



# THE CREDIT MANAGERS TOOL BOX

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# Tools that we have available to make credit decisions:

- ▣ Credit Reports
- ▣ Bank and creditor references
- ▣ Direct communication with customer
- ▣ Trade group information
- ▣ Information from your sales team
- ▣ Audited Financial Statements

# Credit Reports

- ▣ **Pros-** Information you might not be able to get elsewhere without a lot of work, (Actual payment history, Liens, UCC filings, history of owners, years in business.)
- ▣ **Cons-** Old financial information, information based on a few inquiries, cost.

# Direct Communication with customer

- ▣ If you going to do business with a customer treat them as a partner not just an account that owes you money.
- ▣ Call them, speak to the controller find out about the company and tell them what your payment expectations are up front. Find out who the correct contact is and start building a relationship.

# Trade groups

- ▣ One of the best investments your company can make is have you in an industry trade group.
- ▣ Meetings are very informative- speakers
- ▣ Information sharing regarding accounts is by far the best element of these groups.
- ▣ Weekly flash reports
- ▣ Fees – Annual fees and cost to attend meetings

# Use your sales team

- ▣ They are at the facilities that you are calling here are some of the things they see that you would never know:
- ▣ Company has reduced work shifts from 3 to 2
- ▣ Lay-offs
- ▣ No raises given this year or salary reductions
- ▣ Rumors of company for sale
- ▣ Information from other sales people

# Starting the analysis process

- ▣ To understand how to navigate the vast amount of information available to financial statement users, background on the accounting rule-making environment is necessary.
- ▣ Financial statements are prepared according to generally accepted accounting principles (GAAP) that have been adopted in order to achieve a presentation of financial information that is understandable by as well as relevant and reliable for decision making.



# Why so much emphasis of SEC

- ▣ Over the past fifteen years corporate scandals such as Enron and WorldCom have brought to the forefront the challenges and pressures the FASB faces when creating accounting rules. A lot of focus has been put on the accounting firms as they now have to be careful of:  
Conflict of interest, analysts, and politicians.

# Who regulates the SEC

- ▣ The SEC has congressional authority to set the accounting policies and has issued rulings called Accounting Series Releases (ASRs) and Financial Reporting Rulings (FRR's).
- ▣ For the most part however, accounting rule making has been delegated to the Financial Accounting Standards Board (FASB).
- ▣ The FASB is comprised of seven full time paid members. The Board issues Statements of Financial Accounting Standards and Interpretations, usually after some lengthy process of deliberations.
- ▣ The SEC and FASB work together to develop accounting policy, with the SEC playing mainly a supporting role.

# Where to find financial information

- ▣ Corporate financial statements are available from several sources. All publicly held companies must file a form 10-K annually with the SEC. The information in this document is mandated by the SEC and contains uniform content, presented in the same order for all filing companies. Documents filed with the SEC can usually be accessed through the Electronic Data Gathering, Analysis, Retrieval (EDGAR) database at the SEC's website [www.sec.gov](http://www.sec.gov)

# WWW.SEC.GOV

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**Financial Crisis Enforcement Actions**  
*The SEC has charged more than 150 firms and individuals, and secured \$2.6 billion for investors*

