CFA Institute

CFA INSTITUTE INVESTMENT SERIES

INTERNATIONAL FINANCIAL STATEMENT ANALYSIS

Third Edition

Thomas R. Robinson, CFA ▪ Elaine Henry, CFA
Wendy L. Pirie, CFA ▪ Michael A. Broihahn, CFA

Foreword by Anthony T. Cope, CFA

INTERNATIONAL FINANCIAL STATEMENT ANALYSIS

CFA Institute is the premier association for investment professionals around the world, with over 124,000 members in 145 countries. Since 1963 the organization has developed and administered the renowned Chartered Financial Analyst® Program. With a rich history of leading the investment profession, CFA Institute has set the highest standards in ethics, education, and professional excellence within the global investment community and is the foremost authority on investment profession conduct and practice. Each book in the CFA Institute Investment Series is geared toward industry practitioners along with graduate-level finance students and covers the most important topics in the industry. The authors of these cutting-edge books are themselves industry professionals and academics and bring their wealth of knowledge and expertise to this series.

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FOREWORD

The stated objective of the International Accounting Standards Board (IASB) is to produce accounting standards that are principle-based, internally consistent, and internationally converged. The resulting financial statements should provide a framework that gives capital market participants the tools to make rational and intelligent decisions. The role of the analyst as an interpreter of the numbers that appear in the financial statements is critical in this process.

Making valuation estimates and the accompanying decisions in an international context is, in principle, no different from a purely domestic one. In both cases, the financial reporting model is the primary source of the information required. Recommendations and decisions have to be made based on careful analysis. The learning outcomes and techniques described in this volume are designed to enable the analyst to do just that.

Collecting and analyzing data is the core analytical function, but communication is also critical. The best and most rigorous analysis has to be supplemented by an understanding of how investment decisions are made, or it will fail its purpose. It must be communicated to the intended recipient in a way that explains the logic behind the valuation estimate or recommendation and promotes understanding and action. Communication skills, in addition to analytical methods, are discussed in the readings.

The readings also point to the necessity of exercising judgment as part of the analytical process. This is particularly important in the context of International Financial Reporting Standards (IFRS). As noted, an important element of IFRS is that the standards are principle-based and not unduly prescriptive (as some perceive US Generally Accepted Accounting Principles to be). The objective is to allow a degree of flexibility that permits company management to present corporate results in the most meaningful way, while preserving the spirit intended—substance over form. However, this presents the analyst with an additional challenge in interpreting the published figures and comparing them with those of other entities.

CFA Institute and its members have long supported the development of a global set of accounting standards; the benefits, in terms of improved comparability for investors and lowered cost of capital for corporations, are evident. IFRS are now accepted or required, in whole or in part, in some 100 or more jurisdictions around the world. (So far, in the United States, only a few foreign registrants with the SEC are permitted to use the Standards.) Achieving comparability between companies reporting in Tokyo, Toronto, or Turin would seem to meet the cherished goal of a global financial reporting system. But a word of caution is warranted. Few countries want to give up sovereignty to an independent authority based in London, no matter how high the quality of the output may be. Standard setting is ultimately a political process, and powerful constituencies abound that have objectives that may differ from the provision of decision-useful information for investors. And in order to become law in many jurisdictions, some sort of endorsement mechanism has to be established. Endorsements can, in some cases, exclude provisions in standards, or offer exceptions or options not present in the original text. The result can be deviations from the published standards. While there may be one language, various dialects can emerge, and the analyst must be vigilant to discern these differences, and their significance.

Addendum: 30 September 2014

Regrettably, Tony Cope, author of the preceding foreword, passed away in November 2013. As we prepare for the third edition and review his foreword to the second edition of the book, we cannot help but note how well his comments stand the test of time.

Tony was on the forefront of advocating for convergence in international accounting standards and for assuring consistency and transparency in how company performance is reported. Tony was a member of the US Financial Accounting Standards Board from 1993 to 2001. After playing a leading role in the Strategy Working Party that led to the creation of the International Accounting Standards Board (IASB) in 2001, Tony served as a member of the IASB from 2001 through 2007.

Tony made substantial, long-lasting contributions to the quality of global financial reporting. More than that, he was a friendly, caring person and is deeply missed by his many friends and colleagues.

