Financial Statements rating systems and industry benchmarks

Appraisal criterions
for the credit- and capital market

Wolfgang Stegmann
(Vice president, DATEV eG, Germany)

Agenda

- Traditional analysis of the company
- Financial Statements rating systems
- Industry benchmarks
- Summary

Traditional analysis of the company

Classical ratio analysis

Ratio	Sample AG	ø Building Ind.	Interpretation
Equity / Balance sheet total	12.85 %	6.83 %	GOOD
Profit / Sales	16.24 %	21.15 %	BAD
Debt / Cash Flow	6.62	14.37	GOOD
Claims / Sales	71.35	44.47	BAD

The traditional analysis is afflicted with a couple of problems

Problems with the traditional analysis	Solution: Additional analyses
Ambiguous ratios	**Rating systems**
Traditional ratio comparison shows insufficient orientation	**Industry benchmarks**

Rating systems

A Financial Statements rating system calculates the probability of default of a company

DATEV

Separatable ratios

Ordinary result	= 19.75%
Quota of liabilities	= 49.43%
Inter. rate on borrow.	= 4.52%
Quota on sh.-term lia.	= 34.45%
Quota of own funds	= 14.71%

Rating category

Standard & Poor´s	= BB+
Moodys	= Baa2
IFD	= 2
KSV	= 3
DSGV	= 6

Financial Statements rating function → z-value* = 3.98 → Probability of default = 0.42%

* Transformation in PD simplified

A Financial Statements rating is the ticket in the new world of financing

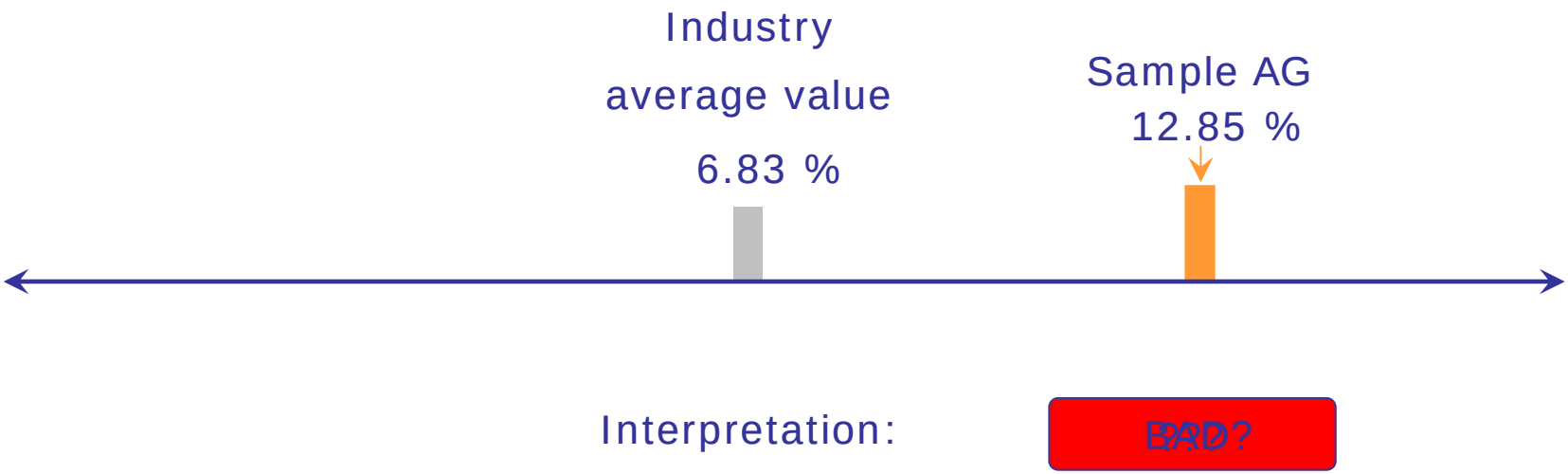
Area	Meaning
• Bank lending	ca. 50 – 60 per cent
• Capital market financing	ca. 80 – 90 per cent
• Financial standing of claims	Standard
• Evaluation of suppliers	Increasing standard

