV	Year	Cashflow	PV
Initial cost	-378.0				
1 s t	20.9	18.9	6-10	193.1	87.2
2 n d	23.9	19.6	11-20	483.3	104.6
3 r d	27.3	20.2	21-30	649.6	51.8
4 t h	31.1	20.8	31-40	873.0	25.6
5 t h	35.3	21.4	41-50	1,173.2	12.7
NPV= all cashflow for 50 years – Initial cost :					4.95

4.6 PAYBACK PERIOD and IRR

Payback period	1 million RMB
1-13 Profit (A)	398.2
Initial cost (B)	378.0

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Payback period =	133 monthes 11 Years 1 month

IRR=10.6% (Appendix 8)

4.7 Investment appraisal

From the data analysis results, the Jinan new branch for the payback period is 11 years and 1 month and net present value is positive value. Therefore, the project investment appraisal as a positive return, and should also help group in exploring sales network, the proposed Parkson should carry out this item.

4.8 New project appraisal methods for analysis

i. Investment returns- the first-year 4 per cent (Schedule 8), but the more Parkson maturity and investment returns will gradually to high. Investment return the advantage of a simple calculation; the disadvantage is that there is no consider the funding time value.

ii. ARR － 15.7%，higher than the company's current return on assets to display the item for investment. The average rate of return strengths of each year calculated the average return on investment and reflect the long-term return projects.

iii. NPV － 2011 ROA 10.5%，NPV 495 million RMB。....

iv. IRR － 10.6% containing low rate of return the advantage of being able to life with the proceeds with total investment of been, noting that the rate of return projects, facilitate its industry standards for investment yield comparison to determine whether the project is worth to evaluate, but IRR performance of the rate is not absolute, an internal rate of return program with low, as a result of the larger and larger net present value, and therefore more worth for the evaluation.

4.9 Suggestion for cashflow of new project

The department store is most sales through an authorised counters such manner, involving a liquidity. If the first year Jinan new branch the necessary cashflow of around 8,900 million RMB (about Parkson 2010 0.23 percent proceeds, and on the net cash flow of 0.39 percent) and can deploy company internal resources are sufficient to meet the liquidity requirements.

5/. Financing and capital management

Parkson now to the Jinan new projects initiated additional cash, a total of 378 million RMB (about 2010 total assets of 3%). We will analyze the various financing program of Parkson capital management of analysis pros and cons.

5.1 Financing methods for analyzing

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1 million RMB	Parkson				金鷹 Golden Eagle	銀泰 Intime	華地 Springland
	2007	2008	2009	2010	2010		
Cash and equivalents	3,642	3,649	3,856	5,238	2,346	1,462	1,538
Bank loans	1,417	2,207	2,241	2,961	458	2,818	123
Cash ratio	182%	152%	96%	87%	56%	37%	71%
retained profit	3.8	3.9	3.8	4.1	3.6	7.6	10.0
Net debt ratio (1)	-77.6%	-41.8%	-41.2%	-50.5%	-51.3%	25.5%	-37.4%
Net Interest Expense (2)	74	86	107	140	-33	2	75
Net Interest expenses/turnover	2.7%	2.7%	3.1%	3.7%	-1.3%	0.1%	2.5%

Note(1) Net debt ratio = (bank loans - Cash) / Equity Note(2) Net Interest Expense = interest payments - interest income

i. cash payments – internal retained earnings/cash as sources of funding. Parkson financial status is stable, in the past four years are all at net cash status, the net debt ratio is negative. But its cash ratio has been industry than 20 percent higher on the domestic financing after 380 million its cash ratio is as high as 81 percent, average industry still high 10 percent. Although retained earnings ratio would drop to 3.9, believe the enterprises little impact on future development.

