

IMPORTANCE OF TREND ANALYSES BEFORE MAKING INVESTMENT IN A COMPANY (Berkshire Hathaway Inc.)

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As any investment involve some risks, investments require very careful examination of a company and investors need to make some financial analyses before putting money in a company. Generally investors are using past 5-10 year financial dates to find out the performance of the company. In our opinion one of the useful method of financial analyse is trend analyse of a company, which helps investors to see the past financial condition of the company and it helps investors look into what “goes on the behind a company’s closed door”. Trend analyse not only shows the past financial condition, it also helps investors to make some forecast about the future trend of the company. Of course only financial dates are not enough to predict companies perspectives, but making trend analyse has real sense because it points out the trend which is possible to come true in the nearest future¹.

Most investors are willing to invest in a company which is highly profitable such as American company **Berkshire Hathaway Inc.** The reason of this is that, highly profitable companies can generate high dividends. As investors major interests are high return from the money, which they have invested in order to multiply their money, they are interested in companies with good profit. Based on these, we approach, that profitability trend analyses are really useful for both existing investors and potential ones before making investment in the company. From our point of view,

¹ http://www.ehow.com/list_7305649_financial-would-useful-investing-company_html

http://www.ehow.com/info_8214599_trend-important-examining-financial-statements.html

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there are some basic useful profitability ratios to measure company's profitability: Return on Equity(ROE), Gross Profit rate, Earnings per Share, Return on assets and Return on sales. By estimating each of these ratios mentioned above, it is possible to answer those important questions to which investors are very sensible: will the profitability of the company continue to grow or fall, has it any sense to put money in the company, how well does the company handle its assets, how well does the their invested capital work and many other questions, which are helpful while making investment decision.

Table.1.1. Financial dates used for estimation ratios from Balances and Statements of Earnings 2005 and 2010 years of Berkshire Hathaway Inc¹.

In Millions

Year	2010	2009	2008	2007	2006
Net Earnings	13494	8441	5596	13213	11015
Outstanding shares	1635661	1551174	1548960	1545751	1541807
Earnings before income taxes	19051	11552	7574	20161	16778
Total Assets	372229	297119	267399	273160	248437
Sales (Net Revenue)	67225	62555	65854	58243	51803
Cost of sales and services	55585	52647	54103	47477	42416
Common stock Equity	162934	135785	109267	120733	108419

One of the important ratio in analysing company's profitability is **Gross Profit Rate**, which shows at what rate does the gross profit excess over the sales revenue. The higher is the gross profit rate the more beneficial it is for the company and investors are willing to put investment in it and buy stock². As **Table.1.2.** shows Gross profit rate for Hathaway is changing slightly over the past five years : in 2006 and 2007 it is 18%,

1 <http://www.berkshirehathaway.com/reports.html>

2 <http://www.investopedia.com/articles/fundamental/04/042804.asp>

in 2008 it decreases by 0.64 percent, in 2009 it decreases again by 2% and in 2010 the rate gets back to the rate as it was in 2008. The reason of this changes is gross profit, which in 2010 increased by 14% and the sales increased by 7.4 %, in 2009 the gross profit decreased by 18% and the sales decreased by 5% .The Average rate of last five year Gross profit rate is 17.5%.

Table.1.2. Gross profit Rate of Berkshire Hathaway 2005-2010 years.