Sandra Peters, CFA
11 November 2014

PREFACE

International Financial Statement Analysis is a practically oriented introduction to financial statement analysis. Each chapter covers one major area of financial statement analysis and is written by highly credentialed experts. By taking a global perspective on accounting standards, with a focus on international financial reporting standards (IFRS), and by selecting a broad range of companies for illustration, the book well equips the reader for practice in today's global marketplace.

The content was developed in partnership by a team of distinguished academics and practitioners, chosen for their acknowledged expertise in the field, and guided by CFA Institute. It is written specifically with the investment practitioner in mind and is replete with examples and practice problems that reinforce the learning outcomes and demonstrate real-world applicability.

The CFA Program Curriculum, from which the content of this book was drawn, is subjected to a rigorous review process to assure that it is:

- Faithful to the findings of our ongoing industry practice analysis
- Valuable to members, employers, and investors
- Globally relevant
- Generalist (as opposed to specialist) in nature
- Replete with sufficient examples and practice opportunities
- Pedagogically sound

The accompanying workbook is a useful reference that provides Learning Outcome Statements, which describe exactly what readers will learn and be able to demonstrate after mastering the accompanying material. Additionally, the workbook has summary overviews and practice problems for each chapter.

We hope you will find this and other books in the CFA Institute Investment Series helpful in your efforts to grow your investment knowledge, whether you are a relatively new entrant or an experienced veteran striving to keep up to date in the ever-changing market environment. CFA Institute, as a long-term committed participant in the investment profession and a not-for-profit global membership association, is pleased to provide you with this opportunity.

THE CFA PROGRAM

If the subject matter of this book interests you, and you are not already a CFA charterholder, we hope you will consider registering for the CFA Program and starting progress toward earning the Chartered Financial Analyst designation. The CFA designation is a globally recognized standard of excellence for measuring the competence and integrity of investment professionals.

To earn the CFA charter, candidates must successfully complete the CFA Program, a global graduate-level self-study program that combines a broad curriculum with professional conduct requirements as preparation for a career as an investment professional.

Anchored by a practice-based curriculum, the CFA Program Body of Knowledge reflects the knowledge, skills, and abilities identified by professionals as essential to the investment decision-making process. This body of knowledge maintains its relevance through a regular, extensive survey of practicing CFA charterholders across the globe. The curriculum covers 10 general topic areas, ranging from equity and fixed-income analysis to portfolio management to corporate finance—all with a heavy emphasis on the application of ethics in professional practice. Known for its rigor and breadth, the CFA Program curriculum highlights principles common to every market so that professionals who earn the CFA designation have a thoroughly global investment perspective and a profound understanding of the global marketplace.

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ABOUT THE CFA INSTITUTE INVESTMENT SERIES

CFA Institute is pleased to provide you with the CFA Institute Investment Series, which covers major areas in the field of investments. We provide this best-in-class series for the same reason we have been chartering investment professionals for more than 50 years: to lead the investment profession globally by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society.

The books in the CFA Institute Investment Series contain practical, globally relevant material. They are intended both for those contemplating entry into the extremely competitive field of investment management as well as for those seeking a means of keeping their knowledge fresh and up to date. This series was designed to be user friendly and highly relevant.

We hope you find this series helpful in your efforts to grow your investment knowledge, whether you are a relatively new entrant or an experienced veteran ethically bound to keep up to date in the ever-changing market environment. As a long-term, committed participant in the investment profession and a not-for-profit global membership association, CFA Institute is pleased to provide you with this opportunity.

THE TEXTS

Corporate Finance: A Practical Approach is a solid foundation for those looking to achieve lasting business growth. In today's competitive business environment, companies must find innovative ways to enable rapid and sustainable growth. This text equips readers with the foundational knowledge and tools for making smart business decisions and formulating strategies to maximize company value. It covers everything from managing relationships between stakeholders to evaluating merger and acquisition bids, as well as the companies behind them. Through extensive use of real-world examples, readers will gain critical perspective into interpreting corporate financial data, evaluating projects, and allocating funds in ways that increase corporate value. Readers will gain insights into the tools and strategies used in modern corporate financial management.

