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**Please NOTE – This *example* report is for a manufacturing company; however, we can address a similar report for any industry sector.**

## **Performance Review**

**For the period ended 12/31/2013**

**Provided By**



Holbrook & Manter, CPAs

## Financial Score

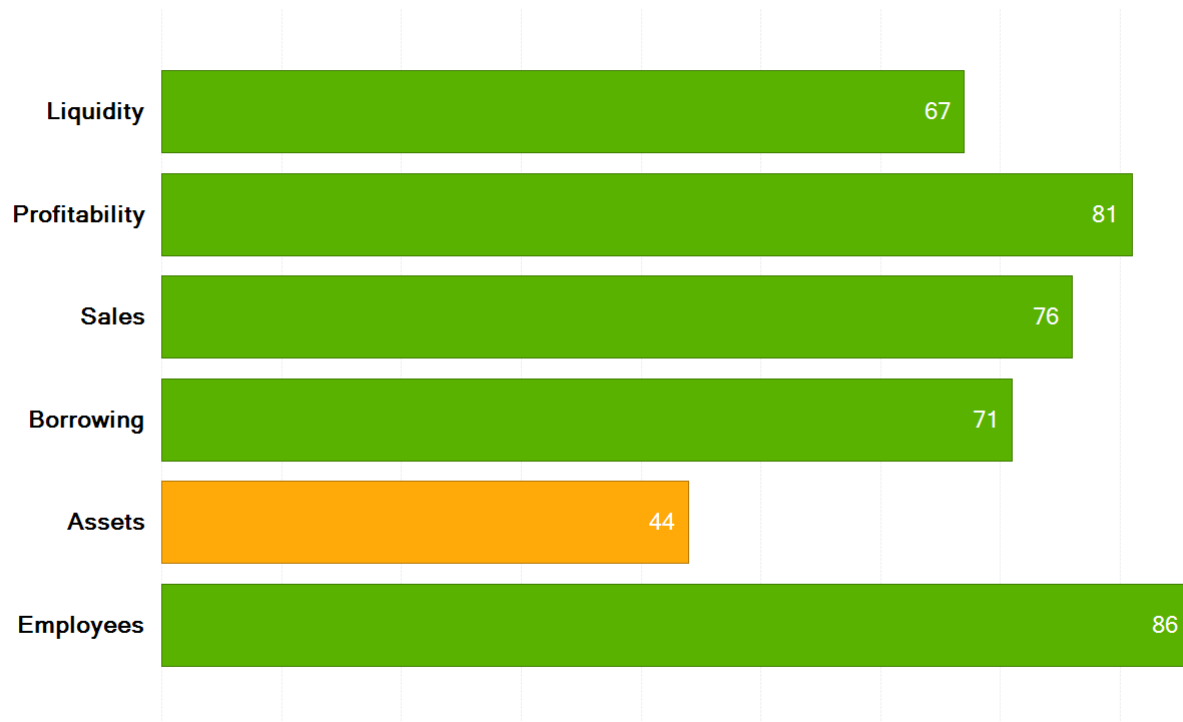
# Sample Manufacturer Narrative Report

Industry: 33911 - Medical Equipment and Supplies Manufacturing

Revenue: \$10M - \$50M

Periods: 12 months against the same 12 months from the previous year

## Report Summary



### Liquidity 67 out of 100

A measure of the company's ability to meet obligations as they come due.

#### Operating Cash Flow Results

Cash flow from operations has increased relative to sales since last period and is at a healthy level, generally. This is always good to see; ultimately, cash flow drives long-run liquidity for almost every company.

#### General Liquidity Conditions

Unfortunately, all too often in financial analysis, companies get so caught up in the details that they miss the big picture. That is what the company is going to derive from this report. The most important component of a firm's success is liquidity -- its ability to pay the bills. Liquidity is a measure of the firm's cash position and it keeps a company in business in the short run.

Despite increases in both sales and profits, the company is in approximately the same liquidity position as it was in last period -- its liquidity barometers have not changed very much. Like last period, the company's overall liquidity position is quite good. This means that the firm has plenty of current assets as compared to short-term financial obligations. This assessment is made by comparing all of the company's current assets to all of its current liabilities (the current ratio). The positions of other similar companies are also

examined to see how this company compares to other firms in the industry.

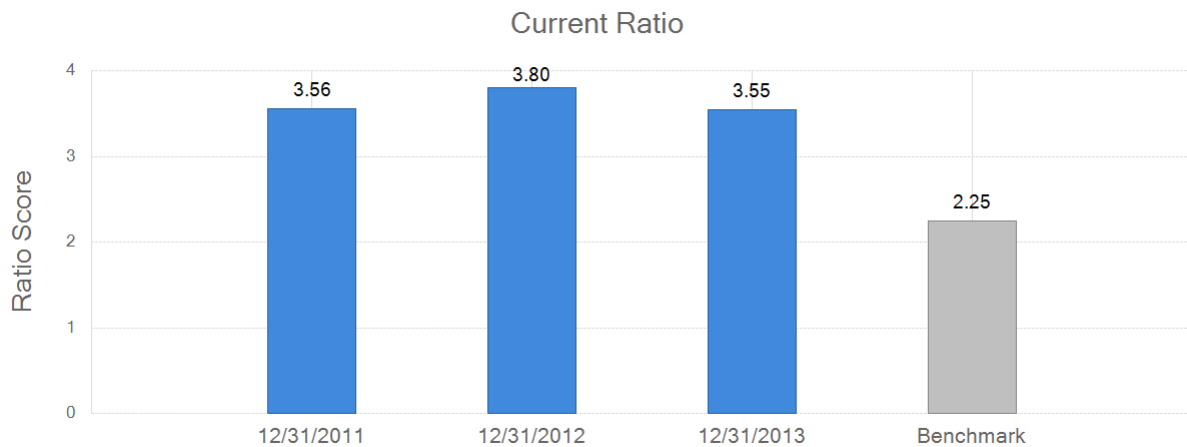
However, as was the case last period, the company's cash and near-cash accounts only look fair as compared to its current obligations. This means that the overall condition of the firm's liquidity is good, but it may want to work on its liquidity composition over time. To be specific, there is a difference between having a good overall position and having strong cash accounts.