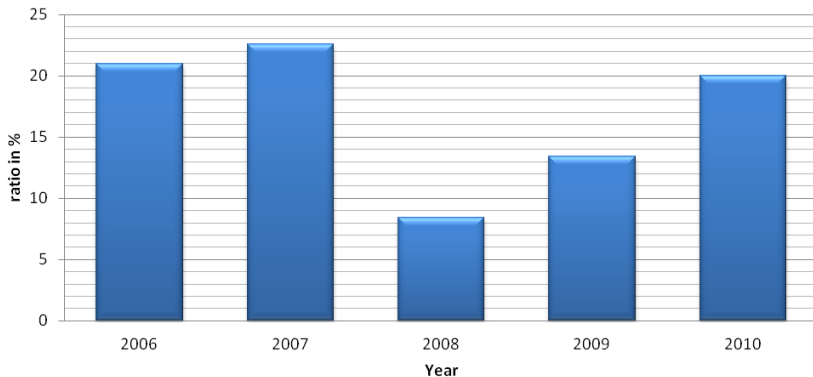
Year	2010	2009	2008	2007	2006
Gross profit	11640	9908	11751	10766	9387
Sales (Net Revenue)	67225	62555	65854	58243	51803
Gross profit rate	0.17315	0.15839	0.1784	0.18485	0.18121

Return On Sales is also one of the useful ratio to analyse company's Financial performance. It gives information of a firm's ability to control the level of its sales. **Table 1.3.** and **Figure 1.** shows the dynamic of the mentioned ratio. The return of sales is very changeable over the years. In 2008, there is a very big downward from 22.68% to 8.49%. The reason of this decline is the 57.6 % decrease of net earnings, which was caused by the decrease of earnings before income tax and income tax expense, and in 2008 there were no earnings from equity method investment. The next year the earnings from equity method investment was 427 million, that increased net earnings and the ratio raised to 13.49%. Again in 2010 the ratio went up to 20%, because of increase in earnings before income tax by 39% and 37% increase in net earnings. As for sales it made only slight influence on the dynamic of the ratio by changing 6-11% over the period.

Table 1.3. Return on Sales

Year	2010	2009	2008	2007	2006
Net Earnings	13494	8441	5596	13213	11015
Sales (Net Revenue)	67225	62555	65854	58243	51803
Return on sales	0.200073	0.134937	0.084976	0.22686	0.212632

Figure.1. Return On Sale(ROS)



Another important ratio which worth to analyse before making investment decision in the company is **Return on Assets (ROA)**. Investors can measure how effectively the company generates profit by the assets. From the **Table 1.4**, we see, that average total assets are increasing every year and the second variable Earnings before income tax is changing from year to year. Like Return on sales, Return on Assets is decreasing in 2008 from 7.7% to 2.8% and begins to increase in 2009 by 2% and then 1.6% increase on rate in 2010. The main reason that caused the decrease in rate in 2008 is the earnings before income taxes which decrease by 62%, while average total assets increased at the same year.

Table.1.4. Return on Assets

Year	2010	2009	2008	2007	2006
Earnings before income taxes	19051	11552	7574	20161	16778
Average Total Assets	334674	282259	270279.5	260798.5	223381
Return on Assets	0.056924	0.040927	0.028023	0.077305	0.075109

Berkshire Hathaway has a very low **Earnings per Share**. In 2007 and 2010 the ratio equaled to \$ 0.8. As it is the ratio which is very important for company's financial performance, this results are not appropriate for the company. But still having low Net Earnings, doesn't mean that the company

is unprofitable. There are some reasons that caused Earnings per share to be so low. First of all, the reason is net earnings, which has a very big influence to the ratios. In 2007 net earnings increased by huge percent 19%, in 2008 net earnings decrease by 57%, in 2009 it begin to increase by 50% and then in 2010 it increased by 59%, while Earnings per share increased slightly.

Another reason that caused Earnings per Share to be low is costs. Warren Buffet, the CEO of the company (Berkshire Hathaway Inc) is oriented to making investments, which itself insists on putting vast amount of money, also taxes are quite high in USA: for Berkshire Hathaway Income tax expense only was 29.4% of Earnings Before Income Tax in 2010, 30% in 2009 and 26% in 2008. Besides operating expenses deals with lot of money spending, all this caused Net Earnings to be low and as a result Earnings per Share is low itself.

Table.1.5. Earnings per Share.

