Box 4

FINANCIAL STATEMENT INFORMATION ON LISTED NON-FINANCIAL CORPORATIONS

This box analyses information derived from the annual financial statements (profit and loss accounts and balance sheets) of listed non-financial corporations.[1] It focuses on profitability and leverage in 2006 and, where appropriate, considers developments in 2006 from a longer-term perspective. The box complements the analysis of an aggregated measure of profits presented in Box 7, entitled "Developments in euro area profits".

The profitability of listed non-financial corporations in the euro area, measured as a ratio of net income to sales, increased further in 2006, reaching its highest level since 1985. Despite this strong profit performance, the ratio of debt to cash flow increased slightly in 2006, mainly owing to a sharp increase in the indebtedness of the construction sector.

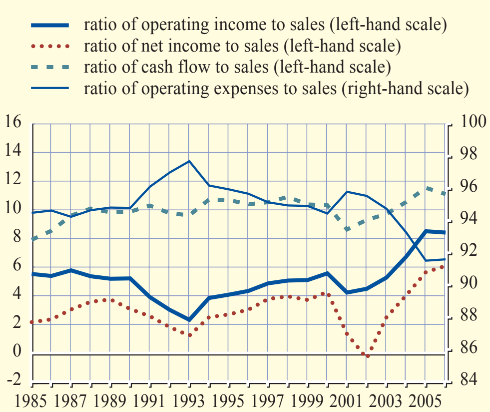
Profitability developments

Various indicators can be used to measure corporate profitability developments, concentrating either on the operating income, on the net income or on the cash flow of a firm.[2] By contrast with operating income, which is defined as sales minus operating expenses, net income refers

1 The Thomson Financial Datastream database, which at the time of the analysis contained a total of approximately 1,600 firms for 2006 (mainly large enterprises, which accounted for around 75% of the sample), was used to construct the annual sample of listed non-financial corporations in the euro area. For a description of data and developments for 2005, see Box 5, entitled "Profitability and leverage developments of listed non-financial corporations in the euro area", in the June 2006 issue of the Monthly Bulletin.
2 Another profitability indicator is the ratio of earnings before interest, taxation and depreciation (EBITDA) to sales. Compared with net income, EBITDA can be more meaningful in the case of cross-country comparisons, as the effects of national taxation and depreciation rules are excluded. However, the ratio of EBITDA to sales is less meaningful as regards the amount of internally generated funds available to an enterprise for investment.

Chart A Profit and cost developments for listed euro area non-financial corporations

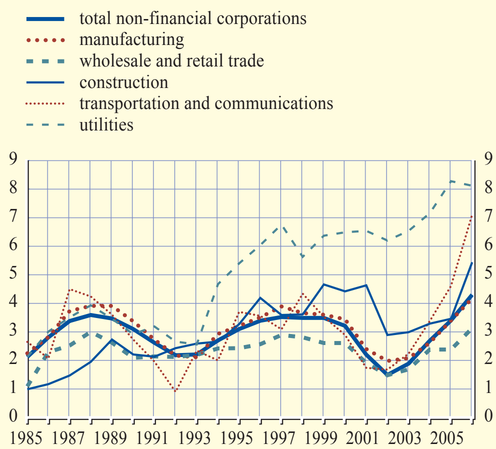
(percentages)



Sources: Thomson Financial Datastream and ECB calculations.
Notes: Calculations are based on aggregated annual financial statements of listed non-financial corporations in the euro area. Data for 2006 are preliminary.

Chart B Ratio of net income to sales for listed euro area non-financial corporations by sector

(percentages)



Sources: Thomson Financial Datastream and ECB calculations.
Notes: Calculations are based on aggregated annual financial statements of listed non-financial corporations in the euro area. Figures show the median value. Data for 2006 are preliminary.

to operating and non-operating (interest) income after income taxation and a deduction for extraordinary items. Cash flow is defined as net income before depreciation.

The profitability of listed non-financial corporations in the euro area, measured by net income as a percentage of sales, continued to increase in 2006, reaching its highest level since 1985. This result is in line with the findings presented in Box 7. The increase in this profitability indicator was less pronounced than in previous years. A comparable development is observed in an alternative indicator of profitability – the ratio of operating income to sales (see Chart A).

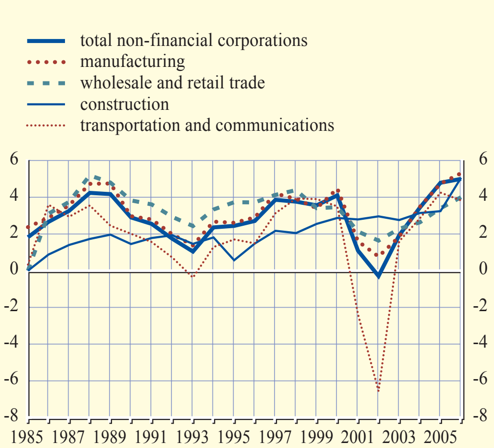
In 2006 the operating expenses of listed non-financial corporations stabilised as a percentage of sales at around the same level as in 2005, staying close to their historical low. Regarding cost developments, the depreciation-to-net sales ratio of listed non-financial corporations remained at a low level in 2006, after declining considerably from its peak in 2001. This might be related to the fact that the growth rate of investment by listed companies was lower than that of those companies' sales. The continued low level of interest payments as a percentage of debt was another factor which contributed to the positive developments in cost ratios.

By contrast with the ratio of net income to sales, the ratio of cash flow to sales of listed non-financial corporations declined slightly in 2006 from the peak reached in 2005, but remained at high levels.

