Report on financial analysis: blue inc

Business, Company

Part 1)

Analyzing financial statements of the company is of great importance as it serves different purposes of each interested party. For Instance, while investors analyze the financial statements to evaluate their investment decision in the company, creditors are more concerned to judge the profitability of the company i. e if the company will be able to honor their agreed payments on time. Apart from these outside parties, even the management of the company conduct financial statement analysis so as to formulate future plans and decisions.

However, there are different tools available for supporting the financial analysis of the companies and the same are discussed hereunder:

Vertical Analysis: A popular method of conducting financial statement analysis in which each entry of the financial statements i. e of Balance Sheet, Income Statement is proportioned with an account. For Instance, all the items of the Balance Sheet are proportioned with Total Assets and all the items of the Income Statement is proportioned to Net Sales. Hence, vertical analysis proposes easy analysis and comparison of the financial statements of the company and also helps the analyst to see relative changes within an entity.

Horizontal Analysis: This method of financial analysis allows the analyst to compare the line items of the financial statements over the year. For Instance, if an analyst reports that revenue of a company has increased by 10%, he must have conducted horizontal analysis to arrive on such results.

Trend Analysis: A complex tool of financial analysis which provides information about the direction of value of a company’s stock over the years.

Ratio Analysis: Ratios provide a concrete financial summary regarding all the areas of the organization i. e Profitability, Liquidity, Efficiency and Solvency. Hence, an analyst can easily judge if the company is performing well in all the financial arenas.

Part 2:

a)Liquidity Analysis:

These ratios judge short term payment ability of the entity. Generally two measures of Liquidity Ratios are used by analyst to adjudge the liquidity position of the company:

- Current Ratio
- Quick Ratio/Acid Test Ratio

i) Current Ratio: Calculated as ratio of Current Asset and Current liability, this liquidity ratio is considered to be true indicator of a firm’s liquidity. The average industry current ratio is 2: 1.

Current Ratio: Current Assets/ Current Liabilities

ii) Quick Ratio:

A more stringent measure of liquidity assessment, quick ratio is calculated as ratio of Current Assets less Inventory and Prepaid Expenses to Current Liabilities. The average industry quick ratio is 1: 1.

Quick Ratio: (Current Assets – Inventory- Prepaid Expenses)/ Current Liabilities

b)Profitability Measures:

One of the important ratios, which indicate the profitability margins of the entity and can said to be true indicator to adjudge whether the company is able to earn profits from its operations and what amount of return it is able to achieve for its investors.

i) Net Profit Margins:

This indicates the bottom line profit margins earned by the company after all the operating and non-operating items , interests , taxes and dividends are deducted from the Gross Profits of the company.

Net Profit Margin: Net Profit/ Net Sales*100

ii) Gross Profit Margins:

Gross Profit Margins indicates the percentage of raw profit being earned by the company on its sales.

Gross Profit Margins: Gross Profits/Net Sales*100

iii) Return on Capital Employed:

ROCE is another measure of profitability analysis of a company which indicates how profitable and effectively a company is using its capital. A high ROCE ratio indicates that the company is efficiently using its capital resources. Also, the ratio so calculated should be higher than than cost of capital of the firm else this will indicate that company is not able to increase shareholder wealth.

Return on Capital Employed: Earning before Interest and Taxes/ Capital Employed

c) Efficiency Ratios:

Also known as Activity Ratios, these ratios indicates how efficiently the management of the company is utilizing various assets like Fixed Assets, Account Receivable etc. Below, discussed are some activity ratios stated in the given overleaf:

i)Fixed Asset Turnover:

This ratio indicates how well the firm is utilizing its fixed assets to generate revenue for the company. It is always desirable for the company to keep the ratio close to the industry norms. While, low fixed asset turnover ratio imply that the firm has obsolete equipment or that the company might have to incur additional capital expenditure in the near future to increase the capacity to support growing revenues.

Fixed Asset Turnover Ratio: Revenue/Average Net Fixed Assets

ii) Stock Turnover Ratio:

This ratio indicates the firm’s efficiency with respect to its processing and inventory management. Just as Fixed Asset Turnover Ratio, companies always desire to achieve a ratio close to industry norms.

Stock Turnover Ratio: Cost of Goods Sold/ Average Inventory

iii) Trade Collection Period:

Trade Collection period is calculated as the inverse of Receivables Turnover Ratio times 365 which indicates the average number of days the debtors of the company takes to pay off their debts. This number is important as it briefs out the credit policy of the company. A collection period that is to high might mean that customers are too slow in paying off their bills, which mean that too much capital is tied up in assets. A collection period that is too low indicates that the firm's credit policy is too rigorous, which might be hampering sales of the company.

