

University

FINANCIAL ANALYSIS

Lecturer's name

Name

Executive summary

This study aims to illustrate the business and strategic analysis of two multinational company IRESS limited and MYOB holding limited both based in Melbourne, Australia. A brief discussion is made on the macroeconomic factors of both the organizations like the political factors, economic and other social factors that affect the business. A comparative analysis is also made on the financial statements of both the companies that include return on equity of the companies, its decomposition, and DuPont analysis based on that. The study further attempts to discuss the prospective analysis of the companies that includes the sales growth rate, NOPAT margin, WC to sales, etc.

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Introduction

Financial statement analysis facilitates the financial managers to make the decision regarding investment and therefore financial statement analysis is to be found as one of the most crucial of financial management. In this context, it is to mention that the financial statement analysis considers the ratios to identify the trends of the financial positions of a company ⁽ⁱ⁾. Therefore, the researcher shall consider ratio analysis for identifying the trend of the performance of the company. In the initial part of the study, the researcher shall consider the business and strategic analysis of IRESS limited- Melbourne. In this part, the researcher shall consider the industry analysis, economic analysis and the analysis of the performance of the competitors of the company. After this part, the researcher shall analyze the accounting analysis and the financial analysis to identify the trends of the ratios and the reasons for changes in the performance of the company. In the next part of the study, the researcher shall make discussion on the sales growth rate and the asset quality of the company to make the comparison with the competitive firms. In addition to that, the researcher shall make the recommendation on the basis of the strategic analysis, financial analysis, and the prospective analysis.

1. Business and Strategic Analysis

1.1 Analysis of the economy

In Australia, the software industry is to be considered as one of the most emerging industries and this industry creates the most employment in the country after the banking industry ⁽ⁱⁱ⁾. As this industry enhances the employability in the country, the government encourages the industry owners by providing the subsidy to the companies of this industry. Therefore, the company could avail the subsidy from the government in future. On the other hand, the researcher is to mention that the software industry in Australia earns foreign income and therefore this industry contributes 21% of the total GDP of the country ⁽ⁱⁱⁱ⁾.

On the other hand, the researcher is to mention that the intellectual property in Australia is generated by the engineering universities in the country (). As the country has an immense source of intellectual properties from the internal and external sources, the company could get

the advantage of skilled employees for the business operation. The software industry relies on the advancement of the technologies and Australia is to be considered as technologically advanced as per as the software technology is concerned (^{iv}). In this context, it is to mention that students from all around the globe come to Australia for the job opportunity and therefore the company could get the internationally approved technological support.

1.2 Industry analysis

Identification of the industry

IRESS limited involved in selling the software services in the internal market as well as in the external market. Therefore, the researcher is to mention that the company is in the software industry in Australia. In this context, the researcher is to mention that the company has earned the highest revenue in 2015 and 2016 among the Australian software companies. In this context, the researcher is to mention that the market share of the company in the stock market is the second highest after XERO. As per as the international business is concerned, the researcher is to mention that the company has made third highest foreign revenue among the software companies in the country.

Competitors of the company

While making discussion on the competitors of IRESS limited, the researcher is mention that MYOB holding limited has earned the highest operating revenue in the industry since 2011, and therefore this company is required to be considered as the most impactful competitor of IRESS limited.

Competitive positioning analysis through Porter's five forces model:

Bargaining power of supplier:

The company purchases software related products from foreign countries, which includes China, Japan, the United States, and India. Moreover, it is also to mention that the competitors of the company including MYOB holding limited purchases raw materials from the USA and China. Bargaining in the international business relies upon the treaties that a company makes with other

companies, and therefore, the issue of bargaining with the suppliers is a macroeconomic issue. Therefore, this factor could not affect the strategic decision making of the company (✓).

Bargaining power of the customers:

MYOB holding limited sells its software to the domestic customers as well as to the foreign clients. As this company has initiated the foreign trading in 2012, the bargaining power of the foreign customers is to be considered as high. Therefore, the researcher is to mention that the high degree of the bargaining power of the customers affects the strategic and comparative decision making of the company.

The threat of new entrants:

The software industry is to be considered as a capital intensive industry and therefore the new firms could not enter into the industry due to lack of capital. On the other hand, the researcher is to mention that the company does not face any problem regarding the threat of new entrants.