Equity Asset Valuation is a particularly cogent and important resource for anyone involved in estimating the value of securities and understanding security pricing. A well-informed professional knows that the common forms of equity valuation—dividend discount modeling, free cash flow modeling, price/earnings modeling, and residual income modeling—can all be reconciled with one another under certain assumptions. With a deep understanding of the underlying assumptions, the professional investor can better understand what other investors assume when calculating their valuation estimates. This text has a global orientation, including emerging markets.

International Financial Statement Analysis is designed to address the ever-increasing need for investment professionals and students to think about financial statement analysis from a global perspective. The text is a practically oriented introduction to financial statement analysis that is distinguished by its combination of a true international orientation, a structured presentation style, and abundant illustrations and tools covering concepts as they are introduced in the text. The authors cover this discipline comprehensively and with an eye to ensuring the reader's success at all levels in the complex world of financial statement analysis.

Investments: Principles of Portfolio and Equity Analysis provides an accessible yet rigorous introduction to portfolio and equity analysis. Portfolio planning and portfolio management are presented within a context of up-to-date, global coverage of security markets, trading, and market-related concepts and products. The essentials of equity analysis and valuation are explained in detail and profusely illustrated. The book includes coverage of practitioner-important but often neglected topics, such as industry analysis. Throughout, the focus is on the practical application of key concepts with examples drawn from both emerging and developed markets. Each chapter affords the reader many opportunities to self-check his or her understanding of topics.

One of the most prominent texts over the years in the investment management industry has been Maginn and Tuttle's *Managing Investment Portfolios: A Dynamic Process*. The third edition updates key concepts from the 1990 second edition. Some of the more experienced members of our community own the prior two editions and will add the third edition to their libraries. Not only does this seminal work take the concepts from the other readings and put them in a portfolio context, but it also updates the concepts of alternative investments, performance presentation standards, portfolio execution, and, very importantly, individual investor portfolio management. Focusing attention away from institutional portfolios and toward the individual investor makes this edition an important and timely work.

The New Wealth Management: The Financial Advisor's Guide to Managing and Investing Client Assets is an updated version of Harold Evensky's mainstay reference guide for wealth managers. Harold Evensky, Stephen Horan, and Thomas Robinson have updated the core text of the 1997 first edition and added an abundance of new material to fully reflect today's investment challenges. The text provides authoritative coverage across the full spectrum of wealth management and serves as a comprehensive guide for financial advisers. The book expertly blends investment theory and real-world applications and is written in the same thorough but highly accessible style as the first edition.

Quantitative Investment Analysis focuses on some key tools that are needed by today's professional investor. In addition to classic time value of money, discounted cash flow applications, and probability material, there are two aspects that can be of value over traditional thinking. The first involves the chapters dealing with correlation and regression that ultimately figure into the formation of hypotheses for purposes of testing. This gets to a critical skill that challenges many professionals: the ability to distinguish useful information from the overwhelming quantity of available data. Second, the final chapter of *Quantitative Investment Analysis* covers portfolio concepts and takes the reader beyond the traditional capital asset pricing model (CAPM) type of tools and into the more practical world of multifactor models and arbitrage pricing theory.

All books in the CFA Institute Investment Series are available through all major booksellers. All titles also are available on the Wiley Custom Select platform at http://customselect.wiley.com, where individual chapters for all the books may be mixed and matched to create custom textbooks for the classroom.

INTERNATIONAL FINANCIAL STATEMENT ANALYSIS

CHAPTER 1

FINANCIAL STATEMENT ANALYSIS: AN INTRODUCTION

Elaine Henry, CFA
Thomas R. Robinson, CFA

LEARNING OUTCOMES

After completing this chapter, you will be able to do the following:

- describe the roles of financial reporting and financial statement analysis;
- describe the roles of the key financial statements (statement of financial position, statement of comprehensive income, statement of changes in equity, and statement of cash flows) in evaluating a company's performance and financial position;
- describe the importance of financial statement notes and supplementary information—including disclosures of accounting policies, methods, and estimates—and management's commentary;
- describe the objective of audits of financial statements, the types of audit reports, and the importance of effective internal controls;
- identify and describe information sources that analysts use in financial statement analysis besides annual financial statements and supplementary information;
- describe the steps in the financial statement analysis framework.