Trade Collection Period= 365/ Receivables Turnover Ratio

*Receivables Turnover Ratio= Annual Sales/ Average Receivables

iv) Trade Payables Period:

Trade Payables Period is the inverse of the Payables Turnover Ratio times 365 which indicates the average amount of time it takes the company to pay off its debt. This number is important for the creditors as it reveals the payment ability of the company. High payables period might force the creditors and suppliers to stop providing credit to the company and might also hamper the corporate image of the company.

Trade Payables Period= 365/ Payables Turnover Ratio

*Payables Turnover Ratio= Annual Purchases/ Average Trade Payables

d) Vertical Analysis Ratios:

The given overleaf also discuss some of the ratios relating to Vertical Analysis of the company and are as follows:

- Administration Expenses to Sales
- Distribution Expenses to Sales
- Mark Up Costs

These ratios indicate, proportion of these expenses to sales of the company, moreover it helps the analyst to know what proportion of operating expenses are being deducted from the gross profits of the company. This provides a clear image of the financial scenario of the company.

Part 3)

Liquidity Analysis:

i)Current Ratio:

ii) Acid Test Ratio:

Summary:

Referring to above ratios of liquidity analysis, it can easily be inferred that Blue Inc. has now losing on its liquid sources. While, the company showed signs of improvement from 2011 to 2012, it again saw a decreasing trend during 2013. This was evident from the Current Ratio of the company which declined from 1. 66(2012) to 1. 42(2013). Even if we apply the stringent measure of judging the performance of the company through acid test ratio, the analysis will be same, with ratio declining from 1. 10(2012) to 0. 85(2013).

Thus, declining liquidity ratios of the company suggests that over an year, the Current liabilities of the company has exceeded the Current Assets.

b) Profitability Analysis:

i) Net Profit Margin:

ii) Gross Profit Margins:

Summary:

Above results confirm our previous conclusion that the year 2013 was indeed a tough one for Blue Inc. Though the company's bottom line profits improved from 2011 to 2012, but later decreased from 12. 3%(2012) to 11.

10%(2013). However, it was interesting to note that while bottom line profits were in decreasing trends, the gross profit margins of the company increased gradually over the three years of our analysis. This indicates that since gross margins are rising, the only reason for the decreasing trend in Net Profit Margins can be the increasing amount of operating expenses. Hence, it will be interesting to find the current trend in Operating Expenses of the company, which we will be discussing in the next section.

c) Operating Expenses Analysis:

i) Administration Expenses to Sales Ratio:

ii) Distribution Expenses to Sales Ratio:

Summary:

The above analysis reveals that the major reason for decline in profitability margins of the company. Referring to Administration Expenses to Sales Ratio, the company has successfully managed to control the administration expenses which resulted in gradual decreasing trend over the years. However, despite the fall in administration expenses, the net profit margins were notified to be in decreasing trend during 2013. This was attributed to the increasing trend in the Distribution Expenses to Sales Ratio. In other words, over the years, Blue Inc. is not able to control the Distribution Expenses, as a result of which, major portion of the Gross Income is being consumed by Operating Expenses which results in low Net Profit Margins.

d) Efficiency Ratios:

i) Stock Turnover Ratio:

Summary:

Over the three years of our analysis, the company achieved high stock turnover during 2012 but the ratio fell from 16. 9(2012) to 15. 5(2013). Thus, the decreasing stock turnover ratio indicates that the company is holding obsolete inventory and too much capital is tied up in inventory now.

ii) Fixed Asset Turnover Ratio:

Summary:

The analysis of Fixed Asset Turnover Ratio of the company shows that over the three years, the ratio has been improving. However, if we consider other aspects that we analyzed in the previous discussions, where we concluded that 2013 was indeed a financially ill period for the company, in such situation, high/increasing fixed asset turnover ratio of the company might indicate that Blue Ltd now have obsolete equipment and with decreasing value of these equipments, the Fixed Asset Turnover Ratio has been increasin, which is not a sustainable increase for the company.

iii) Trade Payables Days:

Summary:

The above schedule and graph indicates that the company has been paying off its bills at a much faster rate. Although, the company was slow in their payments during 2012 when the trade payables days increased from 50 days to 52 days, but during 2013 it paid off its bills in an average of 44 days.

iv) Trade Receivables Days:

Summary:

Unlike improved payment trends of the company, the Trade Receivables of the company has increases which indicates that during 2013, the debtors of the company were slow in paying their bills and hence too much capital of the company is tied up in assets.

Part 4)

In a latest report published during August, 2013, UK's leading fashion retail store, Blue Inc. has bought Five Republic Stores with the objective to improve its womenwear sales. At present, womenwear section accounts for just 20% of the sales of the company, but since the executives of the company cite it as a big opportunity for the company to improve its overall sales. The company took the buyout decision after its EBITDA increased from £3. 5 Million to £5 Million and sales improved by 39%.

This marks the desire of the company to improve its sales figure by targeting untapped but profitable buying section i. e Womenwear. Hence, if we combine the above analysis with this report we can believe that soon Blue Inc will improve its financial condition.

Works Cited

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