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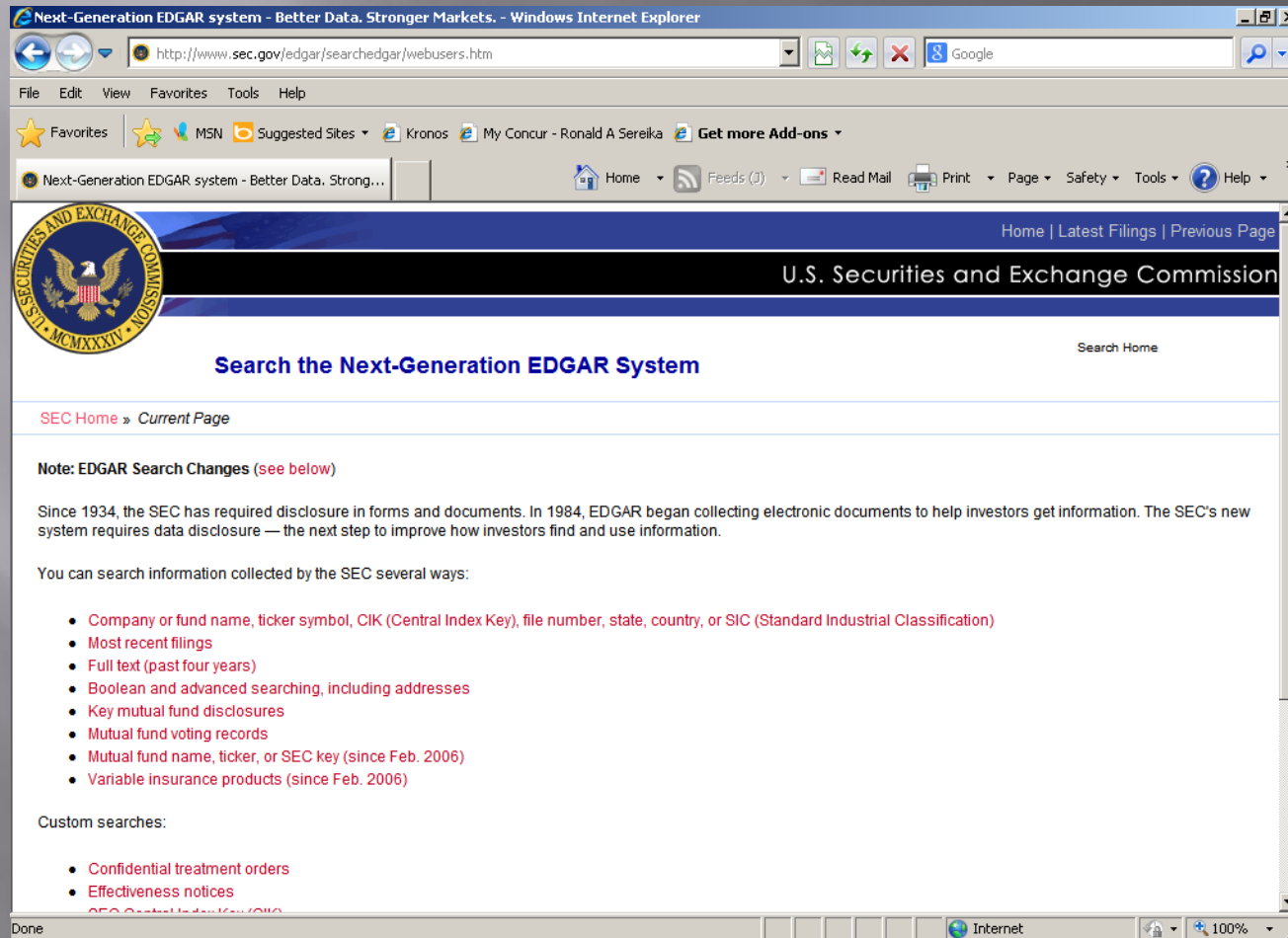
- SEC Issues Risk Alert and Investor Bulletin on Investment Adviser Custody Rule
- SEC Seeks Information to Assess Standards of Conduct and Other Obligations of Broker-Dealers and Investment Advisers
- Steven Harris and Jay Hanson Reappointed to PCAOB
- China-Based Company and Former CFO to Pay Penalties for Disclosure and Accounting Violations

 Search EDGAR for Company Filings

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# Search for Companies in SEC website



The screenshot shows a Windows Internet Explorer browser window displaying the SEC's search page. The address bar shows the URL <http://www.sec.gov/edgar/searchedgar/webusers.htm>. The browser's menu bar includes File, Edit, View, Favorites, Tools, and Help. The Favorites bar shows several bookmarks, including MSN, Suggested Sites, Kronos, My Concur - Ronald A Sereika, and Get more Add-ons. The browser's status bar at the bottom shows "Done" and "Internet".