1. INTRODUCTION

Financial analysis is the process of examining a company's performance in the context of its industry and economic environment in order to arrive at a decision or recommendation. Often, the decisions and recommendations addressed by financial analysts pertain to providing capital to companies—specifically, whether to invest in the company's debt or equity securities and at what price. An investor in debt securities is concerned about the company's ability to pay interest and to repay the principal lent. An investor in equity securities is an owner with a residual interest in the company and is concerned about the company's ability to pay dividends and the likelihood that its share price will increase. Overall, a central focus of financial analysis is evaluating the company's ability to earn a return on its capital that is at least equal to the cost of that capital, to profitably grow its operations, and to generate enough cash to meet obligations and pursue opportunities. Fundamental financial analysis starts with the information found in a company's financial reports. These financial reports include audited financial statements, additional disclosures required by regulatory authorities, and any accompanying (unaudited) commentary by management. Basic financial statement analysis—as presented in this chapter—provides a foundation that enables the analyst to better understand information gathered from research beyond the financial reports.

This chapter is organized as follows: Section 2 discusses the scope of financial statement analysis. Section 3 describes the sources of information used in financial statement analysis, including the primary financial statements (balance sheet, statement of comprehensive income, statement of changes in equity, and cash flow statement). Section 4 provides a framework for guiding the financial statement analysis process. A summary of the key points and practice problems in the CFA Institute multiple-choice format conclude the chapter.

2. SCOPE OF FINANCIAL STATEMENT ANALYSIS

The role of financial reporting by companies is to provide information about a company's performance, financial position, and changes in financial position that is useful to a wide range of users in making economic decisions.[1] The role of financial statement analysis is to use financial reports prepared by companies, combined with other information, to evaluate the past, current, and potential performance and financial position of a company for the purpose of making investment, credit, and other economic decisions. (Managers within a company perform financial analysis to make operating, investing, and financing decisions but do not necessarily rely on analysis of related financial statements. They have access to additional financial information that can be reported in whatever format is most useful to their decision.)

In evaluating financial reports, analysts typically have a specific economic decision in mind. Examples of these decisions include the following:

- Evaluating an equity investment for inclusion in a portfolio.
- Evaluating a merger or acquisition candidate.
- Evaluating a subsidiary or operating division of a parent company.
- Deciding whether to make a venture capital or other private equity investment.
- Determining the creditworthiness of a company in order to decide whether to extend a loan to the company and if so, what terms to offer.

[1] The role of financial reporting is specified in International Accounting Standard (IAS) 1 *Presentation of Financial Statements*, paragraph 9, and paragraph 12 of the *Framework for the Preparation and Presentation of Financial Statements*. An updated framework is currently a joint project between the International Accounting Standards Board (IASB), which issues International Financial Reporting Standards (IFRS), and the Financial Accounting Standards Board (FASB). The FASB issues US generally accepted accounting principles (US GAAP) contained in the FASB Accounting Standards Codification™ (FASB ASC). The set of accounting standards that a company uses to prepare its financial reports depends on its jurisdiction. The IASB and FASB will be discussed further in a later chapter.

- Extending credit to a customer.
- Examining compliance with debt covenants or other contractual arrangements.
- Assigning a debt rating to a company or bond issue.
- Valuing a security for making an investment recommendation to others.
- Forecasting future net income and cash flow.

These decisions demonstrate certain themes in financial analysis. In general, analysts seek to examine the past and current performance and financial position of a company in order to form expectations about its future performance and financial position. Analysts are also concerned about factors that affect risks to a company's future performance and financial position. An examination of performance can include an assessment of a company's profitability (the ability to earn a profit from delivering goods and services) and its ability to generate positive cash flows (cash receipts in excess of cash disbursements). Profit and cash flow are not equivalent. Profit (or loss) represents the difference between the prices at which goods or services are provided to customers and the expenses incurred to provide those goods and services. In addition, profit (or loss) includes other income (such as investing income or income from the sale of items other than goods and services) minus the expenses incurred to earn that income. Overall, profit (or loss) equals income minus expenses, and its recognition is mostly independent from when cash is received or paid. Example 1 illustrates the distinction between profit and cash flow.