ii. bank loan financing – Parkson's major banks partners, the Chinese people provided by banks for long-term loan interest rates of 5-year interest rates on loans interest rates 2.35 % calculated the (2011 on 6 April public bank interest rate at 6.8 percent) (China Bank, 2011) . The net interest expenditure will be raised is now total turnover 3.7 per cent of the ratio will be increased to 3.85 per cent. Although the 1.34 percent more than the peer group, but has not been significant.

iii. Commercial credit financing - mainly in the line on the line of business partners and the money received in advance and money credit too easily. But because it is directly to customers charge a fee (receivables of 2.5 days) and therefore to cope with the line partners for accounts payable to credit transactions. The main partners Parkson for the counters' customers now meet money working capital to 58 days for the industry also average. But the department store industry use this method of financing, where the individual counters customers to its fund-raising Limited, to raise 380 million RMB will need to negotiate with great deal of customers, therefore, not feasible.

iv. Issued share capital fund-raising - such as raise 380 million RMB, its distribution costs have reached 8-12% than the general bank loan for high interest rates. The new shares fund-raising will reduce shareholders' equity ratio, and shareholders to creditors to more than often return high, and therefore the liabilities rate is not high, was not proposing shares fund-raising.

v. Sale of assets - Parkson the fixed assets for than 0.4, far below the level industry 0.7. But their fixed assets of its department Store property, sale on the contrary to rent their operating costs of increasing the pressure (because of its net profit margin is 26%, rental expenses 15.1% compare with the peer group 8.3% is almost double.

5.2 Financing method proposed

With the above analysis, the proposed Parkson should adopt the bank long-term loan program for 380 million RMB financing and annual interest of 9.15%, 5 year amortization. Expected 2011 year, the main financial data are as follows:

Financail items	*2010 Actual*	*2011 Budget*	Industrial *4 Year Average*	*Assessment*

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Fixed Asset to LTL Ratio	0.4	0.45	0.87	Positive
Debt / Equity Ratio	0.35	0.38	0.35	Healthy
Interest expense to Sales	3.7%	3.85%	1.43%	Healthy
Debt Ratio	-50.5%	-46.3%	-28.3%	Healthy

In considering borrowing after the company's debt service capacity as a whole no major impact, but further improve the Company's financial structures; and the operating expenditure new branch substantial of the reduction, are expected to increase the enterprises operating capacity.

6/. Recommendations and audit program

After this data analysis, we have proposed Parkson operational audit of the following three points:

1. 特許專櫃VIP counters sales ratio – raise the license sales counters, could help improve profit margins, and reduce inventory management, thus increasing rate of return. To achieve this, the company should have internal decoration, increase department store, grades, thus attracting more popular and high-end the counters positioning department store, commodities rose can boost stores with growth rates.
2. Other operation costs to sales turnover rate - Parkson other operation costs to sales turnover ratio is increasing as the new branches pre-set cost is increasing, for each new branch of a more pre-set up cost of financial budget, which effectively controlling the expenditure. Rental expenses are the major item for operating costs so the proposed analysis to reduce operating costs should be for the financial comparison between rental expenses and property ownership.
3. Operational Governance - Parkson growth behind industry reflect of its business to operate a room for improvement. Recommends that the corporate may in the following to conduct a review Research:

   - management mechanism - including the independent directors is effective, top-level core team of diversity is adequate planning for the future new point; whether it has tried to ensure that company to comply with good governance code to all the shareholders maximum benefits to premise of the Company.
   - internal monitoring mechanism - objectives and responsibilities are clear, whether to enhance operational efficiency, provide standards do and may rely on information, protect the security of assets complete and appropriate use, the Business Plan and the strategic decision-making and effective implementation, compliance on the laws and regulations for 5 areas (COSO, 1999).