The threat of substitutes:

As the software industry relies upon the advancement of the technology, the industry offers a high number of substitutes to the customers. In this regard, it is to mention that the competitors of the company offer customized products to the clients, which could enhance the threat of substitutes for the company.

Rivalry among the existing competitors:

Large software firms form the cartel in Australia to set a price of the software services in the domestic market. In this context, the researcher is to mention that as the company is involved in international business and therefore it faces strong competition in the global stage. In this context, the researcher is to mention that the company does not face such competition as its face in the international platform.

From the above discussions, the researcher is to mention that the company faces competition in terms of the threat of substitutes. This force could result in the decrease in the profitability of the companies in the industry. On the other hand, the researcher is to mention that the advancement of the technology could facilitate the industry to enhance the profitability level.

Growth potential of the software industry

Companies in Australia consider the advancement in the software as the most impactful factor for achieving the organizational goal. In this context, the researcher is to mention that the software industry is required to be considered as the most emerging industry as this industry has reflected the most steady growth as compared to the other service-providing industries (). Therefore, the researcher is to mention that the industry is required to make the large investment in order to enhance the innovation that would facilitate the companies to enhance the return on investment in future.

1.3 Company's competitive and corporate strategy

The company's competitive strategy

IRESS limited has a separate team for serving the post sales services to the foreign clients (^{vi}). On the other hand, the researcher is to mention that the company appoints employees from internal sources along from the foreign countries. Therefore, the base of knowledge within the company is required to be considered as one of the most crucial core competencies as the company involves in an industry that is affected by the advancement in the technology. Therefore, the knowledge base and the post-sale services are required to be considered as the core competencies of the company. Along with the core competencies, the company has risk drivers, which creates constraints to the company. This includes a risk of duplication of products and the piracy of the company outputs. Therefore, the researcher is to mention that the post sales service and the prevention of the piracy and duplicity of products could enhance the profitability of the company.

The corporate strategy of the company

The company has adopted cost leadership strategy as the primary base of corporate strategy. In this context, the researcher is to mention that the high level of competition in the software industry is to be considered as the main reason that it has adopted the strategy of cost minimization and minimization of a price of the products.

Income statement of IRESS limited

	2016	2015	2014
	\$'000	\$'000	\$'000
Revenue	389,737	361,464	389,738
Customer data fees	(31,385)	(29,192)	(31,385)
Communication and other technology expenses	(23,026)	(17,601)	(23,026)
Employee benefit expenses	(202,428)	(185,062)	(202,428)
Other expenses	(29,389)	(24,731)	(29,389)
Profit before depreciation, amortization, interest and income tax	103,509	104,878	103,510
Depreciation and amortization expense	(21,063)	(26,267)	(21,063)
Profit before interest and income tax expense	82,446	78,611	82,447
Interest revenue	937	849	761
Financing costs	(6,406)	(10,554)	(6,406)
Net interest and financing costs	(5,469)	(9,705)	(5,469)

Profit before income tax	76,977	68,906	76,978
Income tax expense	(17,525)	(13,521)	(17,525)
Profit after income tax	59,452	55,385	59,453
Other comprehensive income			
Items that may be reclassified to profit or loss:			
Exchange differences on translation of foreign operations	(38,931)	8,782	(38,931)
Tax impact of exchange differences recognized in other comprehensive income	(1,610)	–	(1,610)
Total other comprehensive income for the period	(40,541)	8,782	(40,541)
Total comprehensive income for the period	18,911	64,167	18,912
	Cents per	Cents per	Cents per
	share	share	share
Earnings per share			
Basic earnings per share	37	35.2	33.4

Diluted earnings per share	36.4	34.7	33
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Income statement of MYOB holdings limited

Particulars	MYOB holdings limited		
	2016	2015	2014
	\$'000	\$'000	\$'000
Profit or loss from ordinary activities before tax	79608	-60052	-4568
Pre acquisition profit adjustment	-521	0	0
Income tax benefits	-16597		
Net profit	62490	-60052	-4568
Retained loss at the beginning of the year	-	-	-
	406821	240620	74419
		-	-
Transfer	70000	130000	50000
Dividends paid	-62189	0	0