EXAMPLE 1 Profit versus Cash Flow

Sennett Designs (SD) sells furniture on a retail basis. SD began operations during December 2009 and sold furniture for €250,000 in cash. The furniture sold by SD was purchased on credit for €150,000 and delivered by the supplier during December. The credit terms granted by the supplier required SD to pay the €150,000 in January for the furniture it received during December. In addition to the purchase and sale of furniture, in December, SD paid €20,000 in cash for rent and salaries.

1. How much is SD's profit for December 2009 if no other transactions occurred?
2. How much is SD's cash flow for December 2009?
3. If SD purchases and sells exactly the same amount in January 2010 as it did in December and under the same terms (receiving cash for the sales and making purchases on credit that will be due in February), how much will the company's profit and cash flow be for the month of January?

Solution to 1: SD's profit for December 2009 is the excess of the sales price (€250,000) over the cost of the goods that were sold (€150,000) and rent and salaries (€20,000), or €80,000.

Solution to 2: The December 2009 cash flow is €230,000, the amount of cash received from the customer (€250,000) less the cash paid for rent and salaries (€20,000).

Solution to 3: SD's profit for January 2010 will be identical to its profit in December: €80,000, calculated as the sales price (€250,000) minus the cost of the goods that were sold (€150,000) and minus rent and salaries (€20,000). SD's cash flow in January 2010 will also equal €80,000, calculated as the amount of cash received from the customer (€250,000) minus the cash paid for rent and salaries (€20,000) *and* minus the €150,000 that SD owes for the goods it had purchased on credit in the prior month.

Although profitability is important, so is a company's ability to generate positive cash flow. Cash flow is important because, ultimately, the company needs cash to pay employees, suppliers, and others in order to continue as a going concern. A company that generates positive cash flow from operations has more flexibility in funding needed for investments and taking advantage of attractive business opportunities than an otherwise comparable company without positive operating cash flow. Additionally, a company needs cash to pay returns (interest and dividends) to providers of debt and equity capital. Therefore, the expected magnitude of future cash flows is important in valuing corporate securities and in determining the company's ability to meet its obligations. The ability to meet short-term obligations is generally referred to as **liquidity**, and the ability to meet long-term obligations is generally referred to as **solvency**. Cash flow in any given period is not, however, a complete measure of performance for that period because, as shown in Example 1, a company may be obligated to make future cash payments as a result of a transaction that generates positive cash flow in the current period.

Profits may provide useful information about cash flows, past and future. If the transaction of Example 1 were repeated month after month, the long-term average monthly cash flow of SD would equal €80,000, its monthly profit. Analysts typically not only evaluate past profitability but also forecast future profitability.

Exhibit 1 shows how news coverage of corporate earnings announcements places corporate results in the context of analysts' expectations. Panel A shows the earnings announcement, and Panel B shows a sample of the news coverage of the announcement. Earnings are also frequently used by analysts in valuation. For example, an analyst may value shares of a company by comparing its price-to-earnings ratio (P/E) to the P/Es of peer companies and/or may use forecasted future earnings as direct or indirect inputs into discounted cash flow models of valuation.

EXHIBIT 1 An Earnings Release and News Media Comparison with Analysts' Expectations

Panel A: Excerpt from Apple Earnings Release

Apple Reports Second Quarter Results
Record March Quarter Revenue and Profit
iPhone Sales More Than Double

CUPERTINO, California—April 20, 2010—Apple® today announced financial results for its fiscal 2010 second quarter ended March 27, 2010. The Company posted revenue of \$13.50 billion and net quarterly profit of \$3.07 billion, or \$3.33 per diluted share. These results compare to revenue of \$9.08 billion and net quarterly profit of \$1.62 billion, or \$1.79 per diluted share, in the year-ago quarter. Gross margin was 41.7 percent, up from 39.9 percent in the year-ago quarter. International sales accounted for 58 percent of the quarter's revenue.

EXHIBIT 1 (Continued)

Apple sold 2.94 million Macintosh® computers during the quarter, representing a 33 percent unit increase over the year-ago quarter. The Company sold 8.75 million iPhones in the quarter, representing 131 percent unit growth over the year-ago quarter. Apple sold 10.89 million iPods during the quarter, representing a one percent unit decline from the year-ago quarter.