The major liquidity "turn" ratios seem to be in line with industry averages. Specifically, accounts receivable, accounts payable, and inventory days ratios are all in a normal range. All of these tend to have a substantial effect on the cash account specifically.

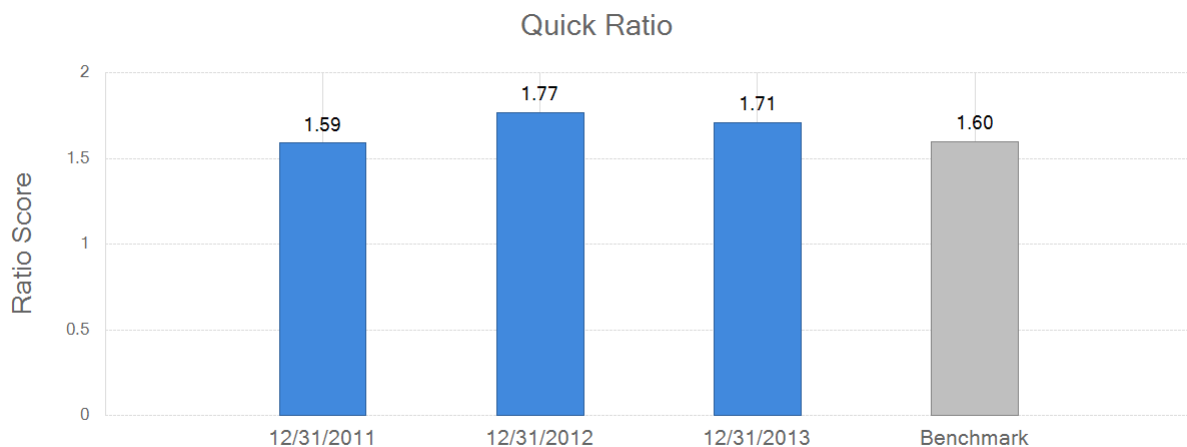
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**LIMITS TO LIQUIDITY ANALYSIS:** Keep in mind that liquidity conditions are volatile, and this is a general analysis looking at a snapshot in time. Review this section, but do not overly rely on it.

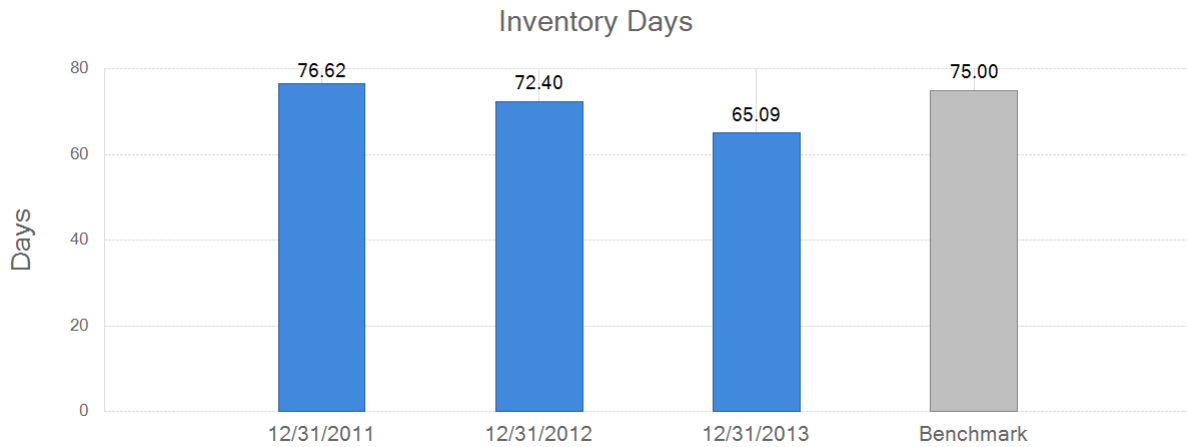
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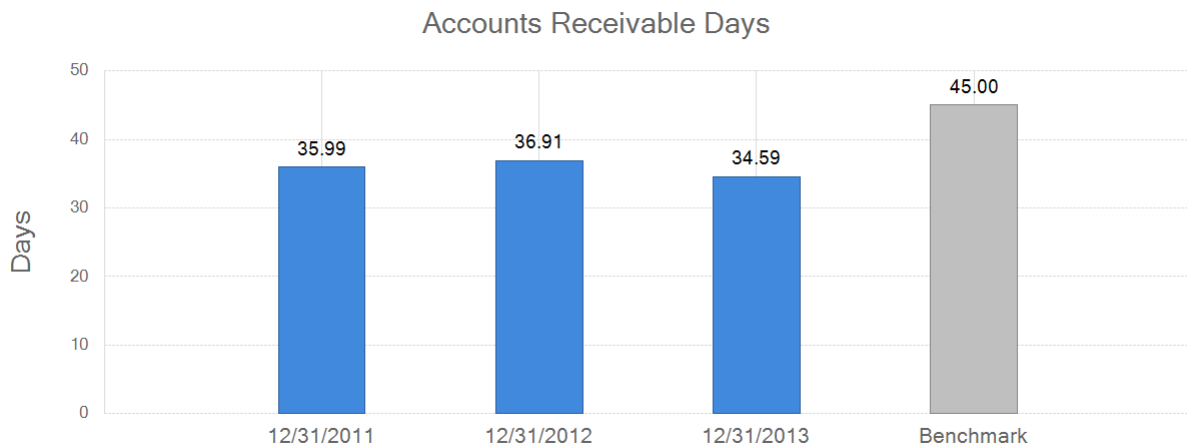
Generally, this metric measures the overall liquidity position of a company. It is certainly not a perfect barometer, but it is a good one. Watch for big decreases in this number over time. Make sure the accounts listed in "current assets" are collectible. The higher the ratio, the more liquid the company is.