The webpage content includes the SEC logo on the left and navigation links (Home, Latest Filings, Previous Page) on the right. The main heading is "U.S. Securities and Exchange Commission". Below this is a search bar with the text "Search the Next-Generation EDGAR System" and a "Search Home" link. A breadcrumb trail reads "SEC Home » Current Page".

A note states: "Note: EDGAR Search Changes (see below)". Below this, a paragraph explains that since 1934, the SEC has required disclosure in forms and documents, and in 1984, EDGAR began collecting electronic documents to help investors get information. The SEC's new system requires data disclosure — the next step to improve how investors find and use information.

The page lists several ways to search information collected by the SEC:

- Company or fund name, ticker symbol, CIK (Central Index Key), file number, state, country, or SIC (Standard Industrial Classification)
- Most recent filings
- Full text (past four years)
- Boolean and advanced searching, including addresses
- Key mutual fund disclosures
- Mutual fund voting records
- Mutual fund name, ticker, or SEC key (since Feb. 2006)
- Variable insurance products (since Feb. 2006)

Under the heading "Custom searches:", there are two items listed:

- Confidential treatment orders
- Effectiveness notices

# Which Financial statements to use

- ▣ **Balance Sheet-** Shows the financial position – assets, liabilities, and stockholders equity of a firm on a particular date, such as the end of quarter or year.
- ▣ **Income Statement-** Presents the results of operations – revenues, expenses, net profit and loss for an accounting period.
- ▣ **The Statement of Stockholders Equity** – reconciles the beginning and ending balances of all the accounts that appear in the Stockholders equity section of the balance sheet.
- ▣ **The Statement of Cash Flows-** provides information about the cash inflows and outflows from operating, financing, and investing activities during an accounting period.

# Notes to the Financial Statements

- ❑ Immediately following the four financial statements is the section entitled Notes to the Financial statements. The notes are in integral part of the statements and must be read in order to understand the presentation on the face of each financial statement.
- ❑ The first note to the financial statements provides a summary of the firm's accounting policies. If there were any changes in any of the accounting policies during the reporting period these changes would be explained and the impact quantified in a financial statement note.
- ❑ Some of the notes would pertain to the following topics in detail: Inventory, property plant and equipment, long term debt.
- ❑ Other items that would show up in the notes would include: any major acquisitions or divestitures that took place in the accounting period, officer and employee retirements, pension plans, law suits, stock option plans.

# Auditors Report and Opinions

- ▣ Related to the financial statements and notes is the report of the independent auditor. Management has the responsibility for the preparation of financial statements including the notes, and the auditors report attests to the fairness of the presentation.
- ▣ There are four basic opinions that you will see:
- ▣ **Unqualified opinion** – States that the financial statements present fairly , in all material respects, the financial position, the results of operations, and the cash flows for the accounting period, in conformity with GAAP.



# Auditors Report and Opinions

- ▣ **Qualified Opinion-** A departure from GAAP will result in a qualified opinion and the use of the following language in the opinion sentence “In our opinion, **except** for the (nature of the departure explained) the financial statements present fairly ....
- ▣ **Adverse Opinion-** If the departure from GAAP affects numerous accounts and financial statement relationships, then an adverse opinion is rendered, which states that the financial statements have not been presented fairly in accordance with GAAP.

# Auditors Report and Opinions

- ▣ **Disclaimer of Opinion** – This is when an auditor cannot evaluate the fairness of the financial statements and therefore expresses no opinion on them. Lack of independence by the auditor will also result in a disclaimer.
- ▣ **Limited Scope** - A scope limitation means that the extent of the audit work has been limited and this will result in a qualified opinion. However if the limitation of work is so material, it will require a disclaimer of opinion.

