Circuit city: financial strengths and recommendation

Running Head: WEEK THREE ASSIGNMENT Week Three Assignment In APA Style By Circuit Financial Strengths and Recommendation

Circuit City, the third largest consumer electronics retailer in the United States is actually experiencing financial problems as evidenced by its computed financial ratios presented by Reuters. It should be noted that during the fiscal year 2006, the business organization reported operating and net losses indicating its failure to create value for the company's shareholders. Circuit City posted a net profit margin of -1. 22% when the industry reported 2. 89% while the sector averaged 9. 56% (Circuit City 2007).

However, amidst the failure of the retailer to operate profitability it should be commended for its financial strengths in terms of liquidity and leverage. It should be noted that during the fiscal year 2006, Circuit City reported a quick ratio of 0. 55 and a current ratio of 1. 53. The company is more liquid than the industry which posts a quick ratio of 0. 41 and current ratio of 1. 27(Circuit City 2007). These higher liquidity ratios indicate that the company's current assets in proportion with short term liabilities can more likely cover its current obligations if they become due immediately. The fact that Circuit City is outperforming the industry is an indication of financial strength.

Circuit City has a relatively less risky capital structure compared to the industry and the retailing sector. The company's long term debt to equity ratio is 0. 03 far less than the industry average of 0. 26. Furthermore, its long term debt to equity ratio is 0. 04 which is also less than the 0. 53 in the industry (Circuit City 2007). These low ratios indicate the lower risk faced by the company since its resources are mostly financed by equity and not by debt. It should be noted that debt presents higher risk because of companies are required to pay interest during certain periods.

With the current low profitability in Circuit City, it is recommended that the retailer focus on enhancing its revenue and minimizing cost. The company should conduct a thorough analysis of its operation and value chain in order to look for avenues where it can remove unwanted expenditures. Circuit City should improve its efficiency by eliminating non-value adding activities in its operations. In this way, the company can minimize its cost and improve profitability.

Why Best Buy

Best Buy is one of the toughest competitors of Circuit City. In revenue and market share alone, Best Buy outperforms its rival. For an investor, this paper recommends Best Buy stocks as a better investment alternative to Circuit City's. In contrast to the poor profitability in Circuit City, the business organization registers an operating profit margin and net profit margin of 5. 63% and 3. 83% respectively (Best Buy 2007).

Best Buy should also be favored when both companies are measured through return on equity. It should be noted that this financial ratio is considered the ultimate test for a company because it shows how the business organization fares in creating value for its stockholders. Return on equity in Circuit City is -8. 36% due to its financial losses while Best Buy is able to create value for its shareholders with its 24. 04% return on equity which is higher than the industry average (Best Buy 2007; Circuit City 2007).

References

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