

Task 5: Default risk in international financial operations

A bank has to decide on the financial and economic situation of two different companies by looking to their financial statements (balance sheet and income statement). Imagine a rating system of indicators for assessing default risk (see the example at the end of the task) and by taking into consideration the financial ratios commonly used in this case.

For more details about Financial Ratios we recommend:

<http://www.accountingcoach.com/financial-ratios/explanation>

<https://www3.nd.edu/~mgrecon/simulations/micromaticweb/financialratios.html>

COMPANY A (Balance sheet and income statement):

Consolidated Income Statement Company A:

In millions, except per share data

REVENUES	
Sales by Company-operated restaurants	\$ 18,169.3
Revenues from franchised restaurants	9,272.0
Total revenues	27,441.3
OPERATING COSTS AND EXPENSES	
Company-operated restaurant expenses	
Food & paper	6,129.7
Payroll & employee benefits	4,756.0
Occupancy & other operating expenses	4,402.6
Franchised restaurants-occupancy expenses	1,697.3
Selling, general & administrative expenses	2,487.9
Other operating (income) expense, net	18.6
Total operating costs and expenses	19,492.1
Operating income	7,949.2
Interest expense-net of capitalized interest of \$14.7, \$15.5 and \$15.9	570.5
Nonoperating (income) expense, net	6.7
Income before provision for income taxes	7,372.0
Provision for income taxes	2,614.2
Net income	\$ 4,757.8
Earnings per common share—basic	\$ 4.85
Earnings per common share—diluted	\$ 4.82
Dividends declared per common share	\$ 3.28
Weighted-average shares outstanding—basic	980.5
Weighted-average shares outstanding—diluted	986.3

Consolidated Balance Sheet Company A:*In millions, except per share data*

ASSETS	
Current assets	
Cash and equivalents	\$ 2,077.9
Accounts and notes receivable	1,214.4
Inventories, at cost, not in excess of market	110.0
Prepaid expenses and other current assets	783.2
Total current assets	4,185.5
Other assets	
Investments in and advances to affiliates	1,004.5
Goodwill	2,735.3
Miscellaneous	1,798.6
Total other assets	5,538.4
Property and equipment	
Property and equipment, at cost	39,126.1
Accumulated depreciation and amortization	(14,568.6)
Net property and equipment	24,557.5
Total assets	\$ 34,281.4
LIABILITIES AND SHAREHOLDERS' EQUITY	
Current liabilities	
Accounts payable	\$ 860.1
Income taxes	166.8
Other taxes	330.0
Accrued interest	233.7
Accrued payroll and other liabilities	1,157.3
Total current liabilities	2,747.9
Long-term debt	14,989.7
Other long-term liabilities	2,065.9
Deferred income taxes	1,624.5
Shareholders' equity	
Preferred stock, no par value; authorized – 165.0 million shares; issued – none	
Common stock, \$.01 par value; authorized – 3.5 billion shares; issued – 1,660.6 million shares	16.6
Additional paid-in capital	6,239.1
Retained earnings	43,294.5
Accumulated other comprehensive income	(1,519.7)
Common stock in treasury, at cost; 697.7 and 670.2 million shares	(35,177.1)
Total shareholders' equity	12,853.4
Total liabilities and shareholders' equity	\$ 34,281.4

Company B (Consolidated Balance Sheet and Income Statement):

Income Statement Company B:

(in millions, except per share data)

Revenues			
Company sales	\$	11,833	\$
Franchise and license fees and income		1,800	
Total revenues		13,633	
Costs and Expenses, Net			
Company restaurants			
Food and paper		3,874	
Payroll and employee benefits		2,620	
Occupancy and other operating expenses		3,358	
Company restaurant expenses		9,852	
General and administrative expenses		1,510	
Franchise and license expenses		133	
Closures and impairment (income) expenses		37	
Refranchising (gain) loss		(78)	
Other (income) expense		(115)	
Total costs and expenses, net		11,339	
Operating Profit		2,294	
Interest expense, net		149	
Income Before Income Taxes		2,145	
Income tax provision		537	
Net Income – including noncontrolling interest		1,608	
Net Income – noncontrolling interest		11	
NET INCOME	\$	1,597	\$
BASIC EARNINGS PER COMMON SHARE	\$	3.46	\$
DILUTED EARNINGS PER COMMON SHARE	\$	3.38	\$
DIVIDENDS DECLARED PER COMMON SHARE	\$	1.24	\$

