Analyze financial statement

Finance

Financial ments Analysis RE: Financial Analysis of Loan Applicant to Ascertain Loan Viability There are several factors to consider before advancing the requested loan to that applicant. Since the advancing company is a financial institution, its aim is to increase the net interest margin in order to make profit.

Where net interest margin is= Interest on assets – Interest cost of liabilities

Total Assets

The assets are the money advanced as loans to different institution. First there are two factors which are of the most interest before advancing loans e. g.

1. Profitability ratio for that business.
2. Liquidity ratio of that business.

Profitability ratios (Peterson Drake & Fabozzi, 2012)

These are the ratios that indicate ability to generate earnings in relation to the expenses, sales and equity. From the company is financial statement this ratios can be calculated as follows

Profit margin = net income/sales

Jan 31, 2015

Feb 1, 2014

Feb 2, 2013

134, 526/22, 492, 360 620, 069/23, 114, 263 (210, 706)/ 24, 380, 510

0. 0059 0. 0268 (0. 0086)

The year 2014 was the most profitable of all the three years. The higher the ratio the better hence some consideration has to be taken over the drop on profit margin in the year 2015 before the loan is advanced.

Return on assets is a ratio of net income to net assets. A higher ratio is

preferred since it indicates that the company is successfully generating earnings from its assets.

= net income/total assets

2015 2014 2013

= 134, 526/10, 313, 728 = 620, 069/11, 174, 876 = (210, 706)/ 12, 280, 005

= 0. 013= 0. 06 = 0. 017

Therefore, the company might not qualify for the loan due to the ratio decline in 2015. Not unless there are other determining factors as to the contrary.

Return on equity is a ratio of net income to the shareholders equity. It indicates the profit the entity makes for its shareholders. We will be interested in a high ratio since we will be assured of a high return on our investments.

= net income/total owner’s equity

2015 2014 2013

= 134, 526/5, 305, 059 = 620, 069/6, 132, 263 = (210, 706)/ 6, 128, 153

= 0. 03= 0. 10 = 0. 03

There was high return on equity on 2014 before it decline on 2015. Hence the company might experience a little challenge in payment of the loan in the short-run if advance.

Liquidity Ratios (Peterson Drake & Fabozzi, 2012)

Current Ratio= Current Assets/Current Liabilities

2015 2014 2013

= 5, 176, 423 /3, 290, 571 = 5, 239, 558 /3, 368, 450 = 6, 200, 437 /4, 418, 625

= 1. 57 times = 1. 56 times = 1. 4 times

A higher ratio is recommended since this indicates the solvency of the organization. Since it has the highest current ratio in 2015 hence shows that the company is having ability to meet its obligation if they fall due. This shows that if loan are to be advance to the company it will be able to pay its interest as per the loan in the short-run.

Quick ratio= (current asset-inventories) /Current Liabilities

2015 2014 2013

= 3031976 /3, 290, 571 = 2911259/3, 368, 450 = 3886379 /4, 418, 625

= 0. 92 times = 0. 86times = 0. 88 times

Higher ratio is preferred as this will indicate liquidity of the entity. Hence it will be wise to consider this company as qualified for loans since it has the highest quick ratio in the year 2015 but this will only be a wise decision after assessing the Going concern principle of the entity.

Financial Leverage Ratios (Peterson Drake & Fabozzi, 2012)

Debt Ratio= total Liabilities/Total Assets

2015 2014 2013

= 5, 008, 669 /10, 313, 728 = 5, 042, 613 /11, 174, 876 = 6, 151, 852 / 12, 280, 005

= 0. 48 = 0. 45 = 0. 50

This shows the ability of the entity to meet its obligation in the long-run. Since the lower ratio is recommended hence this shows that the company will experience the challenges in paying back the loan hence will recommend the loan maturity should be lowered.

Finally apart from the quantitative analysis of the financial statement of the company, it can also be advisable to consider carrying out the following

qualitative analysis before advancing loans and also after advancing loans

Screening and monitoring the loan applicant

Assess whether they have established long-term customer relationships, with the company or its suppliers hence this can proof its viability whether to advance loans or not and if yes how much and at what interest.

Loan commitments, i. e. agreeing with that company to limit the loan to a certain amount.

The company should provide collateral and compensating balance requirements. This will help in loan recovery in case of default. The company advancing the loan can exercise credit rationing by giving a loan but limiting the loan amount to be less than the borrower would like.

References

Peterson Drake, P., & Fabozzi, F. (2012). Analysis of financial statements. Hoboken, N. J.: Wiley.