Balance sheet

Particulars	IRESS limited			MYOB holdings limited		
	2016	2015	2014	2016	2015	2014
Noncurrent assets						
Tangible assets	30428	36195	30428	102361	183337	102361
Intangible assets	529552	529552	529552	1110003	1124284	1138565
Total noncurrent assets	559980	565747	559980	1212364	1307621	1240926
Current assets						
Cash and cash equivalent	22951	39233	55515	5947	2171	-1605
Receivables	50103	37358	24613	41352	25586	9820
Inventory	0	0	0	192	503	814
Other current assets	205	0	205	46697	30379	14061
Total current assets	73259	76591	80333	94188	58639	23090
Total assets	633239	642338	640313	1306552	1366260	1264016
Current liabilities						
Trade payables	44169	41541	38913	55976	35736	15496
Tax provisions	10979	10069	9159	9852	9120	8388
Total current liabilities	55148	51610	48072	65828	44856	23884
Equity shareholders fund	578091	590728	592241	592241	592241	592241
Total equity and liability	633239	642338	640313	658069	637097	616125

Cash flow statement of the company

Particulars			
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Cash flow from operating activity	90568	90746	90924
Cash flow from financing activity	-121163	-84826	-48489
Cash flow from investing activity	13699	-39576	-92851
Net cash generated during the year	-16896	-33656	-50416
Add. Opening cash and cash equivalent	13699	-39576	32656
Closing cash and cash equivalent	-3197	-73232	-17760

2. Accounting Analysis

In the accounting analysis, the researcher shall make discussion on the three significant items in the financial statement of IRESS limited and MYOB Holding limited.

These items are discussed as follows.

1. Retained earnings:

The retained earnings of IRESS limited in 2016 were \$19,136,000, whereas the retained earnings of MYOB holding limited were \$353,800 in 2016. In this context, the researcher is to mention

that the previous discussion reflects that the software manufacturing firms need to make the regular investment in research and development ^(vii). For this purpose, the companies in this industry are to use their retained earnings as the primary source of investment in the research and development sectors. Therefore, the researcher is to mention that IRESS limited is in a competitively advantageous position as compared to its competitive firm.

2. Borrowings:

As discussed earlier, software industry players face risks related to the advancement in the technology ^(viii). In this context, it is to mention that the enhanced amount of borrowings would enhance the financial risks of a company and therefore the companies with high debt capital are to incur more interest costs. In this context, the researcher is to mention that IRESS limited has a debt capital of \$177,805,000. On the other hand, the debt capital of the company was \$434,800 in 2016. Therefore, the researcher is to mention that IRESS limited is riskier as compared to MYOB limited as per as the financial risks are concerned.

3. Intangible assets:

Intangible assets are to be considered as the base of the research and development as this assets helps the companies to develop a core competence ^(ix). In this context, it is to mention that the intangible assets of IRESS limited are \$568,759,000. On the other hand, MYOB holdings limited has an intangible asset of \$1210,2000 on 2016. As IRESS limited had a higher amount of intangible asset, it could build up a profitable product cycle in the market ^(x).

Quality of disclosures

IRESS limited has disclosed the financial and non-financial aspects of the company as the annual report includes audit report and directors report. On the other hand, the researcher has mentioned that the company has disclosed the workings for deriving the account balances as per the IFRS rule. On the other hand, the researcher is to mention that MYOB holdings limited has not disclosed its cash flow statement, therefore it can be said that IRESS limited has reported a quality financial statement as per as the requirements of the IFRS are concerned. This will help the stakeholders of the company to assess the financial reports properly and thus, will be able to make better investment decisions. It will also provide the company a better image in the market.

Three potential red flags of the company

As the company is involved in the business of selling software in the market, it needs to rely upon the intangible assets, and therefore, the intangible assets are the initial red flag of the company. The intangible assets are significant in the company's growth and survivability in the market. On the other hand, the company has hold a significant amount of investment, from which it can earns its profit, hence this item is also required to be considered as a red flag item. The market base of the company is strong and the results are³ reflected in the in its investment. Thus the company needs to perform better in order to maintain their level of investment. Moreover, he researcher is to mention that the company has made international sales during 2016, which is reflected in the net sales figure. As revenue from operations is the primary source of profit of the company, this could also be considered as a red flag of the organization. The profit earned by the organization if retained can be used for several purposes like expansion or growth, for payment of dividend to the shareholders, etc. Thus, it becomes necessary for the organization to increase its productivity from operation and thus increase the profitability of the firm.