Balance Sheet Company B:

(in millions)

ASSETS		
Current Assets		
Cash and cash equivalents	\$	776 \$
Accounts and notes receivable, net		301
Inventories		313
Prepaid expenses and other current assets		272
Deferred income taxes		111
Advertising cooperative assets, restricted		136
Total Current Assets		1,909
Property, plant and equipment, net		4,250
Goodwill		1,034
Intangible assets, net		690
Investments in unconsolidated affiliates		72
Restricted cash		—
Other assets		575
Deferred income taxes		481
TOTAL ASSETS	\$	9,011 \$
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and other current liabilities	\$	1,945 \$
Income taxes payable		97
Short-term borrowings		10
Advertising cooperative liabilities		136
Total Current Liabilities		2,188
Long-term debt		2,932
Other liabilities and deferred credits		1,579
Total Liabilities		6,699
Redeemable noncontrolling interest		59
Shareholders' Equity		
Common Stock, no par value, 750 shares authorized; 451 shares and 460 shares issued in 2012 and 2011, respectively		—
Retained earnings		2,286
Accumulated other comprehensive income (loss)		(132)
Total Shareholders' Equity –		2,154
Noncontrolling interests		99
Total Shareholders' Equity		2,253
TOTAL LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND SHAREHOLDERS' EQUITY	\$	9,011 \$

Default risk rating model (example):

INDICATOR	FORMULA	POOR		ACCEPTABLE		INTERMEDIATE		GOOD		VERY GOOD	
Current liquidity	Current assets	Cl < 0,7	1p	0,7 ≤ Cl < 1	4p	1 ≤ Cl < 1,3	7p	1,3 ≤ Cl < 1,6	9p	1,6 < Cl	10p
	Current liabilities										
Debts service ratio	Gross profit + depreciation	0,00 – 0,49	1p	0,50 – 0,99	4p	1,00 – 1,49	7p	1,50 – 1,99	9p	2,00 – ...	10p
	Instalment + due interest										
Solvency	Own capital*100	S < 9	1p	9 ≤ S < 14	4p	14 ≤ S < 20	7p	20 ≤ S < 26	9p	26 < S	10p
	Total liabilities										
Profitability	Net profit*100	Negative value	0p	Up to 5%			5p	Over 5%			10p
	Turnover										
Speed of turnover	Stocks*n	DISTRIBUTION COMMERCE AND SERVICES									
		Over 181 days	2p	151 – 180 days	6p	121 – 150 days	10p	91 – 120 days	13p	Up to 90 days	15p
	Turnover	INDUSTRY AND AGRICULTURE									
		Over 281 days	2p	241 – 280 days	6p	181 – 240 days	10p	121 – 180 days	13p	Up to 120 days	15p
Clients period collection	Receivables*n	DISTRIBUTION COMMERCE AND SERVICES									
		Over 181 days	1p	151 – 180 days	4p	121 – 150 days	7p	91 – 120 days	9p	Up to 90 days	10p
	Turnover	INDUSTRY AND AGRICULTURE									
		Over 281 days	1p	241 – 280 days	4p	181 – 240 days	7p	121 – 180 days	9p	Up to 120 days	10p
Profitability ratio	Operating profit*100	1 – 4,9%	3p	Between 5 – 9,9%			7p	More or equal with 10%			10p
	Turnover										
Trend of turnover	Turnover 1-Turnover 0	Decreasing	0	Decreasing in comparison with last 6 months	3	Constant	7	Increasing	10		
	Turnover 0										