Analysis on Earnings Quality of Listed Companies

Based on Dupont Analysis

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Abstract—The purpose of this paper is to study earnings quality analysis system of the listed company, to show the research purpose and significance of earnings quality of the listed company, to research the earnings quality of listed companies through four aspects.

Keywords—earnings quality; growth; stability; cash supportability

I.   INTRODUCTION

Since the 1970s, with the rapid development of the economy and the continuous growth of national income, people's living standards have significantly improved, and the consumer market has also expanded. In this situation, China's listed companies continue to flourish. Profit is the core of an enterprise, and profit has always been the concern of both internal and external companies. Therefore, the quality of earnings of listed companies has great value, which is worth a lot of time and energy to study.

The analysis and research on the profit quality of listed companies is conducive to the comprehensive understanding of the financial situation and the development of a scientific operation plan. It is beneficial for shareholders to analyze the operation of the enterprise and master the first-hand information of the enterprise. It is beneficial for external personnel to timely and deeply understand the information of the enterprise and make more rational choices. It is beneficial for the state financial and tax departments to supervise and manage the listed companies.

II.   FINANCIAL INDEX ANALYSIS OF EARNINGS QUALITY

A.   Capital Return Index

The net interest rate on sales is the ratio of net profit to sales revenue. It shows the relationship between net profit and sales revenue. By analyzing this indicator, you can see the strong profitability of the company, which is mainly affected by the business revenue, but it does not mean that blindly increasing the business revenue can improve this indicator and increase the net profit. To improve this target, a balance needs to be struck between expanding the scale of the business, increasing the revenue of the business, and the costs associated with it.

The rate of return on shareholder's equity is the ratio of net profit available for shareholder distribution to common shareholder's equity and represents the level of return on equity. The higher it is, the stronger the return on capital. At the same time, the profit brought by the capital is higher. In addition, it is the product of ROI and equity multiplier. If you want to improve this index, you can increase ROI or equity multiplier.

Earnings per share is the ratio of after-tax profit to equity. It is the net gain or loss of each share held by the shareholders of a company. It can reflect the profitability of common stock, estimate the profitability of the company, judge the future development trend of the enterprise, and make the managers put forward reasonable suggestions on the problems of the enterprise.

The return on total assets is the ratio of net profit to average assets. It is the index that inspects company capital to return ability. It's important to see the quality of the company's earnings. It is often combined with other indicators such as return on equity to examine a company's return on capital. The return on total assets directly indicates the level of a company's operation and management, and it is also an important basis for judging whether an enterprise should be leveraged.

B.   Cash Guarantee Index

Income cash ratio is to show the cash amount that the enterprise receives and advocate what business income compares. It eliminates potential accounts receivable crises and reflects the nature of major revenues in terms of cash flow. If the ratio is greater than 1, it will not only receive the cash now, but also recover the money from the previous period, and it is highly profitable. If it is less than 1, it means that part of the revenue has not been collected and the profitability is poor.

Profit cash guarantee multiple is one of the key contents of cash guarantee ability of listed companies. It is equal to net operating cash flow divided by net profit. It shows the profitability of listed companies and fully examines their actual cash guarantee ability. Generally speaking, it should be larger than 1.The higher the value, the better the profit quality. When it is less than 0, the current earnings quality is poor.

Asset cash recovery is the ratio of net cash flow to average assets. It examines the ability of listed companies' assets to generate cash flow. The larger the value, the more cash assets bring, the stronger the cash protection ability. The smaller this indicator is, the less cash assets bring, the weaker the cash protection ability.

C. Indicators of Profit Stability

Main business profit margin is the ratio of main business profit to main business income. It reflects the amount of income from the company's main business as well as the profit of the company's main business. It allows managers to better examine the benefits of the company. The higher the value of this index, the stronger the profitability of the enterprise, the better the effect of the business strategy, the stronger the product competitiveness, the stabler the sales level, and the better the development momentum. Only in this way can the enterprise have a bigger advantage than other competitors in the industry.

Main business ratio is the ratio of main business profit to total profit. If the enterprise wants to run for a long time and get higher income continuously, it must constantly strengthen its main business. Therefore, the higher the value, the better. The higher the index, the better the company's earnings stability.

D. Indicators of Profit Growth

Main business income growth rate is the main business income of this period minus the main business income of the previous period and the ratio of the main business income of the previous period. It reflects the growth rate of the company's main business. Normally, the higher the index, the better. Generally, when the index is lower than -30%, it indicates that there are big problems in the company's main business, which should be paid more attention by shareholders and managers. When this index is less than the growth rate of accounts receivable, or even less than 0, enterprises may manipulate profits, investors need to pay more attention. Generally, if it is greater than 10%, the listed company is in the growth stage and has a good momentum. If the index is greater than 5% but less than 10%, it indicates that the listed company is a stable company. If the index is below 5%, it indicates that the listed company is a declining company and needs to be reformed and transformed.

