

Case study on finance

Business, Company



Financial Analysis for Riley's Supply

This report is intended to examine and identify Riley's Business issues. The report provides an analysis of the current and projected liquidity, profitability and financial stability of Riley's Supply. The Methods used to analyze Riley's Financials are CCC (cash conversion cycle), cash flow statement analysis and common size income Statement. A ratio analysis has also been conducted. Other calculations include ROA, ROE, payables period etc. All calculations are available in the appendices. The report also contains recommendations to the management to achieve the targeted sales and to counter issues related to the cash flows.

The current picture of the company's financial does not show healthy performance in terms of its cash flows. The gross profit margin dropped to 16.99 from 18.02 percent. Similarly the operating profit margin also got down to 3.06 from 3.52. The asset turnover though low yet remained constant at about 2.5; however the current ratio dropped to 1.4 from 1.6. The inventory turnover also improved to 4.5 from 4.4, like wise other financial indicators show average increase or decrease over the year.

However the cash conversion cycle shows a positive trend. The CCC in 2005 was 87.7 whereas in 2006 it went down to 72.9 days. This indicates that the operating cycle is shortened and the cash is tied up for shorter period. The net income performance of the company has been declining for fiscal 2006 with 1.372%, when computed for common size income statement, these figure has been decreased from the previous years' 1.61% and 1.98%. This decrease in net income resulted in the drop down of profit margin and showed 3.47% in ROA (return on asset) which was lower than the previous

year's 4.09%. The common size income statement reveals that the cost of goods sold has risen up to 83% which was 80% in year 2004 and in 2005 it was 81%.

In general, the company had an average fiscal year. It was able to maintain its ability to generate profit. All three of the main profitability's ratio (profit margin, return on assets and return on equity) have shown a slight downward trend from the previous year; it means that the company needs to use its resources more efficiently. The company is experiencing continued cash flow problems despite of increasing growth. The reason for which could be assessed from the over all performance of the company. However a closer look at the cash flow statement highlights some more and important issues.

One of the major reasons is the unequal or imbalanced stream of cash flows, due to which the company was unable to write off its loans in the FY 2006. The cash flows from operating activities turned negative which is an alarming situation. The accruals also show negative figures (66) which was 48 in the previous FY. The fair value of its debt obligations at December 31, 2006 totaled \$1020 thousand, compared with \$831 thousand at December 31, 2005. This gives the company a little room to breathe. The average collection period of the account receivables has increased to 59days and the payable period has also increased to 66 days from 50 days. This means that the company is facing problems in collecting the receivables and paying back its payables in the targeted time disturbing the stream of cash flows; consequently the company's manufacturer suppliers are becoming unhappy as they are losing confidence in the company.

The report finds the prospects of the company in its current position are not positive. The major areas of weakness require further investigation and remedial action by management. The company needs to improve the average collection period for accounts receivable, improve/increase inventory turnover. To attain the 30% increased sales target in the next fiscal year the company needs to take immediate measures to balance its cash flows for which it can offer lucrative measures to the suppliers and manufactures like trade discounts or bulk purchases so that they agree to sign the payables at better terms and for longer periods. This will give the company space and time to circulate the money and clear other outstanding liabilities. Prior to this the company needs to manage the inflows from the receivables for which again they could offer discounts and imposing fines on late payments. They need to workout a sustainable action plan that could be beneficial and attractive enough for both the customers and the manufacturers. In order to buy back the 40% shares of the company Riley's would have to generate equity through debt financing, though the company is already under large debt yet a smart policy can deal with this by managing to get long term debt. This will reduce the dividends payout which could be compensated in the interest payments.

Exhibit 1

Riley Supply

Balance Sheets

December 31

(Thousands of dollars)

Exhibit 2

Riley Supply

Income Statements

For the Year Ended December 31

(Thousands of dollars)

Exhibit 3

Riley Supply

Cash Flow Statements

(Thousands of dollars)

Exhibit 4

Financial Ratios

Exhibit 5

Riley Supply

Common Size Income Statements

(Thousands of dollars)