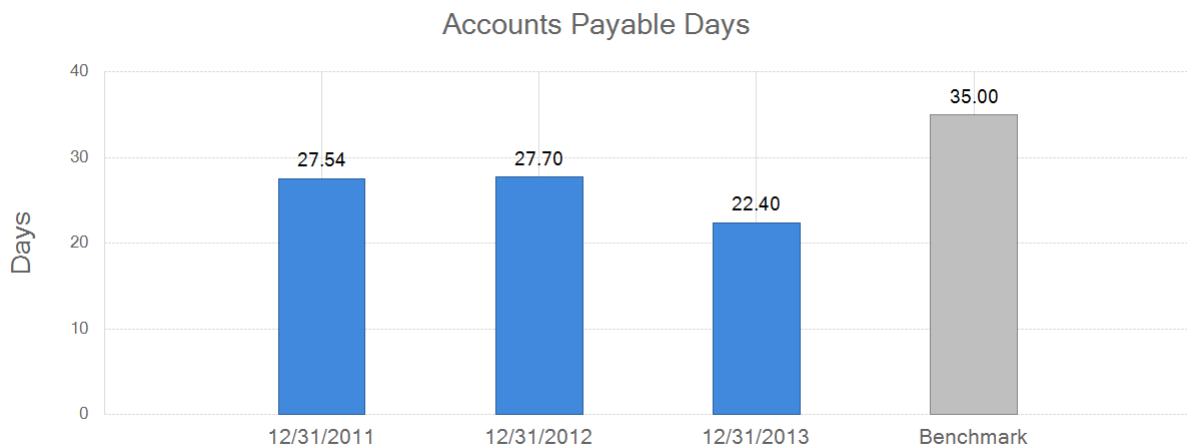
This is another good indicator of liquidity, although by itself, it is not a perfect one. If there are receivable accounts included in the numerator, they should be collectible. Look at the length of time the company has to pay the amount listed in the denominator (current liabilities). The higher the number, the stronger the company.



This metric shows how much inventory (in days) is on hand. It indicates how quickly a company can respond to market and/or product changes. Not all companies have inventory for this metric. The lower the better.



This number reflects the average length of time between credit sales and payment receipts. It is crucial to maintaining positive liquidity. The lower the better.



This ratio shows the average number of days that lapse between the purchase of material and labor, and payment for them. It is a rough measure of how timely a company is in meeting payment obligations. Lower is normally better.

## Profits & Profit Margin ■■■■■ 81 out of 100

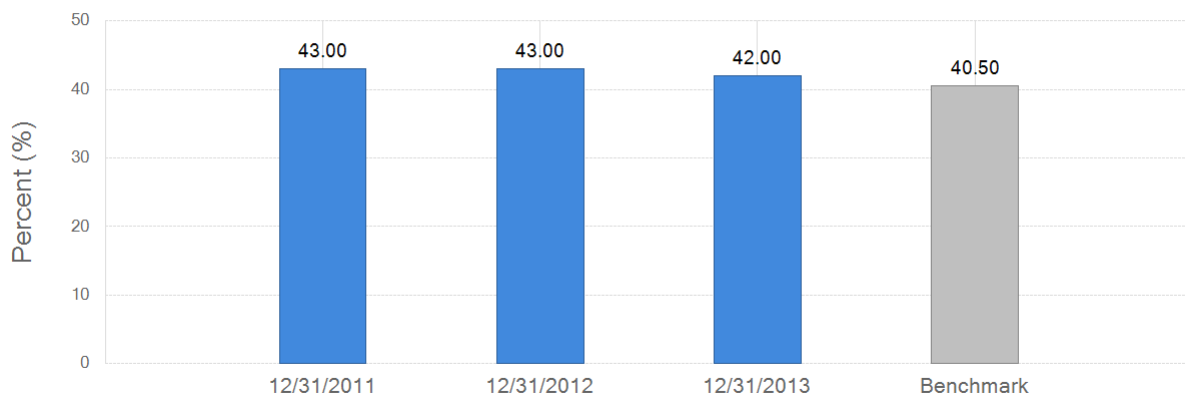
A measure of whether the trends in profit are favorable for the company.

The company's sales have increased this period, and so have its net profit dollars. This

company is clearly performing well in the Profitability area at this time. Not only is the net profit margin good, but net profits (in dollars) have risen by 9.61% from last period. Whenever a company has a good net margin and increases net profits concurrently, most other parts of the business will fall into place. Returns on equity and assets will also generally increase. Even the company's cash position will improve over time. In short, good work in this area, as this company has achieved, generally leads to overall financial health for the company.