"We're thrilled to report our best non-holiday quarter ever, with revenues up 49 percent and profits up 90 percent," said Steve Jobs, Apple's CEO. "We've launched our revolutionary new iPad and users are loving it, and we have several more extraordinary products in the pipeline for this year."

"Looking ahead to the third fiscal quarter of 2010, we expect revenue in the range of about $13.0 billion to $13.4 billion and we expect diluted earnings per share in the range of about $2.28 to $2.39," said Peter Oppenheimer, Apple's CFO.

Source: www.apple.com/pr/library/2010/04/20results.html

Panel B: Excerpt Downloaded from FOXBusiness.com Report: Tuesday, 20 April 2010

"Apple Earnings Surge by 90% in Second Quarter" by Kathryn Glass

In what's beginning to become its trademark, Apple Inc. (AAPL: 238.7911, –9.5489, –3.85%) delivered much better-than-expected second-quarter earnings, but gave third-quarter guidance below expectations.

The personal-technology behemoth said it expects third-quarter earnings in the range of $2.28 to $2.39 per share on revenue between $13 billion and $13.4 billion. Analysts were expecting third-quarter earnings of $2.70 a share on revenue of $12.97 billion, according to a poll by Thomson Reuters.

Apple reported second-quarter profit of $3.07 billion, or $3.33 per share, compared with year-ago profit of $1.62 billion, or $1.79 per share. Revenue rose to $13.5 billion, compared with revenue of $9.08 billion, one year ago. The tech giant said 58% of revenue came from international sales.

The results soared above expectations; analysts' second-quarter profit estimates were for $2.45 per share on revenue of $12.04 billion.

Analysts are also interested in the current financial position of a company. The financial position can be measured by comparing the resources controlled by the company (**assets**) in relation to the claims against those resources (**liabilities** and **equity**). An example of a resource is cash. In Example 1, if no other transactions occur, the company should have €230,000 more in cash at 31 December 2009 than at the start of the period. The cash can be used by the company to pay its obligation to the supplier (a claim against the company) and may also be used to make distributions to the owner (who has a residual claim against the company's assets, net of liabilities). Financial position is particularly important in credit analysis, as depicted in Exhibit 2. Panel A of the exhibit is an excerpt from an April 2010 announcement by a credit rating agency of an upgrade in the credit ratings of Teck Resources Ltd., a Canadian mining company. The rating agency explained that it upgraded the credit rating of the company (its "corporate credit rating") and the credit rating of the company's debt securities (the "issue-level rating") because the company had repaid its debt quickly ("accelerated debt repayment"). Panel B of the exhibit is an excerpt from the company's second quarter 2010 earnings announcement in which the company's CEO describes the company's repayment of debt. Panel C of the exhibit is an excerpt from the company's financial report illustrating the change in the company's financial position in June 2010 compared with December 2009. As shown, the amount of the company's debt liabilities relative to the amount of its equity declined substantially over the period.

EXHIBIT 2

Panel A: Excerpt from Announcement by Standard & Poor's Ratings Services: 16 April 2010

Teck Resources Ltd. Upgraded to "BBB" from "BB+" On Improved Financial Risk Profile; Removed from CreditWatch

We are raising our long-term corporate credit rating on Vancouver-based mining company Teck Resources Ltd. to "BBB" from "BB+."… We are also raising the issue-level rating on the company's notes outstanding to "BBB" from "BB+."… We base the upgrade on Teck's materially improved financial risk profile following the accelerated debt repayment in the past year. The stable outlook reflects our opinion that Teck will maintain relatively stable credit metrics in the medium term, despite inherent volatility in the commodities market.

Source: Market News Publishing.

Panel B: Excerpt from Earnings Announcement by Teck Resources Limited: 28 July 2010

Teck Reports Second Quarter Results for 2010

Vancouver, BC—Teck Resources Limited (TSX: TCK.A and TCK.B, NYSE: TCK) announced quarterly earnings of $260 million, or $0.44 per share, for the second quarter of 2010. Our operating profit before depreciation was approximately $1.0 billion and EBITDA was $844 million in the second quarter.