3. Financial Analysis

Return on equity and its decomposition:

The return on equity or return on net worth is a tool for measuring an organization's profitability based on the profit margin generated by amount of shareholder's equity. The return on equity of a firm is given by,

$$\text{ROE} = \text{Net Income} / \text{Shareholder's equity.}$$

In other words, return on equity is the amount of net income earned as a percentage of shareholder's equity. It is an important tool for measuring the firm's profitability based on the profit generated by the firm with the money invested by the shareholders.

In light of the given situation, the return on equity of IRESS is given below,

Calculation of Return on Equity of IRESS		
Particulars	Amount (2015)	Amount (2016)
Net profit	55385000	59452000
Sales revenue	361464000	389737000
Total assets	642338000	662241000
Total Equity	339311000	400826000
Net profit margin	0.153224111	0.152543895
Assets turnover	0.562731771	0.588512339
Leverage ratio	1.893065654	1.652190726
Return on equity	16.32%	14.83%

Thus, IRESS had a return on equity of 14.83 % in the year 2016 and 16.32 % in the year 2015. From the above results, it is evident that the company had better profitability in the year 2015 than in 2016.

As the return on equity is used to measure the company profitability, the higher the return on the shareholder's equity, the better for the company. However, in the given case, the ROE of IRESS is better in the year 2015 where the company had a ROE of 16.32 %. In the year 2016 the company had a ROE of 14.83 % which indicates that the revenue earned by the company was not expected as compared to the shareholder's equity. The factor that affects the return on equity of a company includes the net profit earned, the sales revenue generated, total assets the company

holds and the total equity. Notable, the company had higher leverage ratio in the year 2015 as compared to 2016, which indicates that the company had more risk in 2015 than in 2016. Thus, it can be interpreted that due to more risk the company was able to earn more return on shareholder's equity as compared to 2016 where the company had a leverage ratio of 1.65.

Financial analysis of IRESS limited and MYOB holding limited for the financial year 2016:

a) Operating ratio: The operating ratio of an organization is calculated to measure its efficiency by comparing the organization's operating expense to its net sales. The lower the operating ratio the better for the organization as it indicates the organization's ability to earn the profit. However, it should be noted that debt payment or expansion is taken into account while calculating the operating ratio. The operating ratio of an organization is given by operating expenses / net sales.

i) Total Assets Turnover ratio: this ratio is used to measure the company's ability to generate sales compared to its total assets. The ratio is given by,

Total asset turnover = net sales / average total assets

Calculation of Return on Equity				
	IRESS limited		MYOB holding limited	
Particulars	Amount (2015)	Amount (2016)	Amount (2015)	Amount (2016)
Sales revenue	361464000	389737000	327777000	370417000
Total assets	642338000	662241000	1379441000	1389203000

Assets turnover	0.562731771	0.588512339	0.237615817	0.266639937
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ii) Equity Turnover ratio: Equity turnover ratio is used to measure the organization's ability to generate sales compared to its investment in total equity. The higher the ratio the better it is for the company as it indicates the revenue generated with respect to every dollar the company has invested in total equity. The equity turnover ratio is given by,

Equity turnover = net sales / average total equity

Calculation of Return on Equity				
	IRESS limited		MYOB holding limited	
Particulars	Amount (2015)	Amount (2016)	Amount (2015)	Amount (2016)
Sales revenue	361464000	389737000	327777000	370417000
Total Equity	339311000	400826000	863277000	856931000
Equity turnover	1.065288187	0.972334629	0.379689254	0.432260007

iii) Fixed assets turnover ratio: This ratio is used to measure the company's ability to generate sales with respect to its investment in fixed assets. It is given by,

Fixed assets turnover ratio = net sales / net fixed assets

Calculation of Return on Equity				
	IRESS limited		MYOB holding limited	
Particulars	Amount (2015)	Amount (2016)	Amount (2015)	Amount (2016)
Sales revenue	361464000	389737000	327777000	370417000
Net fixed assets	539550000	570855000	1219005175	122964000
Fixed assets turnover	0.669936058	0.682725035	0.268888932	3.012402004

b) Investment ratio: The investment ratio is a relationship between the amount of money an organization has invested and the amount of profit earned from it. Two of the significant investment ratios are returned on equity and profit margin of the organization.