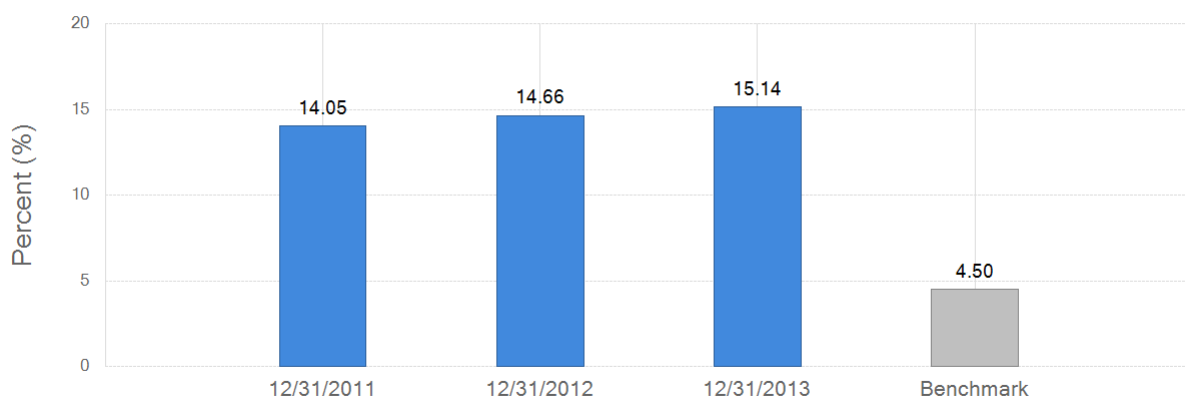
Keep in mind that the net margin is the net profit percentage -- the cents of net profit extracted from each sales dollar generated. This company has maintained a strong net profit margin over multiple periods, which is particularly good. Having a strong net profit margin means that the company is performing well both generally and relative to other firms in this industry; this is depicted in the graph area of the report. The net profit margin is the most important Income Statement ratio to manage because it indicates how effective the company is at balancing its sales dollars and its costs.

Gross Profit Margin



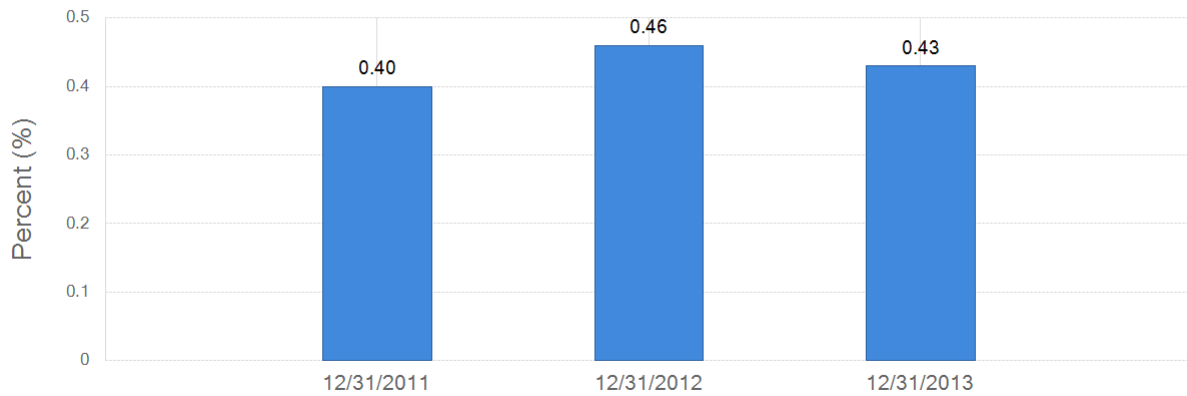
**This number indicates the percentage of sales revenue that is not paid out in direct costs (costs of sales). It is an important statistic that can be used in business planning because it indicates how many cents of gross profit can be generated by each dollar of future sales. Higher is normally better (the company is more efficient).**

Net Profit Margin



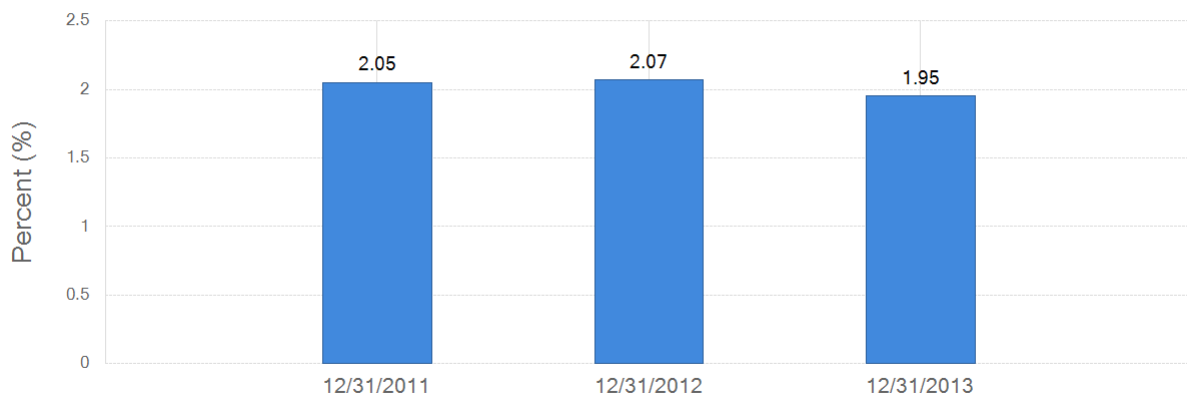
**This is an important metric. In fact, over time, it is one of the more important barometers that we look at. It measures how many cents of profit the company is generating for every dollar it sells. Track it carefully against industry competitors. This is a very important number in preparing forecasts. The higher the better.**

