ANALYZING THE ANNUAL REPORT

The cheaper the paper, the more valuable the information.-- Peter Lynch

Company:____________________________ Year:_______ (All dollar amounts in _________ except per share values)

Bob Adams -- Director, Puget Sound Chapter, NAIC

Data taken from Consolidated Balance Sheet & Statement of Income

Current Assets

Total cash = Cash plus Marketable securities (if any)

	Current Year Cash:	$____________	[1]
+	Current Yr. Marketable Sec.	$____________	[2]
[A]	**Current Yr. Total cash:**	$____________	
	Prior Year Cash:	$____________	[1]
+	Prior Year Marketable Sec.:	$____________	[2]
	Prior Yr. Total cash:	$____________	

Compare this years figure with last year. (Socking away cash is a sign of prosperity)

Accounts Receivable (A/R)

Current A/R ratio = (Current Yr. Sales / Current Yr. A/R)

Prior Yr. A/R ratio = (Prior Yr. Sales / Prior Yr. A/R)

Divide the Current A/R ratio by the prior year's ratio. The result should be greater than one, indicating faster collection of receivables. A result significantly less than one is very concerning - investigate why customers aren't paying their bills as promptly.

	Current Yr. Sales:	$____________	[11]
	Current Yr. Accts. Rec.:	$____________	[3]
[B]	**Current Yr. A/R ratio:**	____________	
	Prior Year Sales:	$____________	[11]
	Prior Year Accts Rec.:	$____________	[3]
[C]	**Prior Yr. A/R ratio:**	____________	
	Compare Prior Yr. to Current Yr.:	____________	[B] / [C]

Inventories

Inventory turnover ratio = (Current Yr. Sales / Current Inventories)
Inventory turnover ratio = (Prior Yr. Sales / Prior Inventories)

Divide the Current Inv. ratio by the prior year's ratio. The result should be greater than one, indicating faster turnover of inventories. A result significantly less than one is very concerning - investigate why merchandise isn'ty selling as promptly.

Excess inventories hurt profitability and the goods may become obsolete.

	Current year Sales:	$____________	[11]
	Current yr Inventories:	$____________	[4]
[D]	**Current Inventory ratio:**	$____________	
	Prior Year Sales:	$____________	[11]
	Prior Year Inventories:	$____________	[4]
[E]	**Prior Yr Inventory ratio:**	$____________	
	Compare Prior Yr. to Current Yr.:	$____________	[D] / [E]

Liabilities

Compare with prior year. *Debt reduction is another sign of prosperity*.

Ignore short-term debt (May give purists heart palpitations -- keep it simple)
Assume other assets [inventories, etc.] will cover short-term debt.

[F]	Current LT Debt:	$____________	[8]
	Prior year LT Debt:	$____________	[8]
	The Trend is:	____________	

Net Cash = Total cash [A] minus LT debt [F]

[G]	Net cash:	$____________	[A] - [F]
	Net Cash is:	____________	

When cash exceeds debt, it is very favorable.

As often as not, long-term debt exceeds cash. But if the cash has been shrinking & debt has been growing, the company may be in weak financial shape. [What is the 5 year trend?] Weak or strong is what you want to know.

Shares Outstanding

What is the trend? If shares are decreasing, company is buying back shares, a positive sign.

Cur.. Shrs outstand.:	$____________	[9]
Prior yr. Shrs. out.:	$____________	[9]
The Trend is:	____________	

Cash Position Per Share

Cash Position per Shr. = Net cash [G] / Shares outstanding [9]

Cash Position Per Shr: $____________ [G] / [9]

This value, when positive, offers price support in a down market and reduces the cash-at-risk.

Debt to Equity -- The Debt Factor

Debt to Equity Ratio = LT Debt [F] / Equity [10] X 100

Current LT Debt:	$____________	[F]
Total Stockholders Eq:	$____________	[10]

Normal balance sheet = 25% debt, 75% equity when based on LT Debt.
This would represent a strong balance sheet. A weak balance sheet might have 70% debt and 30% equity. More than anything else, it's debt that determines which companies will survive and which will go bankrupt in a crisis.