# Auditors Report and Opinions

- Many circumstances warrant an **Unqualified Opinion with explanatory language** such as: a consistency departure due to a change in accounting principle, uncertainty caused by future events such as contract disputes and lawsuits, or events that the auditor wishes to describe because they may present business risk and going concern problems. Unqualified reports with explanatory language result in additional paragraphs to the standard three paragraph report.
- In theory the auditing firm performing the audit and issuing the report is “independent” of the firm being audited. However, keep in mind the auditor is hired by the firm whose financial statements are under review, these same auditors also used to do consulting and tax work for the same firms. This was a huge concern of conflict of interest however, this has now been lessened since new laws came out in 2001.

# Auditors Report and Opinions

- ▣ **Arthur Anderson-** Enron paid them \$52M in 2000, \$25M for audit work and the remaining for other work including consulting. In 2002 Arthur Anderson was ordered to stop auditing publicly traded companies after the firm was convicted of obstructing justice during the federal investigation of Enron.

# Management Discussion and Analysis

- The management discussion and analysis (MD&A) section sometimes labeled “Financial Review” is of potential interest to the analyst because it contains information that cannot be found in the financial data. The content of this section includes coverage of any favorable or unfavorable trends and significant events or uncertainties in the area of liquidity, capital resources, and results of operations. Overall the analyst will know where he can expect to find things such as:
  - The internal and external sources of liquidity
  - Commitments for capital expenditures, the purpose of those commitments and expected sources of funding.
  - A breakdown of sales increases into price and volume components

# Five Year Summary

- ▣ A five year summary of selected financial data required by the SEC includes net sales or operating revenues, income or loss from continuing operations, income or loss from continuing operations per common share, total assets, long term obligations and redeemable preferred stock.
- ▣ The summary offers the user of the financial statements a quick look at some overall trends and allows for comparisons between years.

# Watch out for “Fluff”

- ▣ In addition to the material required for presentation, many companies add to the annual report an array of colored photographs, charts, a shareholders letter from the CEO and other items to make the report and the company attractive to current and prospective investors. Some of these creations also appear on the corporate websites. Getting to what is needed through the PR Fluff can be a challenge as it appears the company is trying to hide their results.

# Objectives of Analysis Management

Looks to financial statement data to determine

- ▣ How well has the firm performed and why?
- ▣ What operating areas have contributed to success and which have not?
- ▣ What are strengths and weaknesses of the company's financial position?
- ▣ What changes should be implemented to improve future performance?



# Tools and Techniques

- ▣ Common-size financial statements
- ▣ Key financial ratios
- ▣ Trend analysis
- ▣ Industry comparisons
- ▣ Common sense and judgment

# Common-Size Financial Statements

Express each account on the

- ▣ balance sheet as a percentage of total assets
- ▣ income statement as a percentage of net sales

# Key Financial Ratios

Five categories of ratios

- ▣ Liquidity ratios
- ▣ Activity ratios
- ▣ Leverage ratios
- ▣ Profitability ratios
- ▣ Market ratios

# Liquidity Ratios:

	2010	2009
▣ Current Ratio <i>Current Assets/Current Liabilities</i>	1.72	2.01
▣ Quick Ratio (Acid Test) <i>(Current Assets – Inventory)/Current Liabilities</i>	1.09	1.16

# Efficiency Ratios: Ron's

	2010	2009
□ Days Sales Outstanding (DSO) Average AR / Average days Sales	21.13	20.79
□ Days Payable (DP) Accounts Payable / CGS / (365)	90.13	67.38

# Average collection period

□ Dates	10/2012	11/2012	12/2012	01/2013
□ A/R Balances	\$54,391	\$51,483	\$44,979	\$62,532
□ Shipments	\$47,288	\$27,232	\$31,513	\$53,050
□ Collection %	96.75%	94.85%	88.97%	98.21%
□ DSO	38Days	47Days	42Days	48Days

