5 factors to consider when assessing company results

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Investors can be deluged with company results announcements during any given day of reporting season. Failing to keep pace with this torrent of information can mean missing out on trading opportunities and gaining deeper company insights. To manage our time most efficiently, we focus on five factors in a company's profit announcement as part our initial analysis of the result.

1. Headline numbers

First and foremost, we examine the headline numbers, including revenue, EBITDA (earnings before interest, tax, depreciation and amortisation), NPAT (net profit after tax) and EPS (earnings per share). We then compare these figures with consensus expectations and our own forecasts.

2. Outlook statement

One of the most important aspects of a result announcement is the management's outlook for the company. Outlook statements are our next 'go to' in the announcement as they can provide valuable detail on current and expected trading conditions and guidance on future profit. A business's experience from the coalface of their industry can also offer important insights into broader economic and market trends.

3. Cash flow

We believe reconciling cash flow is the most important part of analysing a company's financial statements. Specifically, reconciling operating cashflow to EBITDA. We also review the other items in the cash flow statement, such as interest and tax, and how these figures compare to the profit and loss statement. When cash flows fail to reconcile, this can be an ominous signal about the sustainability and integrity of the company's operations.

4. Balance sheet

When we are analysing a company's accounts, the balance sheet is highly important. Our primary consideration is the level of net debt (adjusted for any cash balance). We are not opposed to high levels of debt in principle provided a company has the ability to service that debt.

For companies with larger debt balances, it is critical to assess debt coverage ratios (such as net debt to EBITDA), and how loans rank in relation to the bank's debt covenants. We also need to understand the business's working capital position using simple ratio analysis, as well as debtor/creditor days and inventory movements. This process will also assist in reconciling a company's cashflow.

Other areas of focus are liabilities, such as tax and earn-out payments that have accrued from prior acquisitions, and any provisioning for intangible items that has changed significantly as compared to the previous reporting period.

5. Profit and loss statement

The profit and loss statement helps us determine the overall quality of a company's result. When reviewing the profit and loss statement, we seek to:

- Understand the composition of a company's revenue (paying particular attention to the notes to the accounts in order to fully understand each line item).
- We also look for one-off revenue benefits (as well as any asset write-offs) as these can distort the after-tax profit figure.
- Calculate the company's effective tax rate, taking into account one-off tax benefits or liabilities.
- If there is a debt balance on the balance sheet, quantify the level of interest paid on any existing debt balances.
- Undertake margin analysis that is at gross margin, EBIT, EBITDA and NPAT level – and compare these margins to the previous corresponding period.

When assessing a company's profit and loss statement, we look particularly for any large movements in items from the prior period. Significant increases in marketing or 'other' expenses can good talking points with the company. In more recent years, technology companies in particular have aggressively capitalised costs through their cash flow statements, rather than categorising these as expenses.

COVID-19 considerations

This reporting season is unlike any previously due to the impacts of COVID-19. It is critical investors take into account the various additional items in company result announcements relating to the global pandemic. These include the value of stimulus payments (such as JobKeeper) received, as well as the company's expectations of any future payments. We are focused on any large reductions in labour costs due to the recession and understanding whether these cuts are permanent cost outs, or if they are expected to come back into the business and, if so, over what time horizon.

While there is a high degree of uncertainty regarding future earnings for many businesses and industries, companies are likely to be more guarded than during any prior reporting period in their outlook statements. We are expecting, companies will generally not provide quantitative profit guidance, preferring instead to wait until their Annual General Meetings in November (where applicable) or on an ongoing basis as and when management has greater clarity on trading conditions.