Debt percentage: ____________%

Working Capital Ratio (Also called Current Ratio):

[5] [7]
Working Capital Ratio = Total Current Assets / Total Current Liabilities

Measures the ability of a firm to meet its current oblications to short-term creditors.
About 2:1 is normal for manufacturing companies, and less than 2:1 is a danger sign. Utilities are likely to operate with a 1:1, or less, ratio.
Make comparisons to other years and to other companies in the industry. A Ratio far in excess of 2:1 is not necessarily a plus, as it may indicate the company is not employing its cash to full advantage in income-producing assets.

Total Current Assets: $____________ [5]

Total Current Liab.: $____________ [7]

Working Cap Ratio: ____________

Plant Turnover Ratio:

[10] [6]
Plant Turnover ratio = Sales / Property Plant & Equipment

The higher the ratio the better. If the company invests in the plant or in equipment without an increase in sales, there is clearly a problem

Sales: $____________ [11]

Prop. Plant, & Equip.: $____________ [6]

Plant Turnover Ratio: ____________

Statement of Cashflows

Cashflow Analysis (CF)

[12] [13] [14]
Free CF = Cash Provided by Operations - Dividends paid - PP&E
(PP&E -- Purchases of Property Plant & Equipment)

Look on the Cashflow Statement for Operating Cashflows. These amounts, for most years, should be positive and rising. If Operating CF is negative, it suggests that the company will be dependent on external financing to grow.

Operating Cashflow $____________ [12]

Dividends Paid $____________ [13]

Expenditures on PP&E $____________ [14]

Free Cashflow $____________

In mature industries, "Operating CF" should exceed the sum of "dividends paid" and "expenditures on Plant & Equipment".
This measures the amount of "Free Cashflow" a company can use to create shareholder value by: a)buying back stock, b) repaying debt, or c) making acquisitions. In rapidly growing industries, the Free CF can be minimal, but should be not significantly negative.

Read the "To Our Stockholders" letter and, or, President/CEO letter.
Look for alibis and excuses if earnings or sales are down, especially if the market has been advancing or is stable.
Poor management will blame the market, the economy, outside influences, etc.
Good management will admit they failed to see an unfavorable trend or circumstance.
Good management will explicitly state their expectations for growth and returns (ROA OR ROE).
Look for plans for the future of the company and a discussion of any problems and how they will be handled.

Read the Management's Analysis & Discussion:
This will discuss operating trends and market factors impacting the growth and profitability. These are the key factors derived on the SSG.
If you discover restraining factors on growth or profitability, review your "trend line" assumptions on the SSG for a possible downward revision.
If the growth rate and margins are trending upwards, chances are very good that the stock will appreciate.

Read the Auditor's statement. You will soon recognize normal verbiage:
". . . the financial statements present fairly, in all material respects. . .". Any exceptions or references to the footnotes should be investigated.
Look for any softening of the language used in prior years' reports. Other warning flags include an unheard-of auditing firm, a short operating history and/or exceeding rapid growth.

Use the information from the Annual Report to complete a new SSG, or, as a reminder to check your data source for the new year figures.
CAUTION If you use data from the Annual Report to update your SSG, as soon as the year-end data is reported by Value Line or S&P, or whatever service you used as a data source for the original SSG, check the numbers to be sure they agree. Because of different accounting methods and/or accounting periods, the numbers can be different and cause your SSG to be skewed.
Always use one single source for your SSG data .

If the company you are evaluating is a foreign company (including companies represented as ADRs), the Annual Report figures may be shown in a foreign currency, not U.S. dollars. The report will indicate which currency is being used. Get the exchange rate from your newspaper and convert the values you use before incorporating them into your SSG.