7/. Conclusion and Recommendations

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8. References

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Consolidated Income Statement

Year ended 31 December 2007

	Notes	2007 RMB'000	2006 RMB'000
Revenues	4	2,726,983	1,942,005
Other operating revenues	4	332,703	242,029
Total operating revenues		3,059,686	2,184,034
Operating expenses			
Purchases of goods and changes in inventories		(865,721)	(632,325)
Staff costs		(268,163)	(196,566)
Depreciation and amortisation		(113,812)	(88,737)
Rental expenses		(324,759)	(227,054)
Other operating expenses		(470,709)	(331,439)
Total operating expenses		(2,043,164)	(1,476,121)
Profit from operations	5	1,016,522	707,913
Finance income	6	253,161	75,047
Finance costs	6	(326,966)	(51,509)
Share of profit of an associate		535	538
Profit from operations before income tax		943,252	731,989
Income tax	9	(215,451)	(218,835)
Profit for the year		727,801	513,154
Attributable to:			
Equity holders of the parent		676,000	460,761
Minority interests		51,801	52,393
		727,801	513,154

	Notes	2007 RMB'000	2006 RMB'000
EARNINGS PER SHARE ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT	10		
Basic		RMB1.22	RMB0.83
Diluted		RMB1.22	N/A
DIVIDENDS	40		
Interim		121,582	82,800
Proposed final		211,000	149,040
		332,582	231,840
DIVIDEND PER SHARE	40		
Interim		RMB0.22	RMB0.15
Proposed final		RMB0.38	RMB0.27
		RMB0.60	RMB0.42

Consolidated Balance Sheet

31 December 2007

	Notes	2007 RMB'000	2006 RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment	11	818,705	749,923
Investment properties	12	222,104	227,368
Lease prepayments	13	420,470	431,550
Intangible assets	14	1,562,040	689,565
Investment in an associate	17	2,346	2,214
Other assets	18	248,477	107,408
Held-to-maturity investments, unlisted	19	1,460,920	1,561,740
Investment deposits	20	40,000	—
Deferred tax assets	21	34,971	45,460
Total non-current assets		4,810,033	3,815,228
CURRENT ASSETS			
Inventories	23	143,940	109,904
Trade receivables	24	18,974	18,489
Prepayments, deposits and other receivables	25	374,852	259,492
Investment deposits	20	781,450	—
Cash and short-term deposits	26	2,860,216	3,271,366
Total current assets		4,179,432	3,659,251
CURRENT LIABILITIES			
Interest-bearing bank loans	27	—	(83,886)
Trade payables	28	(1,144,716)	(871,618)
Customers' deposits, other payables and accruals	29	(735,720)	(611,097)
Tax payable		(123,129)	(113,518)
Total current liabilities		(2,003,565)	(1,680,119)
NET CURRENT ASSETS		2,175,867	1,979,132
TOTAL ASSETS LESS CURRENT LIABILITIES		6,985,900	5,794,360

	Notes	2007 RMB'000	2006 RMB'000
NON-CURRENT LIABILITIES			
Interest-bearing bank loans	27	(1,417,000)	(1,607,027)
Long term payables	30	(95,628)	(93,994)
Deferred tax liabilities	21	(184,711)	(247,050)
Senior guaranteed notes	31	(1,435,118)	(1,526,806)
Senior notes	31	(897,179)	—
Derivative financial instruments designated as hedging instruments	35	(88,189)	—
Total non-current liabilities		(4,117,825)	(3,474,877)
NET ASSETS		2,868,075	2,319,483
EQUITY			
Equity attributable to equity holders of the parent			
Issued capital	37	57,925	57,436
Reserves	39(a)	2,731,126	2,170,151
		2,789,051	2,227,587
Minority interests		79,024	91,896
TOTAL EQUITY		2,868,075	2,319,483

4. REVENUES AND OTHER OPERATING REVENUES

Revenues

Revenues, which are also the Group's turnover, represent the net amount received and receivable for the goods sold by the Group to outside customers, less returns and allowances, commissions from concessionaire sales, consultancy and management service fees, and rental income. An analysis of revenues is presented below:

	2007 RMB'000	2006 RMB'000
Sale of goods – direct sales	1,044,130	758,049
Commissions from concessionaire sales (note)	1,511,498	1,027,122
Consultancy and management service fees	32,558	41,681
Rental income	138,797	115,153
	2,726,983	1,942,005

Note:

The commissions from concessionaire sales are analysed as follows:

	2007 RMB'000	2006 RMB'000
Gross revenue from concessionaire sales	7,455,218	5,011,806
Commissions from concessionaire sales	1,511,498	1,027,122

Over 90% of the Group's turnover and contribution to the operating profit is attributable to the operation and management of department stores and over 90% of the Group's turnover and contribution to the operating profit is attributable to customers in the PRC and over 90% of the Group's operating assets are located in the PRC. Accordingly, no analysis of segment information is presented.

37. SHARE CAPITAL

	Number of ordinary shares '000	Nominal value HK$'000	Nominal value RMB'000
Authorised:			
Ordinary shares of HK 0.1 each	1,500,000	150,000	156,000
Issued and fully paid:			
At 1 January 2007	552,000	55,200	57,436
Share options exercised (note)	5,219	522	489
At 31 December 2007	557,219	55,722	57,925

Note:

During the year, 5,218,900 share options were exercised for the same amount of shares at HK$36.75 per share. This gives rise to net proceeds from issue of shares amounting to approximately HK$192 million (equivalent to approximately RMB185,803,000). The share options were granted under an employee share option scheme disclosed in note 38 to the financial statements.

38. EMPLOYEE SHARE-BASED ARRANGEMENTS

On 10 January 2007, a total of 8,188,950 share options were granted to 482 eligible employees, including directors and the chief executive, of the Company at nil consideration and with an exercise price of HK$36.75 per share pursuant to an employee share option scheme (the "Scheme").

The fair value of the share options granted during the year was RMB25,442,000 and the Group recognised share option expenses of RMB25,442,000 during the year ended 31 December 2007.

The fair value of the options granted is estimated at the date of grant using a Black-Scholes-Merton option pricing model, taking into account the terms and conditions upon which the options were granted. The 5,955,600 share options granted under Lot 1 are exercisable from 24 January 2007 to 23 January 2010 and have no other vesting conditions. The 2,233,350 share options granted under Lot 2 are exercisable from 2 January 2008 to 1 January 2011 and required an employee service period until 2 January 2008.

Gross Sales Proceeds rose to RMB
銷售所得款項總額上升至人民幣

14,106

MILLION百萬元

Annual Year 2010 p23

balance of approximately 7.7% came from the Groceries and Perishables category.

The merchandise gross margin (a combination of the concessionaire commission and the direct sales margin) was flat at 19.0% due to lower merchandise margin for new stores opened in the past 15 months. However on a same store basis, the merchandise gross margin improved by 0.1% as the improved market condition and consumer sentiment enable the Group to continue scaling down its discount activities.

Total operating revenues for the year grew by RMB491.4 million or 12.6% to RMB4,400.1 million. The growth rate of operating revenues was lower than the growth rate of the total gross sales proceeds due to the lower growth rate of direct sales and rental incomes as well as the negative growth of the management and consultancy fees in line with the reduction on the number of managed stores.

器類別亦佔約7.2%，餘下約7.7%則是食品與鮮貨類別。

因過往15個月開設的新店，銷售毛利率較低，導致商品銷售總額利潤率（綜合特許專櫃銷售傭金及直接銷售的利潤率）持平於19.0%。但伴隨經濟及消費者信心的逐漸恢復，本集團繼續縮減其折扣活動，因此同店對比下，商品銷售總額利潤率取得0.1%的增長。

本集團的經營收益總額較去年同期增加人民幣491,400,000元或12.6%至人民幣4,400,100,000元。這是由於較低特許專櫃銷售傭金率及因管理店的減少而消減的諮詢及管理費，導致經營收益總額增長率低於合計銷售所得款項總額的增長率。