- **Calculation:** 10/31/12 A/R Plus 1/3/2013 A/R divided by 2
- $A/R = \text{Oct } \$54,391 + \text{Jan } \$62,532 / 2 = \$116,923 / 2 \text{ or } \$58,462$
- Sales 3 mo.  $(\$27,232 + \$31,513 + \$53,050) / 92 = \$111,795 / 92 = \$1,215 \text{ per day}$
- Average A/R is  $\$58,462 / \$1,215 \text{ equals } 48 \text{ Days}$
- **DO NOT EVER ALLOW YOUR MANAGER TO RATE YOU SOLO ON YOUR DSO PERFORMANCE.**

# Key Financial Ratios

## Leverage Ratios

Leverage ratios measure the extent of a firm's financing with debt relative to equity and its ability to cover interest and other fixed charges.

# Leverage Ratios

## Debt Financing and Coverage

### Debt Ratio

Considers the proportion of all assets that are financed with debt

$$\frac{\text{Total liabilities}}{\text{Total assets}}$$



# Financial Ratios

Profitability ratios include:

- gross profit margin
- operating profit margin
- net profit margin
- cash flow margin
- return on total assets (ROA) or return on investment (ROI)
- return on equity (ROE)
- cash return on assets

# Profitability Ratios

## Overall Efficiency and Performance

### Gross Profit Margin

Measures ability of a company to control costs of inventories or manufacturing of products and to pass along price increases through sales to customers

$$\frac{\text{Gross profit}}{\text{Net sales}}$$

# FREE CASH FLOW

- ▣ This lets you know the amount of CASH generated from you Cash from Operations after you're Capital purchases are removed.
- ▣  $\text{Cash from Operations} - \text{Capital Purchases}$

# AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of *ROWS SPORTS* as at October 31, 2010 and 2009 and the consolidated statements of earnings and comprehensive earnings, deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at October 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

# 1 RONS SPORTS

## CONSOLIDATED BALANCE SHEETS

(CAD \$000's)

As at October 31	2010	2009
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents <i>[note 5]</i>	\$ 18,266	\$ 11,532
Accounts receivable	8,866	7,965
Inventory	17,536	15,701
Prepaid expenses	3,109	1,532
Future income tax <i>[note 17]</i>	97	109
Related party promissory notes <i>[note 18]</i>	204	374
	48,078	37,213
Property, equipment and leasehold improvements <i>[note 7]</i>	5,558	2,813
Intangible assets <i>[note 8]</i>	8,908	9,517
Goodwill <i>[note 9]</i>	7,715	7,757
	\$ 70,259	\$ 57,300

**LIABILITIES****Current**

Accounts payable and accrued liabilities	+9,104 +50.8%	\$ 27,012	\$ 17,900
Income tax payable		44	615
Deferred gain on sale of equipment [note 6]		88	
Capital lease obligation [note 6]		811	
		27,955	18,523

Deferred gain on sale of equipment [note 6]		285	
Capital lease obligation [note 6]		2,508	
Long-term lease inducement		140	
Future income tax [note 17]		3,359	3,614
		34,247	22,137

**SHAREHOLDERS' EQUITY**

## Share capital [note 11]

## Authorized:

Unlimited common shares without par value

Unlimited Class A preferred shares without par value

## Issued and outstanding:

55,396,171 common shares [2009 – 56,901,719]		39,176	40,248
Contributed surplus [note 12]		2,663	2,294
Accumulated other comprehensive loss [note 13]		(3,783)	(3,482)
Deficit		(2,044)	(3,897)
		36,012	35,163
		\$ 70,259	\$ 57,300

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE EARNINGS

(CAD \$000's, except share and per share amounts)

