

CORPORATE ANALYSIS

Corporate Financial Health Check - Principles

To start with, finance can only support the implementation of a firm's strategy, which always has to come first. – When assessing the financial health and sustainability of a firm, the areas of liquidity, solvency, profitability and operating efficiency should be foremost focused on. Ultimately, on the long-run shareholder value has to be created.

There are numerous ways to assess and measure corporate and shareholder value creation. From a strategic point of view, of course, the positioning of a firm within its market segment and vis-à-vis its competitors is key and such can only be measured qualitatively. Among others, Michael Porter has undertaken ground-breaking research in this regards and provided us with a framework to assess and develop sustainable business strategies.

However, value maximization may not be the only strategic goal of a firm: How about long-term sustainability, for example? - Some of the oldest firms in Asia and in Europe have been around for hundreds of years and we may conclude from them that the key factor for sustainability is to a lesser extent based upon the access to a certain technology or the domination of a market, but instead based on the corporate culture: the ability to re-invent itself and swiftly absorb and adapt to changes in the environment and grab opportunities.

Also, commonly quoted drivers of value creation, such as revenues, costs and investments as well as related financial metrics can't capture all value-creating aspects: How about all the qualitative parameters, such as customer loyalty and satisfaction or product quality? - In any case, a solid corporate strategy will link corporate objectives with specific employee activities which support them. Management tools such as balanced scorecards can help in monitoring, correcting and designing incentives.

A company can be regarded as fundamentally "healthy" provided it is generating value over medium- and long-term. This should ultimately also be reflected in the creation of value for shareholders through the generation of free cash flows, with returns higher than the cost of capital. - Shareholder value creation may not immediately be reflected in a firm's stock price: Long-term, it should be, though. In general, stock price changes are an interpretation by the market. Whereby, stocks may by times be under- or overvalued, not least due to an overhang of supply or demand, frequently driven by a stock being in or out of fashion or merely by psychological aspects. Therefore, firm management has to have a clear understanding of investment motives, such as: Are shareholders seeking stable dividends or rather an increase in the stock price? –This underlines the importance of investor relations and justifies transactions with a purpose to unlock value, such as restructurings, spin-offs or a re-levering of the balance sheet.

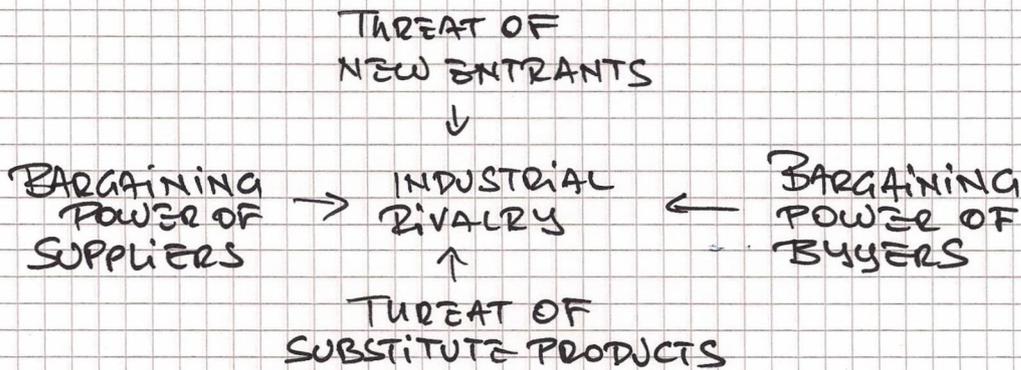
Shareholder value creation can – for example - be measured by parameters such as economic profit or the generation of Economic Value Added (EVA). Whereby, most approaches assessing a firm's ability of value creation are forward-looking and based on future, expected cash flows: For outside investors, such methodologies are sometimes only difficult to apply.

A reasonably simple financial ("snap shot") corporate health-check tool should ideally be able to answer the following questions swiftly:

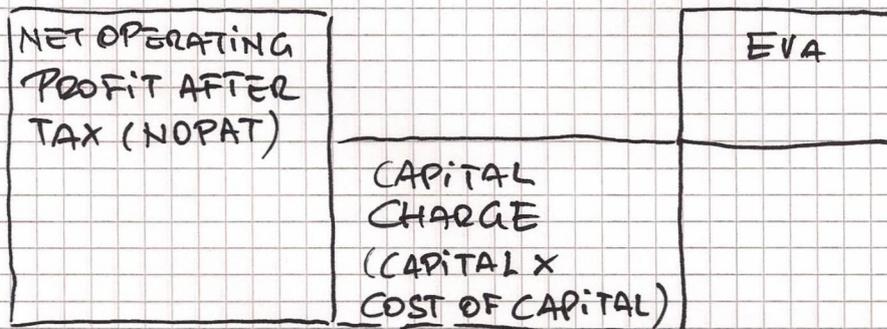
- Does the company provide an attractive investment for a shareholder?
- Does it make sense to continue the firm's business and operations?
- Are creditors sufficiently safe?
- Is the firm liquid?
- Does the firm have sufficient access to additional liquidity and funding?

Of course, there are numerous other themes one may want to look into, such as a firm's dividend policy, funding of growth or its optimal cost of capital structure. But a brief – and in the following suggested - 5-Minute Company Analysis should already provide valuable first insights.

PORTER'S 5 FORCE MODEL



ECONOMIC VALUE ADDED (EVA)



BASICS OF A CORPORATE HEALTH CHECK