A regular Financial Statements rating is absolutely recommended

Industry benchmarks

The ratio values were compared with industry average values so far

Equity ratio



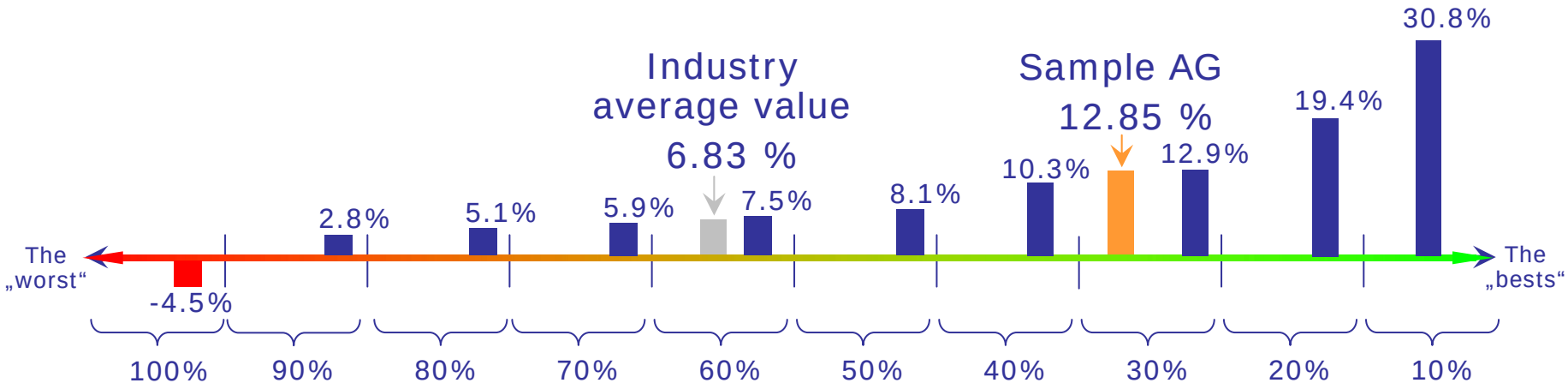
➡ The comparison of ratio values with industry average values is only limited meaningful

The solution of the problem: Industry benchmarks

Imagine …

… you know the „Bests“ (in rating) of the industry and their (classical) characteristic of ratios …

Equity ratio



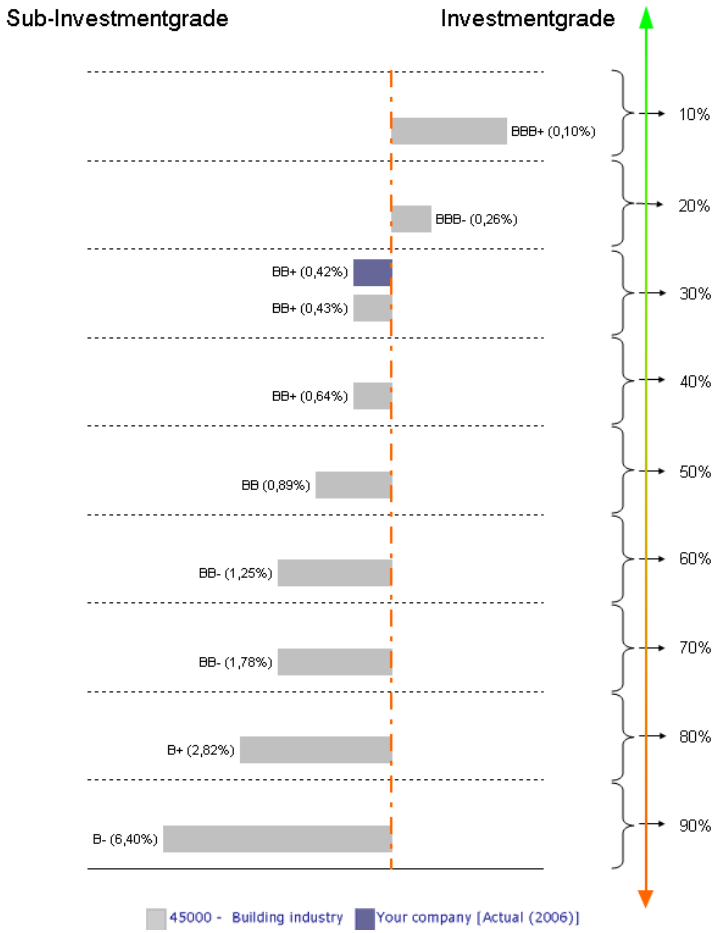
➡ Interpretation:

The ratio value can be seen above-average.
But anyway exist substantially optimisation measures, in view of the equity quota of the bests of the industry (30.8%).