Years ended October 31	2010	2009
Sales	\$ 153,166	\$ 139,870
Cost of sales	109,390	97,009
Gross profit	43,776	42,861
Advertising	18,069	18,098
Selling, general and administration	19,708	16,758
Amortization	2,272	2,585
Share-based compensation [note 12]	485	694
Interest expense (income)	96	(67)
Foreign exchange (gain) loss	97	(110)
Listing costs	-	906
Earnings before income taxes	3,049	3,997
Income tax expense – current [note 17]	171	1,286
Income tax recovery – future [note 17]	(224)	(36)
Net earnings	3,102	2,747
Unrealized foreign exchange losses on translation of financial statements of self-sustaining foreign operations	(301)	(578)
Comprehensive earnings	\$ 2,801	\$ 2,169
Basic net earnings per share	\$ 0.05	\$ 0.05
Diluted net earnings per share	\$ 0.05	\$ 0.05
Weighted average number of common shares outstanding [note 14]		
Basic	56,910,149	57,559,629
Diluted	58,101,504	57,869,238

+13,296,000 +9.5%

71.4

69.4

28.6

30.6

40,727 -26.6%

38,864 27.8

2.0

2.9

2.0

2.0

# CONSOLIDATED STATEMENTS OF CASH FLOWS

(CAD \$000's)

Years ended October 31

2010

## OPERATING ACTIVITIES

Net earnings	\$	3,102
Non-cash items affecting earnings:		
Amortization		2,272
Amortization of deferred lease inducement		74
Share-based compensation		485
Future income taxes		(179)
Changes in non-cash working capital:		
Accounts receivable		(979)
Inventory		(2,125)
Prepaid expenses		(1,240)
Accounts payable and accrued liabilities		6,634
Income tax payable		(514)
Deferred gain on disposition of property and equipment		373
<b>Cash provided by (used in) operating activities</b>		<b>7,903</b>



**INVESTING ACTIVITIES**

Repayments from (advances to) related parties	169	(12)
Acquisition of property, equipment and leasehold improvements	(4,033)	(721)
Acquisition of intangible assets	(424)	(221)
Disposition of property and equipment <i>[note 6]</i>	3,411	60
<b>Cash used in investing activities</b>	<b>(877)</b>	<b>(894)</b>

**FINANCING ACTIVITIES**

Issuance of common shares on exercise of options	146	-
Purchase of common shares for cancellation	(158)	(1,169)
<b>Cash used in financing activities</b>	<b>(12)</b>	<b>(1,169)</b>

Effect of exchange rate changes on cash and cash equivalents	(280)	(1,019)
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Increase (decrease) in cash and cash equivalents	6,734	(3,674)
Cash and cash equivalents, beginning of year	11,532	15,206
<b>Cash and cash equivalents, end of year</b>	<b>\$ 18,266</b>	<b>\$ 11,532</b>



