IMPERIAL

Finance & Pricing Strategy

1. Using financial statements to assess firms - Office Hours

Emilio Luis Sáenz Guillén
19/09/2024

Introduction

Q & A?

Pre-prepared activities

Introduction

About myself

- Welcome everyone! My name is Emilio Luis Sáenz Guillén, I'll be your Teaching Assistant for the Finance & Pricing Strategy module.
- Doctoral Researcher in Actuarial Science at Bayes Business School, City St George's, University of London.
- Email: esaenzgu@ic.ac.uk
- Personal Website: https://emilioluissaenzguillen.github.io/

Tutorials & Office Hours

- **5 Tutorials**
  - Monday 23/09; Tuesday 01/10; Thursday 10/10; Monday 04/09; Monday 18/09.
  - At 10:00-11:00 and at 18:00-19:00 (London time).
- **Weekly Office Hours**
  - Odd weeks, Fridays at 10:00-11:00.
  - Even weeks, Thursdays at 17:00-18:00.

Tutorials & Office Hours Structure

1. Review/summary of <u>some</u> of the week's contents
2. Q & A?
   - Questions previously received on Ed Discussion Forum or via email
   - Questions you want to make in situ.
3. Pre-prepared activities.

Note:

➜ Each week we'll review each week's corresponding contents.

➜ ICL policy: turn on your cameras ! ☺

Introduction

Q & A?

Pre-prepared activities

1.4. Exploring the balance sheet

Is equity positively correlated with these companies' market capitalisation?

What info do we need?

➜ **Total Equity Gross Minority Interest** (available from the balance sheet)

- Overall equity attributable to both the company's common shareholders and minority interests (non-controlling interest)

➜ **Market Capitalisation**:

- Google it, or,
- calculate it yourselves: Market Value of Equity $=$ Shares outstanding $\times$ Market price per share

✳ Intra-firm analysis / Inter-firm analysis:

- AAPL balance sheet; AAPL market cap
- UBER balance sheet; UBER market cap
- WMT balance sheet; WMT market cap

Introduction

Q & A?

Pre-prepared activities

Earnings Calculations

1. Gross Profit
2. Operating Profit
3. EBIT (Earnings Before Interests and Taxes)

Profitability Ratios

1. Gross Margin
2. Operating Margin
3. EBIT Margin

Gross Profit

A company's profit after deducting the costs associated with producing and selling its products or services.

$$\text{Gross Profit} = \text{Revenue/Net Sales} - \text{Cost of Goods Sold (COGS)}$$

- Revenue/Net Sales: Total amount of money generated from sales for the period. It can also be called net sales because it can include discounts and deductions from returned merchandise.
- Cost of Goods Sold (COGS): Direct costs associated with producing the goods/services sold.

- **Includes variable costs**, which fluctuate with production levels
- **Excludes fixed costs** such as rent, insurance, and administrative expenses.

Operating Profit

Reflects the company's profitability from its core operations before accounting for non-operating items (like interest and taxes).

$$\text{Operating Profit} = \underbrace{\text{Revenue/Net Sales} - \text{Cost of Goods Sold (COGS)}}_{\text{Gross Profit}} - \text{Operating Expenses (OPEX)}$$

- Operating Expenses (OPEX): expenses from the ordinary course of running the business that are not directly related to producing the goods or services being sold.
  - Rent, salaries (not directly involved in production, e.g. management salaries), utilities, marketing, and administrative costs; also depreciation and amortisation.

EBIT (Earnings Before Interests and Taxes)

You may see that operating profit is also referred to colloquially as earnings before interest and tax (EBIT). However, EBIT can include non-operating income and expenses, which is not included in operating profit.

- Non-operating income is the portion of an organization's income that is derived from activities not related to its core business operations (e.g., dividend income, P&L from investments, by foreign exchange,...).

$$\text{EBIT} = \text{Revenue/Net Sales} - \text{COGS} - \text{Operating Expenses} \pm \text{Other Business Income/Expenses}$$

or

$$\text{EBIT} = \text{Net Income} + \text{Interest} + \text{Taxes}$$

where,

$$\text{Net Income} = \text{Revenue/Net Sales} - \text{COGS} - \text{Operating Expenses} \pm \text{Other Business Income/Expenses} - \text{Interest} - \text{Taxes}$$

$$= \text{Total Revenues} - \text{Total Expenses}$$

Profitability Ratios

$$1.\ \textbf{Gross Margin} = \frac{\textbf{Gross Profit}}{\textbf{Sales}}$$

$$2.\ \textbf{Operating Margin} = \frac{\textbf{Operating Profit}}{\textbf{Sales}}$$

$$3.\ \textbf{EBIT Margin} = \frac{\textbf{EBIT Profit}}{\textbf{Sales}}$$

Analysing ratios like these is useful because they give us a quick way to compare different companies or track performance over time, without being distracted by the size of the company or temporary costs.

Summarising video: https://www.youtube.com/watch?v=kXwAHQtstf0&t=15s

1.5. Income statements - Exercise

The company is contemplating several marketing actions, such as increased advertising, increased social-media engagement, special deals for loyal customers, etc. For a more general discussion, let's assume there are three actions being considered: actions 1, 2, and 3. Each action has a unique effect on marketing parameters. Specifically:

1. Action 1 increases acquisition rate from 8% to 11%. Implementing action 1 will increase the marketing expenses by £20,000.
2. Action 2 decreases churn rate from 5% to 3%. Implementing action 2 will increase the average cost per purchase by £5.
3. Action 3 increases average sales per customer from 7 to 7.15. Implementing action 3 will increase the marketing expenses by £10,000 and the average cost per purchase by £10.

Evaluate the effect of each action on the gross and operating profits.

IMPERIAL

Thank you.
Questions?

Finance & Pricing Strategy
19/09/2024