### Advertising to Sales



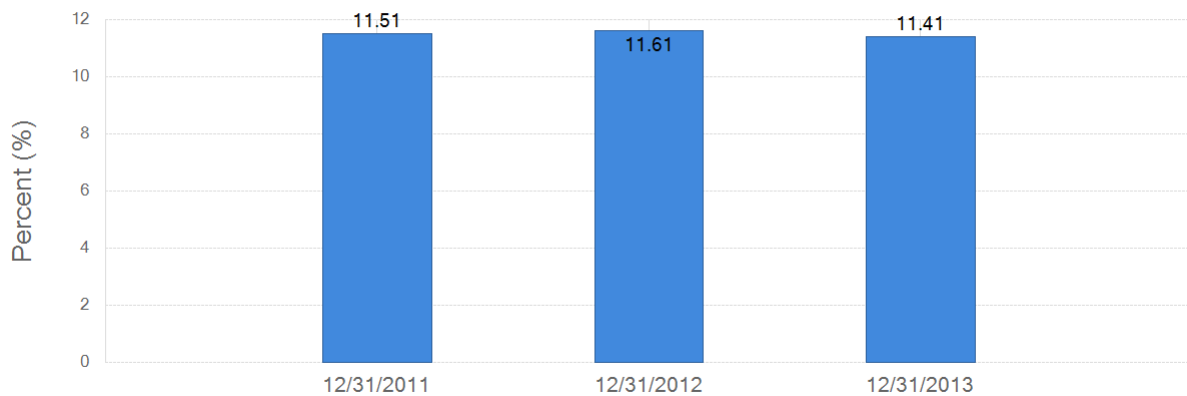
This metric shows advertising expense for the company as a percentage of sales.

### Rent to Sales



This metric shows rent expense for the company as a percentage of sales.

### G & A Payroll to Sales



This metric shows G & A payroll expense for the company as a percentage of sales.

## Sales 76 out of 100

A measure of how sales are growing and whether the sales are satisfactory for the company.

The company's sales have risen this period, which is clearly a positive result. This report does not focus on sales results because this data tends to be straightforward to analyze. However, the company's fixed asset base grew at a **faster rate** than sales. This means that

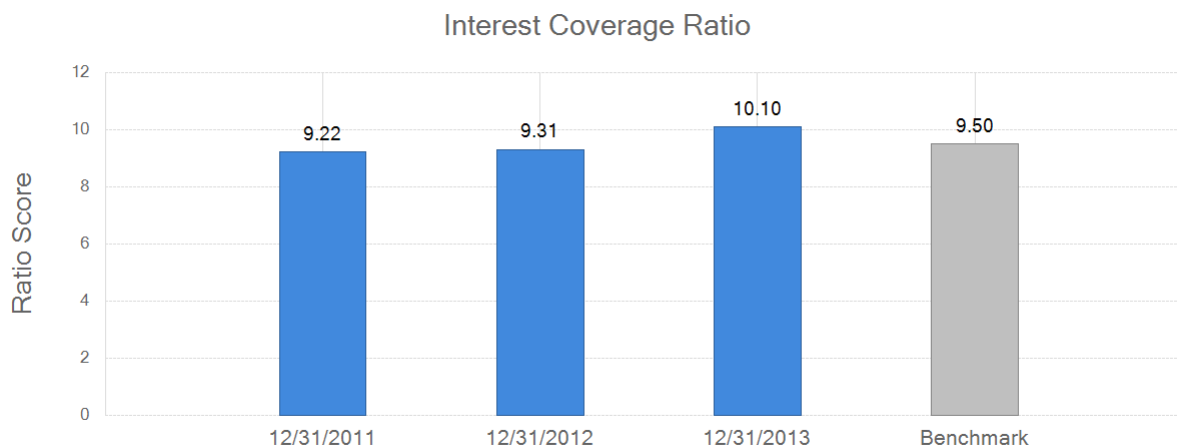
"asset turns" (or the amount of sales revenue driven through each dollar of fixed assets) has fallen slightly from last period, which might be considered unfavorable. It is possible that these new assets require some time to contribute to sales, or that the assets were not purchased with the idea of increasing sales. Managers should look for long-term trends in this area.

