The 20-minute annual report checklist

Read the evidence before the story. Work through these 20 questions in order, tick each one, and write down anything that needs a closer look. You will rarely get a verdict; you will always get better questions.

1. Before you start · 2 minutes

- [ ] Download the **consolidated** annual report (it includes subsidiaries) and the previous four years' reports.
- [ ] Note the financial year and the units (crore or lakh) used in the statements.

2. The auditor's report · 2 minutes

- [ ] Is the opinion **unmodified**? Note any qualified opinion or 'emphasis of matter'.
- [ ] Has the auditor changed or resigned mid-term? If so, look for the stated reason.

3. Cash flow statement · 5 minutes

- [ ] Compare **cash from operations** with **net profit** for 3 to 5 years. Over time they should be close.
- [ ] Cash conversion (cash from operations / net profit) below 70% for several years is a warning sign.
- [ ] Is free cash flow (operating cash minus capital spending) positive in most years?
- [ ] Is the company borrowing or issuing shares to fund operations or dividends?

4. Profit and loss account · 3 minutes

- [ ] Revenue growth over 5 years: steady, lumpy, or one exceptional year?
- [ ] Operating margin: stable, rising, or swinging with costs?
- [ ] Do 'exceptional items' appear every year? If so, they are not exceptional.

5. Balance sheet · 3 minutes

- [ ] Debt to equity: is borrowing rising faster than the business?
- [ ] Receivable days (receivables / revenue x 365): rising sharply year after year?
- [ ] Inventory days: growing much faster than sales?

6. Returns on capital · 2 minutes

- [ ] ROCE (operating profit / capital employed): consistently above the company's cost of borrowing?
- [ ] ROE much higher than ROCE? Debt may be inflating returns.

7. The notes to accounts · 3 minutes

- [ ] Related-party transactions: large loans, sales or purchases with promoter-owned firms?
- [ ] Contingent liabilities: disputed taxes, guarantees, legal claims, and are they growing?
- [ ] Promoter pledging, from the shareholding pattern: is any promoter stake pledged?

8. Management's word · 1 minute

- [ ] Re-read last year's management discussion: did the company deliver what it promised?

Profit is an opinion. Cash is a fact. Read the facts first.

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