i) Return on equity: Return on equity can be defined as the amount of net income earned by an organization with respect to its shareholder's equity. It is given by

$$\text{Return on equity} = (\text{net profit} / \text{sales}) * (\text{sales} / \text{total assets}) * (\text{total assets} / \text{total equity})$$

	IRESS limited		MYOB holding limited	
Particulars	Amount (2015)	Amount (2016)	Amount (2015)	Amount (2016)
Net profit	55385000	59452000	-42415000	55647000
Sales revenue	361464000	389737000	327777000	370417000

Total assets	642338000	662241000	1379441000	1389203000
Total Equity	339311000	400826000	863277000	856931000
Net profit margin	0.153224111	0.152543895	-0.129402002	0.150227986
Assets turnover	0.562731771	0.588512339	0.237615817	0.266639937
Leverage ratio	1.893065654	1.652190726	1.597912373	1.621137524
Return on equity	16.32%	14.83%	-4.91%	6.49%

ii) Profit margin: Profit margin is used to measure the amount of profit earned by an organization. It is given by,

Profit margin = net profit / net sales

Calculation of Return on Equity				
	IRESS limited		MYOB holding limited	
Particulars	Amount (2015)	Amount (2016)	Amount (2015)	Amount (2016)
Net profit	55385000	59452000	-42415000	55647000
Sales revenue	361464000	389737000	327777000	370417000
Net profit margin	0.153224111	0.152543895	-0.129402002	0.150227986

iii) Current ratio: Current ratio is one of the liquidity ratios that is used to measure the company's ability meet short-term obligations. It is given by,

$$\text{Current ratio} = \text{Current assets} / \text{current liabilities}$$

Particulars	IRESS limited		MYOB holding limited	
	Amount (2015)	Amount (2016)	Amount (2015)	Amount (2016)
Current assets	76591000	73054000	64225000	96268000
Current liabilities	60323000	55148000	78523000	91471000
Current ratio	1.269681548	1.324689925	0.817913223	1.052442851

iv) Return on assets: It is one of the financial ratios that is used to measure the percentage of profit the company earns with respect to its overall resources. It is given by,

$$\text{Return on assets} = \text{net income} / \text{total assets}$$

Particulars	IRESS limited		MYOB holding limited	
	Amount (2015)	Amount (2016)	Amount (2015)	Amount (2016)
Net income	361464000	389737000	327777000	370417000

Total assets	642338000	662241000	1379441000	1389203000
Return on assets	0.562731771	0.588512339	0.237615817	0.266639937

c) Financial leverage ratio: While carrying out its day-to-day business activity, an organization has to rely on various factors that includes the owner's equity and the debt taken to finance its operations. A leverage ratio is used to assess the company's ability to meet its financial obligations by measuring the amount of capital that comes in form of debt.

i) Debt - equity ratio: The debt-equity ratio indicates the extent to which an organization depends on the amount of borrowed capital to carry out its day-to-day operation. This ratio is calculated to ascertain the soundness of the organization's financial position in the long run.

It is given by,

Debt - Equity ratio = long term debt / shareholder's fund or total debt / total shareholder's fund

	IRESS limited		MYOB holding limited	
Particulars	Amount (2015)	Amount (2016)	Amount (2015)	Amount (2016)
Total debt	242704000	206267000	437641000	440801000
Total Equity	339311000	400826000	863277000	856931000
Debt equity ratio	0.715284798	0.514604841	0.506953156	0.514394975

ii) Debt to the total capital ratio: Debt to total capital ratio is used to show a relationship between the long-term debts of an organization with the total capital employed. In this case, the total capital includes both long-term liabilities and shareholder's equity. It is given by,

$$\text{Debt to total capital ratio} = \text{long term debt} / \text{total capital or Total debt} / \text{total capital}$$