## Borrowing ●●●●● 71 out of 100

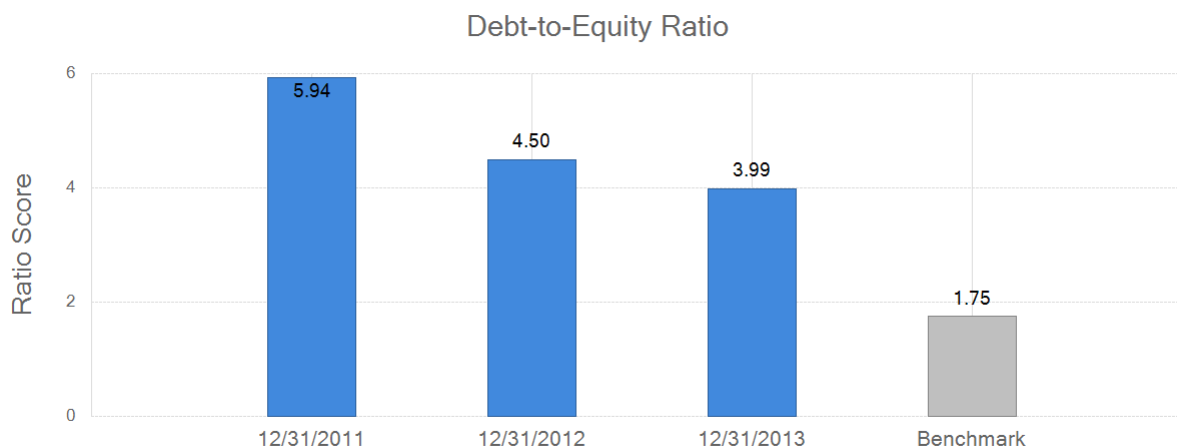
A measure of how responsibly the company is borrowing and how effectively it is managing debt.

Net profitability improved with relatively little change in borrowing (debt), which is very good. There does not **seem** to be a correlation at this time between debt and profitability, since profitability improved on an even debt base. Yet, it might be interesting to determine if there were any prior period changes (increases or decreases) in debt that might have helped profitability this period. If not, the company has improved Income Statement performance without adding significant debt, which is positive. Over the short term (two years or less) it is generally preferable to borrow money when there will be a demonstrated return -- when the increases in borrowing will improve profitability. In this case, the company was able to improve profitability without borrowing money, which indicates an efficient use of debt by the company.

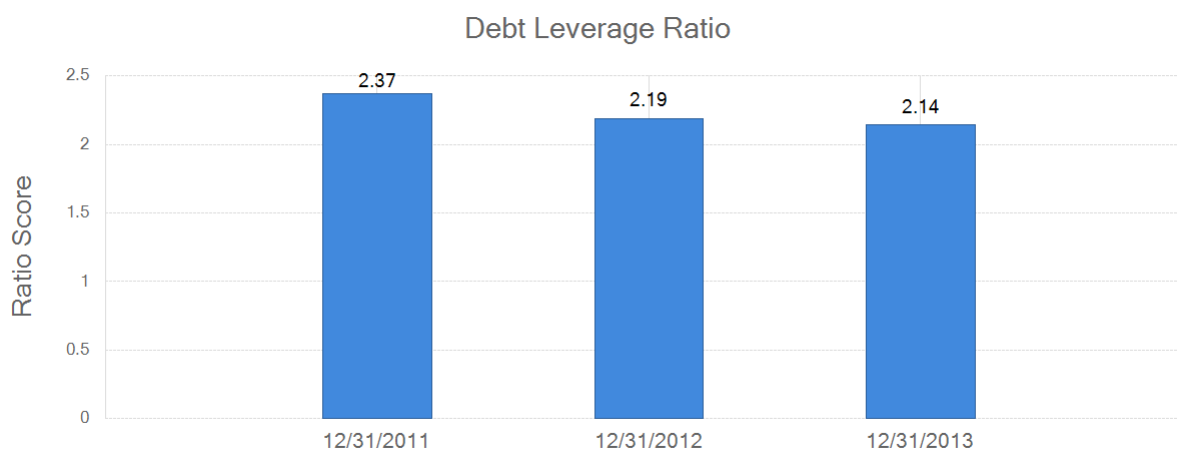
While the overall trend in this area seems to be positive, the following areas may merit further attention. When compared to its industry peers, the company has generated an average amount of earnings (before interest and non-cash expenses) to cover its debt obligations. It also seems to have a relatively high level of debt compared to equity. Therefore, small changes in earnings could have a significant impact on the company's ability to meet interest obligations.



This ratio measures a company's ability to service debt payments from operating cash flow (EBITDA). An increasing ratio is a good indicator of improving credit quality. The higher the better.



This Balance Sheet leverage ratio indicates the composition of a company's total capitalization -- the balance between money or assets owed versus the money or assets owned. Generally, creditors prefer a lower ratio to decrease financial risk while investors prefer a higher ratio to realize the return benefits of financial leverage.



This ratio measures a company's ability to repay debt obligations from annualized operating cash flow (EBITDA).

## Assets ■ ■ ■ ■ ■ 44 out of 100

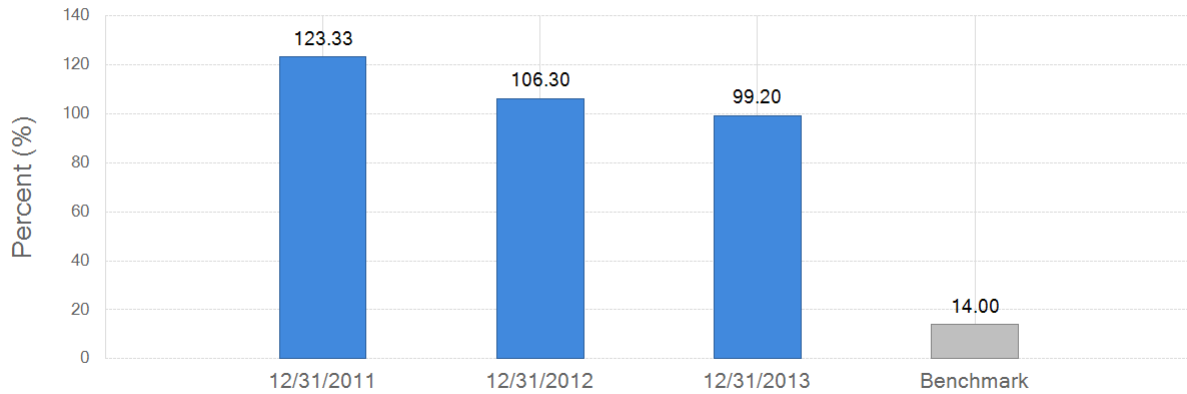
A measure of how effectively the company is utilizing its gross fixed assets.

