

Thunder electronics company case study example

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Introduction

Thunder Electronic Company is one of the players in the electronics industry. The strength of any company within the industry that it operates is determined by its financial position. The basic aim of any venture or business is to make or increase its profits. There are several financial ratios that are used in determining a company's financial position.

Question 1

Liquidity ratios gauge a company's ability to convert its short term assets into cash. Liquidity ratios for TEC Company are moderately poor since the current ratio and quick ratios indicate the company is not performing well. The company has since 2010 experienced a persistent decline in its current ratio: 2010-2.04, 2011-1.72 and 2012- 1.31. Similarly, the quick ratio is relatively low for the three years which means a lower liquid position. Comparing the current and quick ratio of TEC to the industry ratio; it is slightly performing below average. In three consecutive years the current ratio and quick ratio is below the industry's ratios. This is not a healthy position for the company to continue being a key player in the industry. One

of the risks that come with low liquidity ratios is the inability of the company to pay its short term debts. The extreme of this financial position is suffering from bankruptcy which has an overall effect of drawing faith and trust from the shareholders.

Figure 1

This is a downtrend line indicating a decrease in company performance even as the liquidity ratios increase.

It is apparent that the company is enjoying fairly high profit ratios. However, it is worth to note that these ratios are on a down ward trend for three consecutive years. The return on equity and profit margins are declining for the last three years. The profit margin was 7.35% in 2010 to 6.12% in 2011 and began to increase with a ratio of 6.38% in 2012. Return on equity was 15.90% in 2010, 14.20% in 2011 and 13.98% in 2012. The company is performing below the industry's capacity. This is evident because the industry profitability ratios are on an upward trend while TEC'S ratios are on a downward trend. If this trend persists then the company will be at great risk of losing potential investors as well as shareholders. Decreased profit ratios basically mean that there are less financial advantages that are trickling down to the shareholders. Not unless the company engages in intensive profits boosting activities or promotional activities, then it should be warning for a tough financial period ahead. Return on assets was 8.02% in 2010, 6.80% in 2011 and 5.70% in 2012. This indicates a down ward trend which is dangerous for TEC.

Figure 2

This is an uptrend line indicating an increase in company performance even as the profitability ratios increase.

The increasing leverage ratios for TEC Company justify its deteriorating performance. The increase in leverage ratio portrays a picture of reduction of the company's equity. It is also apparent that the industry's leverage ratios are below TEC'S. This is an indication that the company is performing poorly in the industry and may not be able to compete with other players in the same industry. The risk involved is that the company may become bankrupt if it continues to increase and mismanage its debts. One of the remedies to this situation is laying off some workers or imposing budget restrictions. This will increase the company's equity.

Figure 3

This is a downtrend line indicating a decrease in company performance even as the leverage ratios increase.

The company's activity ratios are slightly higher than that of the industry. The inventory turnover is slightly low which indicate that the company is not able to manage its inventory efficiently. The average collection period is more than 50 days. However this is slightly higher than the industry's ratios. If the company is not able to manage its resources wisely then it may suffer from liquidation. Low activity ratio implies that the company is at the risk of failing to service short term debts. The company thus needs to streamline its operations so that its activity ratio can be high. Fixed asset and total asset turnover are too low which means that the company is not able to manage its assets efficiently.

Figure 4

This is a downtrend line indicating a decrease in company performance even as the activity ratios increase.

Finally market investor's ratio is also poor because its EPS (4.1% in 2011 to 2.9%) is quite low which indicates that the investors will be faced with low earnings expansion in contrast to general market's the company is performing below the industry's capacity. The industry has got higher earnings per share than TEC. The key risk involved is that the potential and existing investors may withdrawal from investing in TEC Company. Investors want to invest in a company that shows the possibility of high returns from their shares.

Figure 5

This is an uptrend line indicating decrease in company performance even as the market investor's ratios increase.

Question 2

Financial information on these ratios is required.

