

Visual Learning Maps

Introductory Financial Accounting



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VIRTUAL TEXT BOOK

Financial Strength... **PLS GROW** - 1 of 2

PLS GROW is a memory trigger for the categories of measuring financial strength – **P**rofitability, **L**iquidity, **S**tability and **G**rowth.

Remember – no single measurement, ratio or % can be relied upon to measure the financial health of a business.

Growth

“Is the business growing?”

Growth analysis looks at key numbers from the financial statements over time; internal management reviews month to month; external analysts look at quarterly and annual growth patterns.

These are usually plotted on a spreadsheet and a graph – the change from month to month, quarter to quarter or year to year is the focus of the analysis.

PURPOSE OF GROWTH ANALYSIS

The purpose of Growth Analysis is:

- To determine what elements of the business are growing or not

e.g. - Net Sales, Net Income, and Assets are three important elements.

- To determine if the growth patterns reflect consistency

e.g. – If Net Sales are growing and Net Income isn't – what is the explanation?

- Additional component of risk assessment

Financial Strength... **PLS GROW** - 2 of 2

Growth... **continued**

Here are two analytical Examples:

Business A – Growth – Reflecting Consistency

Item (Millions)	Year 1	Year 2	Year 3	Year 4	Year 5
Net Sales	80	88	98	113	124
Growth Over Previous Year		10%	11.4%	15.3%	9.7%
Net Income	25	28	31	36	49
Growth Over Previous Year		10%	10.7%	16.1%	8.3%

This business is growing in Net Sales and Net Income at about the same rate. This indicates that expenses are growing at about the same rate as Net Sales – management would consider looking at the growth of expenses to assess the legitimacy of the growing costs.

Business B – Growth Analysis – Reflecting Inconsistency

Item (Millions)	Year 1	Year 2	Year 3	Year 4	Year 5
Net Sales	100	110	130	137	137
Growth Over Previous Year		10%	18.1%	5.4%	0%
Net Income	20	20	31	34	37
Growth Over Previous Year		0%	55%	9.6%	8.8%

Despite the increases in Net Sales, Net Income reflects a very different growth pattern. And what happened in year 3, where there was an 18.1% increase in Net Sales and a 55% increase in Net Income? Why the big difference?

There may be valid explanations for wild fluctuations - analysts and investors would want to the answers. It is up to management to provide these answers – for example:

- There was a bad debt of \$7 recovered in Year 3 (remove this and the Net Income would be \$24; a 20% increase over Year 2.)