Improved profitability is not the sole indicator of success with regard to resource management. This case is a perfect example: although profitability has improved from last period, fixed assets increased at a much higher rate than profitability. This is not a favorable result, because assets are like any other type of cost. When they are added, profitability should improve at an even faster rate. It is possible that the assets added need time to become fully contributing or they may simply not be producing enough profitability.

Notice that the company generated a relatively strong return on assets and equity this period. This is a positive result for both investors/owners and creditors of the company. Assets generally represent a cost to the company that is expected to reap future benefits, so it is good to see the company earning strong profitability relative to its assets.

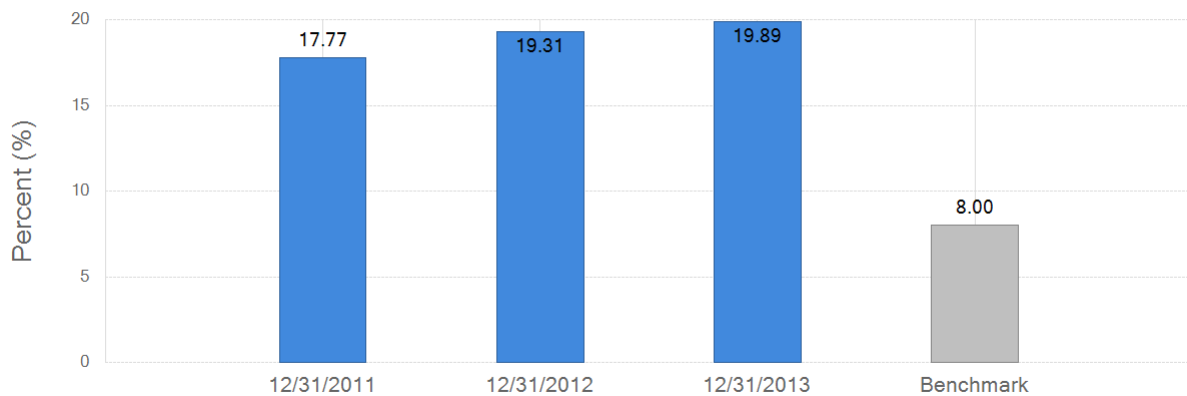


### Return on Equity



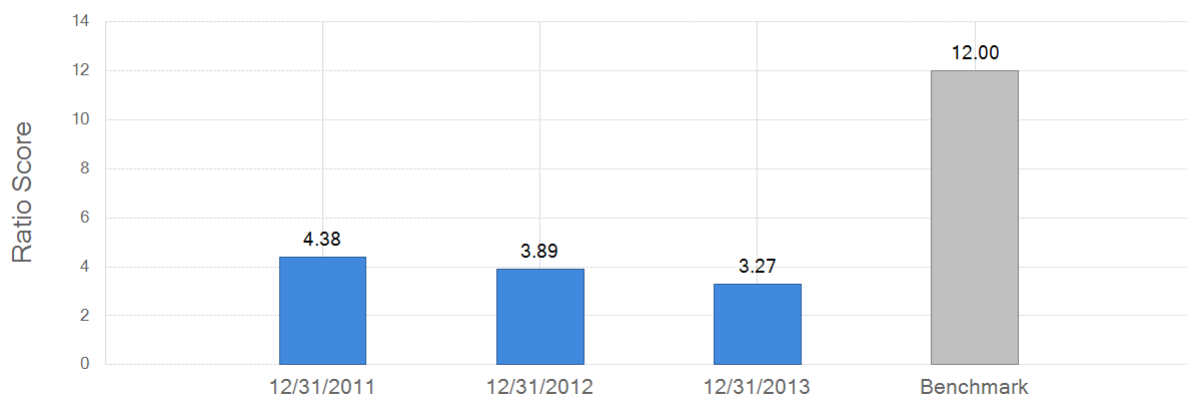
This measure shows how much profit is being returned on the shareholders' equity each year. It is a vital statistic from the perspective of equity holders in a company. The higher the better.

### Return on Assets



This calculation measures the company's ability to use its assets to create profits. Basically, ROA indicates how many cents of profit each dollar of asset is producing per year. It is quite important since managers can only be evaluated by looking at how they use the assets available to them. The higher the better.

### Fixed Asset Turnover



This asset management ratio shows the multiple of annualized sales that each dollar of gross fixed assets is producing. This indicator measures how well fixed assets are "throwing off" sales and is very important to businesses that require significant investments in such assets. Readers should not emphasize this metric when looking at companies that do not possess or require significant gross fixed assets. The higher the more effective the company's investments in Net Property, Plant, and Equipment are.

