

Free essay about financial statements

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Financial statements contain all the information about the company but they require being interpreted so that the financial health of the company can be analyzed; for this purpose, they use the financial ratios. In order to gauge the effectiveness of the business operations, the owners use various tools.

Financial ratio is a significant tool through which the financial statements are broken down in order to evaluate and manage the performance of the company. The ratios are used as a tool to conduct quantitative analysis; this means that a mathematical analysis is conducted through which the accurate picture of the company is foreseen (Drake & Fabozzi, 2010). First of all, the ratios are useful to understand the financial position of the business and specially the investors and the bankers gain benefit from it during their decision making. Secondly, with these ratios, the efficiency of the company is judged with particular reference to the management and the operations of the business. But the most important aspect is that the ratios help in identifying the weaknesses within the operation of the company; this is particularly helpful when the weaknesses are hidden underneath good performance of the company and no remedy is being taken (Velez-Pareja, 2010). In the case, the financial statements of Garner's Platoon Mental Health Care, Inc. have been given for the year 2012. The biggest advantage of the financial ratios is that the company can compare its performance with other firms and with the industry average ratio to analyze its performance.

Current ratio = $3290/2055 = 1.60$ times; Cash ratio = $421/2055 = 0.20$ times; Inventory Turnover = $4980/1760 = 2.83$ times; Fixed Asset Turnover = $4980/4972 = 1.0$ times; Avg. Collection period = $1109 \times 365 / 4980 = 81.28$ days; Total Assets Turnover = $4980/9154 = 0.54$ times; Avg. Payment

Period = $867 \times 365 / 2246 = 140.89$ days; Day's sales in Inventory = $1760 \times 365 / 4980 = 128.99$ days; Accounts receivable turnover = $4980 / 1109 = 4.49$ times; Accounts payable turnover = $2246 / 867 = 2.59$ times; sales to working capital = $4980 / (3290 - 2055) = 4.03$ times; Capital Intensity = $9154 / 4980 = 1.84$ times; Profit margin = $1267 / 4980 = 25.44\%$; Basic earnings power = $2409 / 9154 = 26.32\%$; ROE = $1267 / (637 + 3312) = 32.08\%$; ROA = $1267 / 9154 = 13.84\%$; Debt ratio = $(2055 + 3090) / 9154 = 56.20\%$; Debt-to-equity = $(2055 + 3090) / 4009 = 1.28$ times;

In comparison to the industry average, the cash ratio and the current ratio are less which shows that the company does not have enough cash. In case of the asset management ratios, it can be seen that the company is overall outperforming the industry but the issue is that its payment period is more than the average of the industry. Firm is able to turn over its inventory faster than the industry so this means that more dollars of sales are being produced for a dollar of inventory. It has faster collection as compared to its payments as compared to the average firm. The company is generating more sales per dollar of total assets and working capital as compared to the average firm of industry. But the per dollar sales generated of fixed assets is lower as compared to the average. There is more risk of bankruptcy for the firm as it has more financial leverage (Velez-Pareja, 2010). There is more debt for the firm as can be seen from the debt ratios. The profitability ratios show that the company is more profitable than an average firm in the industry where the profit margin, ROA, ROE, and even BEP are higher than the industry average.

APPLICATION

In my view, the problem is that the company has too much fixed assets and is low in liquidity which means that it has fewer cash and it has bound its liquidity in fixed assets. Already it can be seen that even though the performance of the company is more than that of the average firm in the industry, but its sales generation in terms of fixed assets falls below that of the average; in addition, the liquidity ratios also indicate that the company lacks the instant cash; cash is the blood and fuel of the business and in times of crisis, it can be very risky for the company to survive without proper cash in hand (Velez-Pareja, 2010). It is highly critical to take into consideration this issue and more fixed assets need to be converted into cash. Another issue is that the company is holding more debt as compare to the industry and this is also linked with the lower liquidity of the company. The business requires to release some fixed assets, hold more cash in hand and to restrict some debt so that it gains more dollars of the earning and also gets more cash so that it can meet its interest obligations (Drake & Fabozzi, 2010). Holding high debt while having very less cash is a very risky situation specially when the business world is so uncertain.

References

Drake, P. P. & Fabozzi, F. J. (2010). Financial ratio analysis. Handbook of finance.

Velez-Pareja, I. (2010). Financial ratio analysis.