# Altman Z Score for Ron's 2009

Given

$$Z = 1.2X_1 + 1.4X_2 + 3.3X_3 + 0.6X_4 + 1.0X_5$$

X<sub>1</sub>=Working Capital/Total Assets

X<sub>2</sub>=Retained Earnings/Total Assets

X<sub>3</sub>=EBIT/Total Assets

X<sub>4</sub>=Market Value of Equity/Total Liabilities

X<sub>5</sub>=Net Sales/Total Assets

## Inputs

Total Assets \$ 57,300,000

Working Capital \$ 18,690,000

Retained Earnings \$ 35,163,000

Pre-Tax Earnings (EBIT) \$ 2,747,000

Market Value of Equity \$ 35,163,000

*(If not public use book value)*

Total Liabilities \$ 22,137,000

Sales \$ 139,870,000

## Altman Z Score

**4.80**

Z greater than 2.99

Z between 1.81-2.99

Z less than 1.81

Indicates a non-bankrupt company

Indicates the Zone of Ignorance

Indicates a bankruptcy prone company

# Altman Z Score for Ron's 2010

Given

$$Z = 1.2X_1 + 1.4X_2 + 3.3X_3 + 0.6X_4 + 1.0X_5$$

X<sub>1</sub>=Working Capital/Total Assets

X<sub>2</sub>=Retained Earnings/Total Assets

X<sub>3</sub>=EBIT/Total Assets

X<sub>4</sub>=Market Value of Equity/Total Liabilities

X<sub>5</sub>=Net Sales/Total Assets

## Inputs

Total Assets \$ 70,259,000

Working Capital \$ 20,123,000

Retained Earnings \$ 36,012,000

Pre-Tax Earnings (EBIT) \$ 3,102,000

Market Value of Equity \$ 36,012,000

*(If not public use book value)*

Total Liabilities \$ 34,247,000

Sales \$ 153,166,000

## Altman Z Score

**4.02**

Z greater than 2.99

Z between 1.81-2.99

Z less than 1.81

Indicates a non-bankrupt company

Indicates the Zone of Ignorance

Indicates a bankruptcy prone company

# Ron's Sporting Goods

Company Name	Ron's Sports			
BP Number(s)	111111			
Year of statements	10/31/2010		10/31/2009	
<b>Cooper Sales</b>				
Current Year	\$4,125,258		\$3,857,520	
Prior Year	\$3,857,520		\$3,582,250	
<b>Current Ratio</b>				
CA/CL	1.72		2.01	
<b>Debt/Equity</b>				
Toal Debt/Equity	0.95		0.63	
<b>Free Cash Flow</b>				
Cash from Op - Cap Purch	\$3,870,000		-\$592,000	
<b>Cash Flow Liquidity</b>				
Cash+Mark Sec+CFO/C/L	\$26,169,000	0.94	0.59	
<b>Working Capital</b>				
CA- CL	20,123,000		18,690,000	
<b>DSO</b>				
AR/Average daily sales	419,633	21.13	383,205	20.79
<b>DPO</b>				
AP/Average Daily CGS	299,699	90.13	265,778	67.38
<b>Sales</b>	153,166,000		139,870,000	
<b>Gross Profit</b>	43,776,000	28.58%	42,861,000	30.64%
<b>Operating expenses</b>	40,727,000	26.59%	38,864,000	27.79%
<b>Earnings Before Income Tax</b>	3,049,000	1.99%	3,997,000	2.86%
<b>Net Income</b>	3,102,000	2.03%	2,747,000	1.96%
<b>Altman Z score</b>	4.02		4.80	
<b>Auditor Opinion</b>	Unqualified		Unqualified	
<b>Past Credit Limit Total</b>				
<b>New Credit limit</b>				

# History of Ron's Sporting Goods

- Ron's sporting goods store was founded in Vancouver, British Columbia by Ron Sereika in 2000. They are one of the largest online sporting goods stores in North America, and the largest seller of personalized sports equipment in the world. In 2011, the company sold more than \$180 million of merchandise. In 2004 Ron's raised \$6M in an initial public offering which they used to expand in the United Kingdom and parts of Europe. In late 2004 they acquired a mail order sporting goods business in Europe called Sven's and in 2006 they also bought one in Holland and one in Japan. In 2010 they moved into the women's sportswear arena with designer personalized sportswear. In 2011 they changed their name to R&S sporting goods and in January of 2012 they had shipments totaling over \$800,000 in just women's designer personalized clothes which at that time set a service record for online sales of made-to-order personalized women's clothes by an online provider. As of 2012 R&S owned the following company's; Especially for her.com, Personalize it for her.com.uk, She is the one.com.jp, Clearlyher.com. au and It's all hers.com.uk. In 2010, R&S introduced overnight shipping on all products in response to customer feedback. As a result, in 2010 they saw a 41% sales increase in the United States. Ron's provides top end athletic wear that they purchase from Nike, Addias, and Eastbay. In March of 2011 R&S expanded their designer sportswear to include the Plus sizes for women and have signed a contract with Liz Claiborne Ltd for the next 5 year. R&S also started a project called cloth the children of Africa and they will donate 1% of their annual sales to the children of Africa fund each year. Internet Retailer magazine ranked R&S as one of the top 3 web retailers in social media in January 2013.

# Conclusion

- ▣ Many methods to get your information regarding your accounts, find the one most conducive for your company and industry and remember “One size does not fit all”