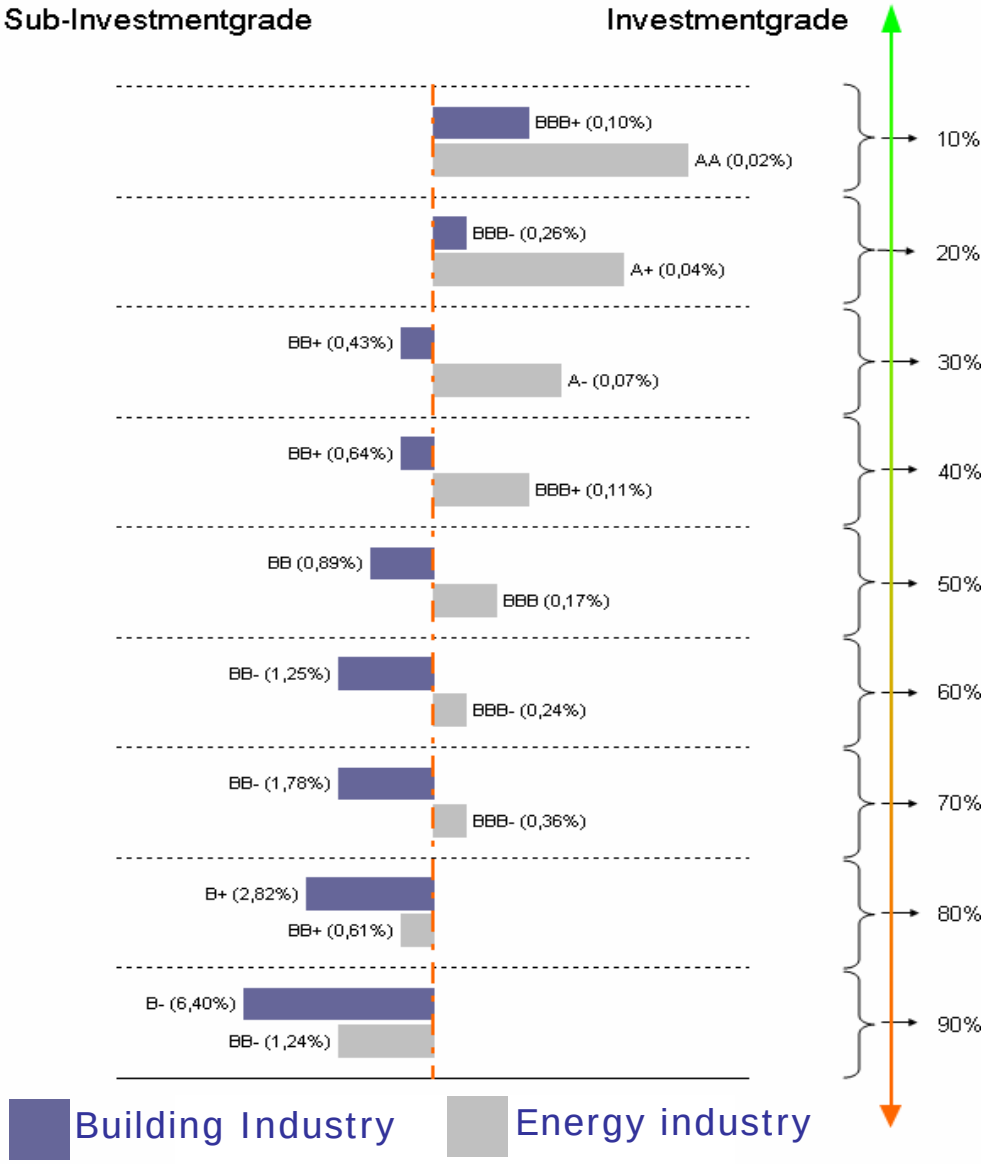
Source of the Reference vaule: Krehl H.; Schneider R., Fischer A.; DATEV eG; Branchenrating 2006; Page 837.

Industry benchmarks entail a substantial potential

- Useful interpretation of ratio values
- Determination of the position of a company within an industry
- Orientation on the ratios of the „Bests“ of an industry (benchmarking)
- Analysis of industry risks



Which industries does it concern?



Summary

Summary

- Rating is the ticket into a new world of financing
- Industry benchmarks allow a target-oriented comparison with the „Bests“ of an industry
- Extend your traditional ratio analysis – also and especially in the area of testing companies by help of Financial Statements rating and industry benchmarks

Thank you for your attention

Backup

Effects on modern Financial Statements rating systems

Mezzanine Financing

Accounting standard
IFRS

First analyses:
„No appreciable effects on the Financial Statements rating“*

No resp. just low effects on the probability of default

*see DVFA-Finanzschriften No. 05/07; Mezzanine methods of financing and balance sheet rating