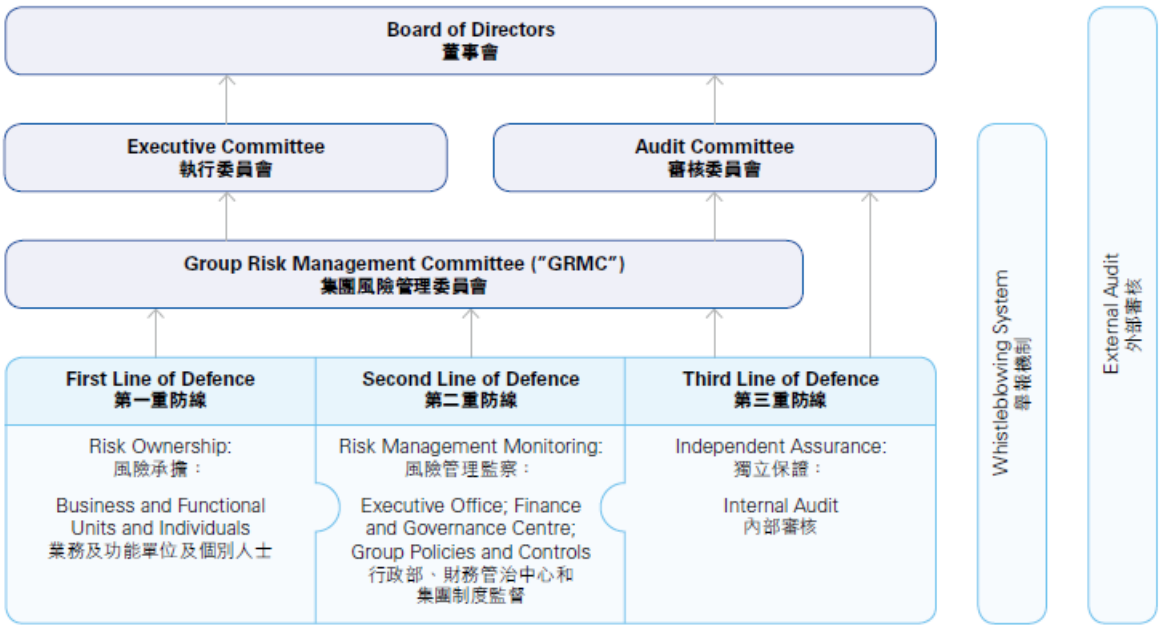
3. Corporate Governance – Internal control and risk management

Corporate Governance is crucial for a company as a responsibility to the business's interest of the shareholders for transparency, fair and accountable (Arjoon, 2005). In this chapter, we will study CTFJ's governance system and its risk management, followed by recommendations to enhance efficiency.

3.1 Corporate Governance System

CTFJ has a transparent and well-defined governance system, as reflected in its annual report (Chow Tai Fook, 2019, pp. 105-189).

Figure 3-1 Corporate Governance System



Source: (Chow Tai Fook, 2019, p. 166)

Its risk governance system is articulated between:

(i) The Board Oversight helmed by the Board of Directors that appoints the Executive Committee and an independent Audit Committee that oversees the risk management and internal control systems on behalf of the board. The board is accountable for scrutinizing and assessing the CTFJ's policies are under legal and regulatory obligations, primarily the Listing Rules, the Companies Ordinance and the Securities & Futures Ordinance (Chow Tai Fook, 2019, p. 131).

(ii) Management Oversight through a Group Risk Management Committee comprises of Managing Director and executive directors from significant business and divisions, maintaining the risk management and internal control structure, and reviews principal risks quarterly (Chow Tai Fook, 2019, p. 167).

(iii) Three Lines of Defense (Chow Tai Fook, 2019, pp. 167-168) that comprises

First Line of Defense: Mainly is the business and function units.