- Cash ratio: This ratio is of high value because it will give TEC Company an indication of whether its financial assets are strong enough to help it weather through tough economic times. In addition, it will also indicate whether the company is actually able to repay its short term debts to creditors. A larger cash ratio is always preferred.
- Debt ratio: This ratio gives an indication of whether the liquidation of all the company assets can generate funds that will be enough to cover all its debts, both long term and short term
- Long term debt ratio provides an overview into the basic financial well being of TEC Company. The greater the long term debt the riskier the occurrences of an organization decline.

- Interest coverage ratio will indicates whether the profits generated by TEC Company are adequate enough to settle its funding costs and interest rates for funds that it had potentially acquired from investors or other relevant stakeholders.
- Creditor pay period: This figure is extremely important because it indicates the amount of time or the period that it will take the company to pay its creditors, for example its suppliers. The more time there is the better.
- Return on capital employed ratio: It is very paramount that this ratio is included in the TEC Company accounting books because it will serve as an indicator of its profitability. This because it measures the amount of money generated by the company using the funds contributed by shareholders and is usually expressed as a percentage. In addition, the ratio complements the return on equity (ROE) ratio by adding a company's debt liabilities, or funded debt, to equity to reflect a company's total " capital employed". This measure narrows the focus to gain a better understanding of a company's ability to generate returns from its available capital base. Financial analysts consider the ROCE measurement to be a more comprehensive profitability indicator because it gauges management's ability to generate earnings from a company's total pool of capital.

Question 3

The CEO's statements are not giving enough information because even in his briefing, he concentrated on growth of revenues rather than the overall performance of the company. As much as the revenues increased, it is also clear that the liabilities also increased considerable which is something he should have tackled in detail. The financial performance of a business cannot

be evaluated from a revenue perspective solely. The CEO should also have expounded on the net income and the details of the balance sheet. He should have brought about the comparisons between the total assets, stockholders equity, company ratios and the total liabilities. These too tell a lot about the company's financial position. He should have also provided a cash flow statement to show investors the general flow of money into and out of the company.

Question 4

One of the worst trends in the company that is surely having devastating effects on its financial performance is its accounts receivable turnover that has witnessed radical shifts in this particular accounting period. An analysis of this aspect reveals that company is very weak in fact when it comes to the collection of outstanding cash balances from its general debtors like customers in a given accounting period. This is not good at all because the money is needed by TEC Company to be pumped back into the company's operations. Another ratio that has dramatically shifted is the debt ratio which has considerably increased. The effect of this is that investors may be threatened by this humongous debt ratio and may therefore not be willing to invest in TEC Company. These are actually the two worst performing trends in TEC Company and the sentiments of VP Finance to the Financial Controller are hugely justified since the two ratios significantly affect the earnings of TEC Company.

Question 5

Debt ratio and current ratio are the two major ratios that need to be considered by any potential investor of this company. Debt ratio will guide the investor to know the ability of the company to service its long-term debts. The current ratio is supposed to guide the investor on knowing whether the company will be able to pay its short term financial obligation and debts.

As these financial ratios show, the company is not performing well. This company can be described to be performing below average. From the above analysis investing in this company is risky. However, many companies recollect and pick up from poor financial positions and become vibrant players in the industry. Investing in this company can be worthy if at all the company engages in some financial rejuvenation programs.

Below is graph showing the trend of these ratios at TEC Company for the three year accounting period.

Figure 6

Question 6

After examining the stated financial ratios, the investor should not invest because the performance of TEC Company is not healthy. The CEO has concentrated on growth of the company of 25% without considering other factors that may affect the company in future. For instance, the leverage ratios and liquidity ratios indicate that the company is performing poorly and may not be in a position to meet its obligations. By comparing the TEC company performance and the Electronic industry performance, it is obvious that TEC Company is performing poorly and any investor must be cautious

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when investing in this company. The top management should come up with solutions that will enhance good performance and this will attract many investors.