	IRESS limited		MYOB holding limited	
Particulars	Amount (2015)	Amount (2016)	Amount (2015)	Amount (2016)
Total debt	242704000	206267000	437641000	440801000
Total capital	339311000	400826000	863277000	856931000
Debt to total capital ratio	0.715284798	0.514604841	0.506953156	0.514394975

iii) Interest Coverage ratio: This ratio is used to determine the company's ability to pay interest expenses on its outstanding debt. It is given by,

$$\text{Interest coverage ratio} = \text{EBIT} / \text{interest expenses}$$

iv) Debt ratio: This ratio is one of the solvency ratios and is used to measure the total liabilities of the firm with respect to its total assets. It is given by,

$$\text{Debt ratio} = \text{total liabilities} / \text{total assets.}$$

	IRESS limited	MYOB holding limited

Particulars	Amount (2015)	Amount (2016)	Amount (2015)	Amount (2016)
Total liabilities	516164000	532272000	327777000	370417000
Total assets	642338000	662241000	1379441000	1389203000
Debt ratio	0.803570706	0.803743652	0.237615817	0.266639937

4. Prospective Analysis

Sales growth

Particulars	2015	2016	Sales growth rate (%)
Sales	361,464	389,737	7.821802448

Forecasting of the financial data

Particulars	2015	2016	Forecasted amount
Sales	361,464.0	389,737.0	418,010.0
NOPAT	55,385.0	59,452.0	63,519.0

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Working capital	339,311.0	400,826.0	462,341.0
WC to sales ratio	0.9	1.0	1.1
Long-term assets	589,187.0	565,747.0	542,307.0
Long term asset to sales	1.6	1.5	1.3
Debt	242,704.0	242,704.0	242,704.0
Equity	400,826.0	339,311.0	277,796.0
Debt ratio (Debt / Equity)	0.6	0.7	0.9
Finance cost	9,705.0	5,469.0	1,233.0
Debt capital	242,704.0	242,704.0	242,704.0
After tax cost of debt (After tax cost / Debt capital)*100	4.0	2.3	0.5
Dividend per share	0.1	0.1	0.1

Earnings per share	0.3	0.4	0.4
Dividend rate (Dividend per share / Earnings per share)	0.3	0.3	0.3

From the above analysis, the researcher could identify that the financial leverage of IRESS limited is lower than its competitor company MYOB holdings limited. Therefore, the researcher is to mention that it has a lower risk profile than its competitor. Moreover, the sales revenue has been shown as increasing and it has a growth rate of above 7%.

On the other hand, the researcher has seen that the working capital to sales has also increased by 10% from 2015 to 2016. On the other hand, the researcher is to mention that the long-term assets to sales ratio have been seen as decreasing, which could be identified as the result of enhancement in the forecasted sales of the company. The debt-equity ratio has been seen as increasing, which could be identified as the reason of decreasing finance cost of the company. The company has earned higher earnings per share as compared to 2015; however, the dividend per share has been constant over the periods.

Particulars	Abnormal earnings approach (\$ in millions)	Market multiple approaches (\$ in millions)
Noncurrent assets		
Tangible assets	30428	33470.8
Intangible assets	529552	582507.2
Total noncurrent	559980	615978

assets		
Current assets		
Cash and cash equivalent	22951	25246.1
Receivables	50103	55113.3
Inventory	0	0
Other current assets	205	225.5
Total current assets	73259	80584.9
Total assets	633239	696562.9
Current liabilities		
Trade payables	44169	48585.9
Tax provisions	10979	12076.9
Total current liabilities	55148	60662.8

Value of the firm	578091	635900.1
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From the above calculation, the researcher is to mention that the value of the firm has been calculated at \$578091 million under the abnormal earning approach. On the other hand, the value of the firm has been calculated at \$635900.1 million under the market. In this context, the researcher is to mention that the market value of the assets and liabilities have been calculated by considering the growth at the rate of 10%.

5. Conclusions and Recommendation

From the above discussions, the researcher has identified that IRESS limited has earned a steady profit. On the other hand, the researcher has seen that the sale of the company is increasing along with the assets turnover. Hence, it could be said that the investors could invest in this company for availing growth in earnings. In this context, it is to mention that the earning per share has also increased over 2015 and 2016. This could also be considered as a crucial point that justifies the decision to make the investment in the company.

In this context, the researcher is to mention that the company has performed more efficiently as compared to its competitor firm MYOB holdings limited. In this context, the researcher is to mention that the performance of the company has been seen as improving as the revenue figure and the profit figures are increasing for the company. Therefore, the shares of the company could be retained or purchased by an investor. Furthermore, the researcher is to mention that the company has shown an enhancement in the operating cash flow, which is to be considered as a good sign for the investor in making the investment in the company.

References

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