Second Line of Defense: Made up of Executive Office, Finance and Governance Centre, and Group Policies. The above offices determine guidelines, processes, and benchmarks to underpin risk management and internal control systems. They also examine the prosecution of critical group guidelines such as anti-fraud policy, code of conduct, and crisis management policy.

Third Line of Defense: It is the independent audit department that reports to both the Group Risk Management Committee and the Audit Committee. Internal auditing independently assesses the suitability and efficacy of the risk management and internal control systems.

(iv) External audit offers opinions and measurements of the procedures. It conveys with board committees and management on any risk araised (Chow Tai Fook, 2019, p. 168).

(v) A separate whistleblowing system gives a private network to persuade staff to bring up matters on fraudsters, and misbehavior whilst assuring confidentiality and job protection (Chow Tai Fook, 2019, p. 168).

3.2 Transparency and board diversity within a traditional family business

CTFJ grew from a traditional family business, with 89% of shareholdings from the founding family (Chow Tai Fook, 2019, p. 162). To date, 4 out of 9 executive members are from the Cheng family helmed by Dr. Henry Cheng (Table 3-1). The rest of the board is from third parties, which forms more than 50% of the executive board, including the Managing Director, Mr. Wong Siu-Kee Kent.

The team of independent non-executive directors are all non-family members, which serves as chairmen or members of the independent nomination committee, remuneration committee, and audit committee, i.e., there is transparency and independence in the business.

Table 3-1 Executive directors from the Cheng family

Cheng Family members who are executive directors on the board	Responsibilities
Dr. Cheng Kar-Shun Henry (Chairman)	Strategic direction & overall performance of the Group
Dr. Cheng Chi-Kong Adrian	Strategic investment of the Group
Mr. Cheng Chi-Heng Conroy	Raw material procurement
Mr. Cheng Kam Biu Wilson	Bank and landlord relationship management

Source: Constructed by the author

Segregation of duties: The roles of Chairman Dr. Henry Cheng and Managing Director, Mr. Keng Wong, are well-defined. Dr. Cheng is providing leadership for the board and ensures the board delivers effectively. On the other hand, Mr. Wong is responsible for CTFJ's day-to-day operations and business developments.

Internal policies, controls, and practices: CTFJ has in place policies, controls and practices approved by the management led by Mr. Wong, including insider trading and business ethics, with an escalation process to the board for non-compliance. A review of internal controls is closely linked to its risk management framework, as defined above. The internal controls are subject to internal audits.

3.3 Compliance with Corporate Governance Code

Since its listing in 2011, there has been no adverse news on non-compliance with the Exchange. CTFJ compliance with all relevant listing rules and obligations outlined in Appendix 14 (HKEx, 2020a) of the Corporate Governance Code (Chow Tai Fook, 2019, p. 131). In terms of code of conduct covering insider trading (HKEx, 2020b), annual checks on directors and relevant employees have been conducted, and the above is in compliance (Chow Tai Fook, 2019, p. 171).

3.4 Emerging Risks and Challenges

Regulatory Risks: Other regulatory risks include environmental risk, local cyber-security risk, and Personal Data Privacy Ordinance (Hong Kong e-Legislation, 1996). CTFJ's production facilities are primarily based in China, and it must observe the local environmental regulations, such as carbon emissions. An annual sustainability report (Chow Tai Fook, 2019b) is published on both CTFJ & HKEx website. Separately, with an extensive online store, CTFJ has to ensure that there is sufficient protection on its customer information, including the General Data Protection Regulation in the European Union and Cybersecurity Law in China, are abided (Chow Tai Fook, 2019, p. 178).

Anti-Money Laundering: Jewellery and its products are at higher peril of being used for money laundering due to its size, weight, and value. Considering that anti-money laundering regulations do not bound the industry, jewellery retailers may not be equipped with the essential skills and competence to distinguish dubious trades. CTFJ employed third party consultants to assess and examine its internal controls, competency of staff in identifying fraudulent transactions, and executing adequate regulations (Chow Tai Fook, 2019, p. 171).