The growth rate of earnings per share is the amount of profit that can be shared by each share. The higher the index, the better.

III. PROBLEMS EXISTING IN EARNINGS QUALITY ANALYSIS

A. Too Much Emphasis on Profitability Index Analysis

It is undeniable that profitability is indeed the most important indicator both inside and outside the company in the current market environment. Under the condition of China's market-oriented reform, its status is getting higher and higher. The internal staff will examine its situation to make new plans for the company's future and then improve its operation mode. Outsiders dissected the company's finances to see if it was worth buying shares. In such a case of so much emphasis on profitability, this index is bound to affect the development of an important index, listed companies will focus on the profitability of this index management. Too much attention to profitability has also led to the emergence of many financial fraud events, profit manipulation more and more.

B. The Evaluation System Is Not Sound Enough

The evaluation of profit quality index of listed companies cannot evaluate only one aspect, but also comprehensively analyze the profit quality. First of all, the current accrual basis in China lacks a comparison with the earnings quality under the cash basis. In addition, the existing analysis system is difficult to predict the future profit level, whether the existing profitable enterprises can maintain the current level and progress, whether the poor profit can reverse the existing situation to achieve bottle-out rebound, these are difficult to investigate.

Another problem is that most of the current methods for evaluating the quality of earnings are mathematical, but some of these mathematical models are too complex to be understood by people with less professional skills.

In the above analysis of financial indicators of earnings quality of listed companies, basically all indicators are calculated by mathematical formulas. Although these mathematical formulas are relatively simple, for non-professionals, they generally do not know the need to use these indicators to measure earnings quality. In addition to the formulas used in the above indicators, there are also some more professional analysis models, such as time series analysis model.

C. Too Much Emphasis on Historical Data

Because it is difficult to find the law of future profit quality, more than half of people will focus on the analysis of historical data. Through the analysis of the historical data, we hope to find the listed companies with rising earnings quality to buy their shares. However, investors often put too much emphasis on their own experience in the process of studying historical data and most of the time judge the future earnings quality of a listed company by their experience. However, for most analysts, their professional level has not reached a certain level, and the experience based on does not have much scientific reason.

D. The Qualitative Analysis Is Not Perfect

Qualitative analysis is an indispensable part of the profit quality analysis system, which includes the analysis of operating scale, accounting policies and accounting estimates, but the existing system is not perfect. It is difficult to maintain a unified judgment condition on the judgment scale, so it can supplement quantitative analysis as an auxiliary part. For example, in recent years, the real estate industry has been developing rapidly, the housing price has been soaring, and the rent of shops has also been soaring, especially in the first-tier cities like Beijing, Shanghai, Guangzhou and Shenzhen,

the housing price and rent are several times higher than those in the second and third-tier cities. When analyzing the profit quality of listed companies, we should take into account the business scope and position of listed companies, which are compared with listed companies based on the same housing price and rent. In addition, with the rapid development of economy, people's consumption needs are more diversified, and marketing methods are becoming more and more diversified. In addition to the traditional offline marketing, the development of the Internet has also increased the means of online marketing, and the online and offline marketing expenses have increased accordingly. When analyzing the cost of the listed company, we should pay attention to the analysis of whether the increased cost is marketing cost or other indirect costs including electricity, office expenses, employee welfare, etc., and analyze whether the increase of these costs brings the corresponding improvement of profit quality.

IV. CONCLUSION

A. Streamlining Profitability Indicators

Although at present the analysis of the earnings quality of listed companies we too much emphasis on profitability analysis in the process, but this does not mean that we want to abandon the analysis of profitability, the current analysis indicators, we just need to streamline the existing indicators, for appropriate index to retain, redundant indicators can be cut. For example, the main business margin recommendation is retained. It can be seen through the investigation of the profitability of the main business of the enterprise, is an essential content. For some indicators commonly used in earnings quality analysis, such as deducting non-net profit growth rate, we can consider appropriate deletion. Most companies still rely on their main business to make profits, and there are similar indicators in other earnings quality analysis indicators.

B. Improving the Profit Quality Evaluation System

The current earnings quality evaluation system is mainly composed of capital return index, cash guarantee index, earnings stability index and earnings growth index. These four indexes can cover all aspects of earnings quality analysis of listed companies, but there is still room for improvement in some aspects. For example, you can increase security. It's basically a series of leverage factors. Let's take financial leverage as an example. The financial leverage factor is a multiple of the change in earnings per share when ebit is doubled or decreased. The greater the coefficient, the greater the financial risk.

C. Improving Indicators of Stability and Growth

Current evaluation system basically is to inspect historical data. There are few studies on stability and growth. We should take a longer view to examine the quality of earnings and enrich the indicators of stability and growth. A listed company may have a high earning quality at present, but it does not mean that it will maintain a high earning quality in the future. We should inspect its future profit

quality condition, profit level, development prospect more. For example, growth indicators can be appropriately increased on earnings, p/e, profit, earnings per share forecast indicators.

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