Don Lindsay, President and CEO said, "During the quarter we eliminated the outstanding balance of our term bank loan and have now repaid the US$9.8 billion bank debt related to the Fording acquisition in less than 18 months, just over two years ahead of schedule. In addition, all of our operations performed well, and we met or exceeded the guidance given in our previous quarterly report. Our second quarter benefitted from a substantial increase in coal sales to 6.4 million tonnes and the higher benchmark prices negotiated for the second quarter. In addition, in the quarter we re-established our investment grade credit ratings from all of the major rating agencies and declared a semi-annual dividend of $0.20 per share."

Source: Teck Resources form 6-K, filed 11 August 2010.

EXHIBIT 2 (Continued)

Panel C: Financial Position of Teck Resources Limited: 28 July 2010 and 31 December 2009

(in millions of Canadian $)	28 July 2010	31 December 2009
ASSETS	$ 28,570	$ 29,873
LIABILITIES		
Debt	5,678	8,004
All other liabilities	7,273	7,288
Total liabilities	12,951	15,292
EQUITY	15,619	14,581
Debt divided by equity	0.36	0.55

In conducting a financial analysis of a company, the analyst will regularly refer to the company's financial statements, financial notes, and supplementary schedules and a variety of other information sources. The next section introduces the major financial statements and some commonly used information sources.

3. MAJOR FINANCIAL STATEMENTS AND OTHER INFORMATION SOURCES

In order to perform an equity or credit analysis of a company, an analyst collects a great deal of information. The nature of the information collected will vary on the basis of the individual decision to be made (or the specific purpose of the analysis) but will typically include information about the economy, industry, and company as well as information about comparable peer companies. Much of the information will likely come from outside the company, such as economic statistics, industry reports, trade publications, and databases containing information on competitors. The company itself provides some of the core information for analysis in its financial reports, press releases, investor conference calls, and webcasts.

Companies prepare financial reports at regular intervals (annually, semiannually, and/or quarterly depending on the applicable regulatory requirements). Financial reports include financial statements along with supplemental disclosures necessary to assess the company's financial position and periodic performance. Financial statements are the result of an accounting recordkeeping process that records economic activities of a company, following the applicable accounting standards and principles. These statements summarize the accounting information, mainly for users outside the company (such as investors, creditors, analysts, and others) because users of financial information inside a company have direct access to the underlying financial data that are summarized in the financial statements and to other information that is collected but not included in the financial reporting process. Financial statements are almost always audited by independent accountants who provide an opinion on whether the financial statements present fairly the company's performance and financial position in accordance with a specified, applicable set of accounting standards and principles.

3.1. Financial Statements and Supplementary Information

A complete set of financial statements include a statement of financial position (i.e., a balance sheet), a statement of comprehensive income (i.e., a single statement of comprehensive income or an income statement and a statement of comprehensive income), a statement of changes in equity, and a statement of cash flows.[2] The balance sheet portrays the company's financial position at a given point in time. The statement of comprehensive income and statement of cash flows present different aspects of a company's performance over a period of time. The statement of changes in equity provides additional information regarding the changes in a company's financial position. In addition, the accompanying notes or footnotes to the financial statements are required and considered an integral part of a complete set of financial statements.

Along with the required financial statements, a company typically provides additional information in its financial reports. In many jurisdictions, some or all of this additional information is mandated by regulators or accounting standards boards. The additional information provided may include a letter from the chairman of the company, a report from management discussing the results (typically called management discussion and analysis [MD&A] or management commentary), an external auditor's report providing assurances, a governance report describing the structure of the company's board of directors, and a corporate responsibility report. As part of his or her analysis, the financial analyst should read and assess this additional information along with the financial statements. The following sections describe and illustrate each financial statement and some of the additional information.

3.1.1. Balance Sheet

The **balance sheet** (also called the **statement of financial position** or **statement of financial condition**) presents a company's current financial position by disclosing the resources the company controls (assets) and its obligations to lenders and other creditors (liabilities) at a specific point in time. **Owners' equity** represents the excess of assets over liabilities. This amount is attributable to the company's owners or shareholders. Owners' equity is the owners' residual interest in (i.e., residual claim on) the company's assets after deducting its liabilities.