COVID-19 Risk: COVID-19 risk is unprecedented. There may not be adequate risk controls to meet the unprecedented disruptions in supply chains, temporary closure of outlets, re-deployment of staff, management of high inventories during lock-down periods, and implementing of other cost-cutting measures without compromising risk controls.

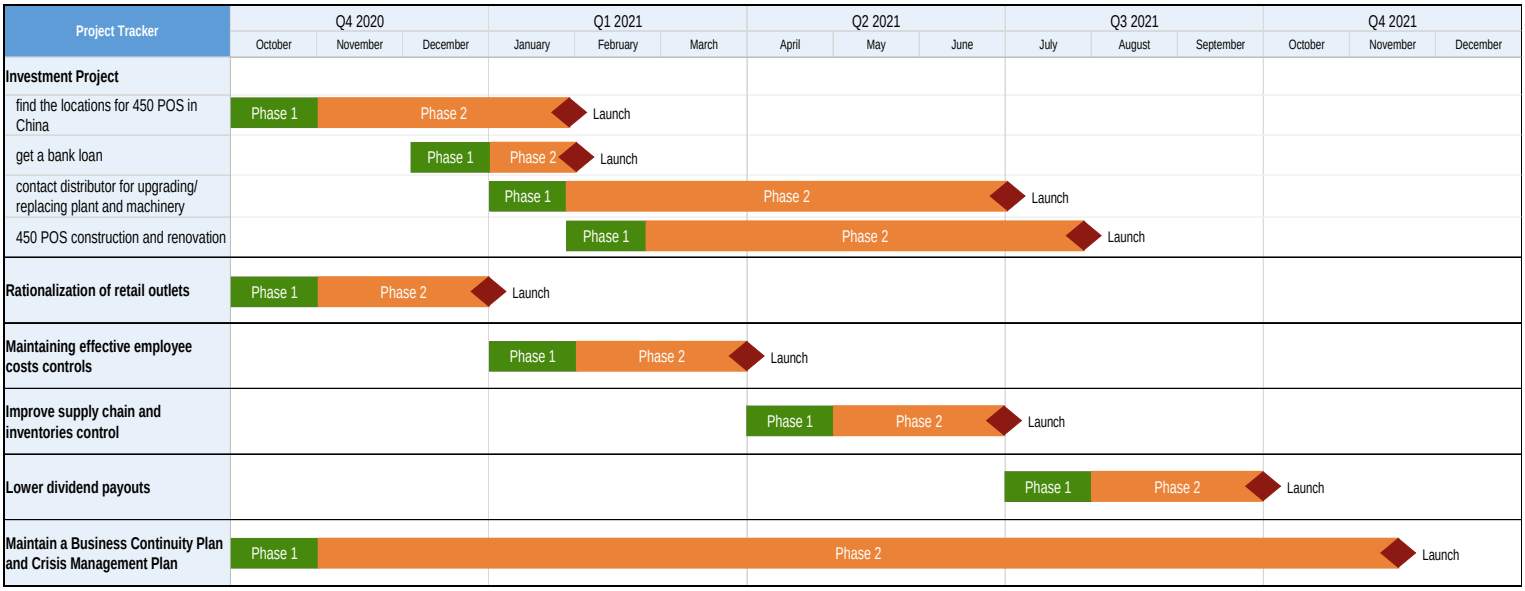
6. Conclusion and recommendation

CTFJ is financially healthy and has a growing potential compared to its peer in Hong Kong. The company is compliant with the corporate governance code, and it is transparent to its shareholders. An investment project is suggested to CTFJ and showing a good return in revenue.

6.1 Suggestions to CTFJ

Apart from the investment project proposed in Chapter 4, below are other prioritized suggestions that CTFJ may proceed in the coming quarters, that may improve the overall performance.