From a cross-sector perspective, the profitability – measured by the ratio of net income to sales – of listed non-financial corporations increased in 2006 in all main sectors of the euro area economy, with the exception of the utilities sector, for which profitability declined slightly from the extraordinarily high levels seen in previous years (see Chart B). In addition, the recovery from the trough seen in 2002 has been particularly pronounced in the transportation, communications and construction sectors. While the profitability of listed non-financial

Chart C Return on assets of listed euro area non-financial corporations by sector

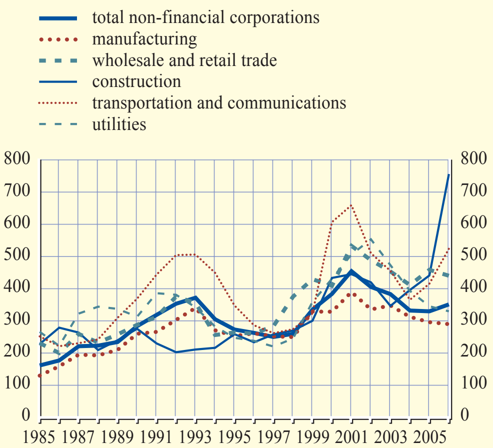
(percentages)



Sources: Thomson Financial Datastream and ECB calculations.
Notes: Calculations are based on aggregated annual financial statements of listed non-financial corporations in the euro area. Data for 2006 are preliminary.

Chart D Ratio of debt to cash flow for listed euro area non-financial corporations by sector

(percentages)



Sources: Thomson Financial Datastream and ECB calculations.
Notes: Calculations are based on aggregated annual financial statements of listed non-financial corporations in the euro area. Data for 2006 are preliminary.

corporations in the manufacturing sector continued to develop broadly in line with the euro area average in 2006, that of the wholesale and retail trade sector remained at a lower level, although it has increased significantly since 2001.

The measure of profitability based on sales may be affected by industry-specific characteristics. An investigation of the return on assets or equity can help to overcome the resulting differences. The return on assets, measured as net income in relation to total assets in the previous period, reached its highest level since 1985 (see Chart C) in the construction and manufacturing sectors in 2006. By contrast, the return on assets declined slightly in the transportation and communications sectors, but remained at a fairly high level in historical terms.

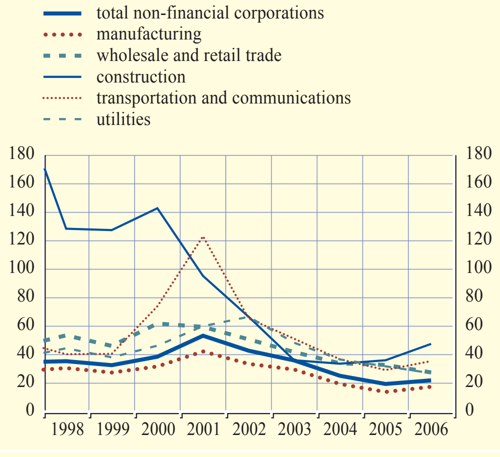
Leverage developments

Overall, listed non-financial corporations marginally increased their debt in relation to cash flow in 2006, following a reduction in the ratio of debt to cash flow from 2002 to 2005 (see Chart D). This rise in debt was driven by sharp increases in the construction, transportation and communications sectors. Debt developments in the construction sector in 2006 need to be interpreted with some caution, as the indicator is influenced by a relatively small group of companies in the sample which conducted large M&A operations.

An indicator which is used to evaluate the financial situation of non-financial corporations is the interest payment burden, as measured, for example, by the ratio of interest payments on debt to operating income. This reflects the share of operating income that firms need to use for interest payments. Another measure is the ratio of interest payments on debt to the total amount of debt outstanding, reflecting the average interest rate on debt which listed non-financial corporations have to pay.

Chart E Ratio of interest payments on debt to operating income for listed euro area non-financial corporations by sector

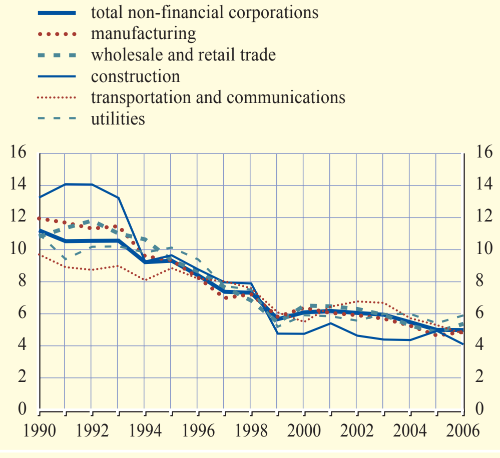
(percentages)



Sources: Thomson Financial Datastream and ECB calculations.
Notes: Calculations are based on aggregated annual financial statements of listed non-financial corporations in the euro area. Data for 2006 are preliminary.

Chart F Average interest rate on the debt of listed euro area non-financial corporations by sector

(percentages)



Sources: Thomson Financial Datastream and ECB calculations.
Notes: Figures represent the ratio of interest payments on debt to the amount of debt outstanding. Calculations are based on aggregated annual financial statements of listed non-financial corporations in the euro area. Data for 2006 are preliminary.

The ratio of interest payments on debt to operating income of listed non-financial corporations rose slightly in 2006, following the increase in interest rates (see Chart E). However, it remained at low levels when compared with the peak in 2001.

The average interest rate on the debt of listed non-financial corporations remained largely unchanged in 2006 (see Chart F). Taking a longer-term perspective, the average interest rate on the debt of listed non-financial corporations declined significantly from the start of the 1990s until 1999. After an increase in 2000 and 2001, it resumed its downward trend to reach historically low levels in 2006.