The relationship among the three parts of the balance sheet (assets, liabilities, and owners' equity) can be expressed in the following equation form: Assets = Liabilities + Owners' equity. This equation (sometimes called the accounting equation or the balance sheet equation) shows that the total amount of assets must equal or *balance* to the combined total amounts of liabilities and owners' equity. Alternatively, the equation may be rearranged as follows: Assets – Liabilities = Owners' equity. This formulation emphasizes the residual claim aspect of owners' equity. Depending on the form of the organization, owners' equity may be referred to as "partners' capital" or "shareholders' equity."

Exhibit 3 presents the balance sheet of the Volkswagen Group (FWB: VOW) from its Annual Report 2009.

[2]The names of the financial statements are those in IAS 1. Commonly used terms for these financial statements are indicated in parentheses. Later chapters will elaborate on each of these financial statements.

EXHIBIT 3 Balance Sheet of the Volkswagen Group

€ million	Note	31 Dec. 2009	31 Dec. 2008
Assets			
Non-current assets			
Intangible assets	12	12,907	12,291
Property, plant, and equipment	13	24,444	23,121
Leasing and rental assets	14	10,288	9,889
Investment property	14	216	150
Equity-accounted investments	15	10,385	6,373
Other equity investments	15	543	583
Financial services receivables	16	33,174	31,855
Other receivables and financial assets	17	3,747	3,387
Noncurrent tax receivables	18	685	763
Deferred tax assets	18	3,013	3,344
		99,402	**91,756**
Current assets			
Inventories	19	14,124	17,816
Trade receivables	20	5,692	5,969
Financial services receivables	16	27,403	27,035
Other receivables and financial assets	17	5,927	10,068
Current tax receivables	18	762	1,024
Marketable securities	21	3,330	3,770
Cash and cash equivalents	22	20,539	9,474
Assets held for sale	23	—	1,007
		77,776	**76,163**
Total assets		**177,178**	**167,919**
Equity and liabilities			
Equity	**24**		
Subscribed capital		1,025	1,024
Capital reserves		5,356	5,351
Retained earnings		28,901	28,636
Equity attributable to shareholders of Volkswagen AG		35,281	35,011
Minority interests		2,149	2,377
		37,430	**37,388**

(continued)

EXHIBIT 3 (Continued)

€ million	Note	31 Dec. 2009	31 Dec. 2008
Noncurrent liabilities			
Noncurrent financial liabilities	25	36,993	33,257
Other noncurrent liabilities	26	3,028	3,235
Deferred tax liabilities	27	2,224	3,654
Provisions for pensions	28	13,936	12,955
Provisions for taxes	27	3,946	3,555
Other noncurrent provisions	29	10,088	9,073
		70,215	**65,729**
Current liabilities			
Current financial liabilities	25	40,606	36,123
Trade payables	30	10,225	9,676
Current tax payables	27	73	59
Other current liabilities	26	8,237	8,545
Provisions for taxes	27	973	1,160
Other current provisions	29	9,420	8,473
Liabilities associated with assets held for sale	23	—	766
		69,534	**64,802**
Total equity and liabilities		**177,178**	**167,919**

Note: Numbers are as shown in the annual report and may not add because of rounding.

In Exhibit 3, the balance sheet is presented with the most recent year in the first column and the earlier year in the second column. Although this is a common presentation, analysts should be careful when reading financial statements. In some cases, the ordering may be reversed, with years listed from most distant to most recent.

At 31 December 2009, Volkswagen's total resources or assets were €177 billion. This number is the sum of non-current assets of €99 billion and current assets of €78 billion.[3] Total equity was €37 billion. Although Volkswagen does not give a total amount for all the balance sheet liabilities, it can be determined by adding the non-current and current liabilities, €70,215 million + €69,534 million = €139,749 million, or €140 billion.[4]

[3] Current assets are defined, in general, as those that are cash or cash equivalents; are held for trading; or are expected to be converted to cash (realized), sold, or consumed within 12 months or the company's normal operating cycle. All other assets are classified as non-current.

[4] Current liabilities are defined, in general, as those that are expected to be settled within 12 months or the company's normal operating cycle. All other liabilities are classified as non-current.