Figure 6-1 Gantt Project Chart



Source: Constructed by the author

Q4 2020 - Rationalization of retail outlets, including regular review of its leases during down cycles**.** CTFJ has experienced steady growth in its China market, and there is growth potential and higher yields in 3rd and 4th tier cities in China compared to mature markets in Hong Kong and Macau with escalating rental costs uptill Dec-2019. CTFJ should constantly review the lease contracts vis-a-vis the shop's monthly performance. For instance, there are three retail outlets in sky-high rental Central Hong Kong, where these shops are located within proximity of 100 meters (Figure *6-2* CTFJ's retail outlets in Central Hong KongFigure 6-2). CTFJ can leverage on its strong market position to negotiate for better lease terms such that it has more flexibility in managing its retail outlets in the same region during down cycles.

Figure 6-2 CTFJ's retail outlets in Central Hong Kong

Source: (Google Maps, 2020)

Separately, CTFJ can expand on its online network where rental of premises is not required. Online networks can increase their coverage to internet-savvy clients and to cater to customers when travel is inaccessible. Alternatively, it can strengthen its franchise model where the franchisees cover rentals.

Q1 2021 - Maintaining effective employee costs controls**.** General and distribution costs represent 13.6% and 13.9% of total revenue in 2019 and 2018, respectively (Chow Tai Fook, 2019, p. 190).

Table 6-1 CTFJ's General and distribution costs

Financial Year End (HK'million)	FYEMar-18	FYEMar-19
Total Revenue	59,156,400	66,660,900
Selling and distribution costs	(8,238,700)	(9,037,800)
	13.9%	13.6%

Source: Constructed by the author

Apart from leases that contributed 2.3% (Chow Tai Fook, 2019, p. 68) of the 13.6% mentioned above, employee costs contributed to a higher 6.9% (Chow Tai Fook, 2019, p. 68). Hence, CTFJ must maintain a robust employee cost structure. Whilst relocating certain stores from Hong Kong & Macau to 3rd & 4th tier Chinese cities will indirectly cut down on its staff costs per store, it is crucial for the CTFJ to adopt flexibility in staff management such as incorporating a percentage of salaries for downward adjustments during down-cycles or contracts on a renewal basis.

Q2 2021 - Improving its supply chain and inventories control. Jewellery retailers typically have high cash cycles, mainly due to high inventories-days on hand hovering between 294 to 300 days from 2017 and 2019 (Table 2-2). The above figures may increase during retail down cycles. CTFJ should continuously review its supply chain to maintain its inventories level, and if need beholds global/region-specific events to move sales.

Q3 2021 - Lowering its dividend payouts for higher retained earnings. Over the last 3 years, dividend payouts (Chow Tai Fook, 2019, p. 77) has been higher than its net profits (Chow Tai Fook, 2019, p. 195), which led to stagnated equity levels despite strong profitability. Strong dividend payouts may improve the share price; however, it will lead

to slower equity growth. Indirectly, the CTFJ will have to rely more on debt or equity financing for future expansions instead of relying on its equity.

Table 6-2 CTFJ's dividend payouts

Financial Year End (HK'000)	Chow Tai Fook		
	Mar-17	Mar-18	Mar-19
Net cash generated from operations	10,022,400	3,852,700	7,153,500
Dividends paid	(6,080,600)	(4,260,300)	(5,147,500)

Source: Constructed by the author

On-going Q4 2020 to Q4 2021 - Maintain a robust Business Continuity Plan and Crisis Management Plan**.** To ensure efficient operations during unforeseeable situations, e.g., massive earthquakes and flooding in China that have impacted to 27 provinces in 2019 (Lee, 2020), or prolonged protests and health crisis in Hong Kong which have worried Paul Chan, Financial Secretary of HK, and forewarned for an economy's burden (Choy, 2020).