Year	2010	2009	2008	2007	2006
Net Earnings (hasn't preferred stock)	13494	8441	5596	13213	11015
weighted average share outstanding	1593418	1550067	1547356	1543779	1540791
Earnings per share	0.008466	0.005446	0.003616	0.008559	0.007149

The Return on Common Stockholders' Equity Ratio compares net earnings with invested capital. For Berkshire Hathaway Inc Return on Common stock Equity is equal to Return on Equity, because it hasn't preferred stock, so they are the same in this case. Usually shareholders are interested how does their invested capital works. ROE measure how well does the company invest the money invested in it and high ratio indicates that management of these company spends money wisely and from the point of view of investment it is profitable company, where investors can rely on qualified managers. As for Return on Common Stock Equity ratio helps to "measure the return that a firm's management is able to earn on common stockholders investment¹. Will they get any profit or loss? Table

¹ <http://financial-dictionary.thefreedictionary.com/Return+on+Common+Stock+Equity> .

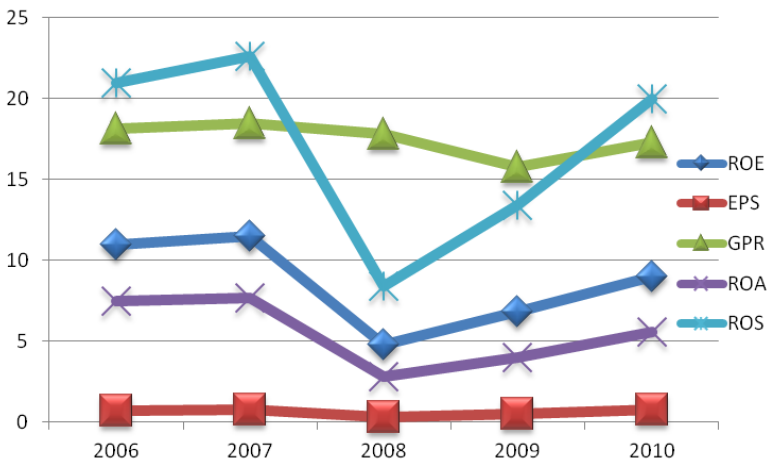
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1.6. gives us the following dates: ROE in 2006 and 2007 was 11% and 11.5%, but in 2008 it went down to 4.8% and again in 2009 it raised to 6.8% and in 2010 it become 9%. It worth to analyse, what caused the change of ROE during this period. First of all, the reason was net earnings discussed above in Earnings per share. Another reason of this change is Average common stock equity, which increased by 14.6% in 2007, in 2008 it increased slightly by 0.34%, in 2009 Average common stock equity increased by 6.5% and in 2010 by 21%.

Table.1.6. Return on common stockholder Equity (ROE)

Year	2010	2009	2008	2007	2006
Net Earnings	13494	8441	5596	13213	11015
Average common stock equity	149359.5	122526	115000	114576	99951.5
Return on common stockholder Equity (=ROE)	0.090346	0.068892	0.048661	0.115321	0.110203

Figure.2. Profitability Ratios 2006-2010 years: ROA, EPS,GPR, ROA and ROS.



After we have made 5 year trend analyse of **Berkshire Hathaway Inc** based on 5 most used profitability ratios by investors we get some results from our estimations. From **Figure 2.** it is obvious that 2008 year was the lowest point for Return on Equity(ROE), Earnings per Share(EPS), Return on assets(ROA) and Return on sales(ROS). Despite of the sharp fall of this 4 ratio, in 2008 the falling tendency quickly changed in 2009 year and now the ratios have growing trend. Unlike these 4 ratio Gross Profit rate had the lowest point in 2009, but these slight fall quickly changed in 2010 and went up.

By taking into consideration Berkshire Hathaway Inc's great potential and growing tendency of the ratios discussed above, we expect them to continue to increase and Berkshire Hathaway Inc will stay as one of the attractive and profitable company for investors as it had been for past decades. In addition, we think that still trend analyse does not guarantee the forecasted results, the probability of expected trend is quite high and worth to make trend analyse before we make investment decision.