### Employees ●●●●● 86 out of 100

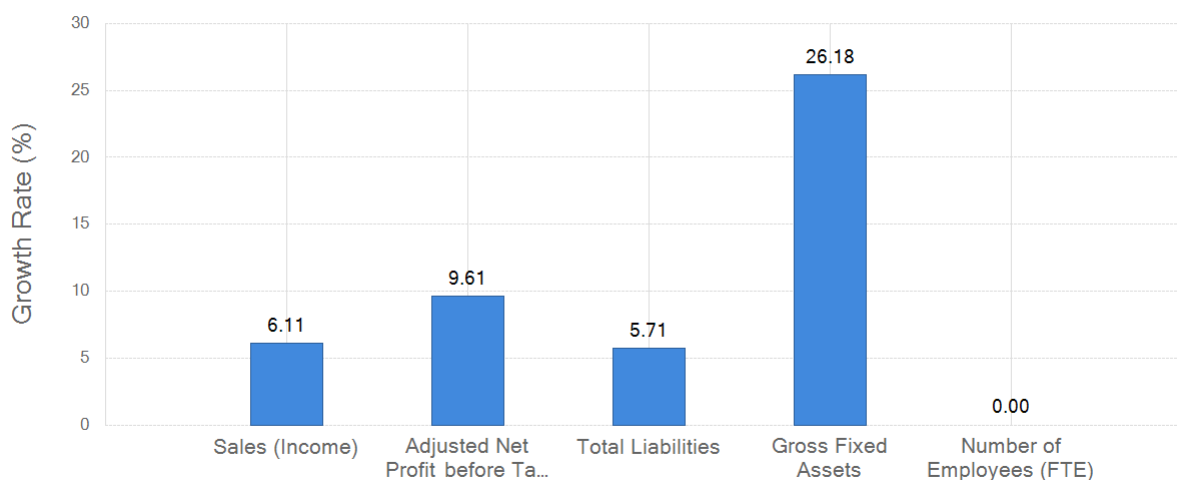
A measure of how effectively the company is hiring and managing its employees.

This company has some rather interesting results with regards to employee management. Net profitability has improved from last period while the employee base has remained relatively flat. This means that the company is improving its net profitability per employee statistic, which is a key performance indicator in this particular industry. It also indicates that the company's management of its existing employee base is better than it was last period.

There is no indication from these specific results that hiring more people is necessary at this time. If the company can generate improved net profitability with about the same employee base, there **may** be no compelling reason to add more employees. One exception to this would be if the company has reached a sort of "employee ceiling" -- the point after which the efficiency of existing employees is exhausted, and thus the company will need more employees to improve profitability. This can only be determined internally, so careful planning is needed here.

"Management is doing things right; leadership is doing the right things." -- Peter F. Drucker

Selected Resource Indicators (Growth Rate %)



This data is based on the two most recent available periods.

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**A NOTE ON SCORING:** Each section of this report (Liquidity, Profits & Profit Margin, etc.) contains a numerical score/grade, which is a rough measure of overall performance in the area. Each grade represents a score from 1 to 100, with 1 being the lowest score and 100 being the highest. Generally, a score above 50 would be a "good" score and a score below 50 would be a "poor" score. The scores are derived by evaluating the company's trends, either positive or negative, over time and by comparing the company to industry averages for different metrics.

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## Raw Data

<b>Income Statement Data</b>	<b>12/31/2011</b>	<b>12/31/2012</b>	<b>12/31/2013</b>
Sales (Income)	\$19,965,000	\$19,800,000	\$21,010,000
Cost of Sales (COGS)	\$11,380,050	\$11,286,000	\$12,185,800
Gross Profit	\$8,584,950	\$8,514,000	\$8,824,200
Gross Profit Margin	43.00%	43.00%	42.00%
G & A Payroll Expense	\$2,298,250	\$2,298,000	\$2,396,600
Rent	\$410,100	\$410,100	\$410,100
Advertising	\$79,480	\$91,350	\$89,750
Depreciation	\$399,300	\$406,000	\$420,200
Interest Expense	\$389,615	\$398,000	\$395,625
Net Profit Before Taxes	\$2,804,835	\$2,902,375	\$3,181,425
Adjusted Net Profit before Taxes	\$2,804,835	\$2,902,375	\$3,181,425
Net Profit Margin	14.05%	14.66%	15.14%
EBITDA	\$3,593,750	\$3,706,375	\$3,997,250
Net Income	\$1,766,655	\$1,911,700	\$2,130,925
<b>Balance Sheet Data</b>	<b>12/31/2011</b>	<b>12/31/2012</b>	<b>12/31/2013</b>
Cash (Bank Funds)	\$589,640	\$619,500	\$657,000
Accounts Receivable	\$1,968,848	\$2,002,000	\$1,990,800
Inventory	\$2,388,920	\$2,238,785	\$2,173,190
Total Current Assets	\$5,726,688	\$5,629,935	\$5,490,790
Gross Fixed Assets	\$4,553,160	\$5,085,275	\$6,416,600
Total Assets	\$9,939,728	\$9,899,210	\$10,711,990
Accounts Payable	\$858,753	\$856,377	\$747,863
Total Current Liabilities	\$1,607,675	\$1,480,941	\$1,545,726
Total Liabilities	\$8,507,288	\$8,100,881	\$8,563,844
Total Equity	\$1,432,440	\$1,798,329	\$2,148,146
Number of Employees (FTE)	123.0	121.0	121.0

## Common Size Statements

<b>Income Statement Data</b>	<b>12/31/2011</b>	<b>12/31/2012</b>	<b>12/31/2013</b>	<b>Industry* (2879)</b>
Sales (Income)	100%	100%	100%	100%
Cost of Sales (COGS)	57%	57%	58%	48%
Gross Profit	43%	43%	42%	52%
G & A Payroll Expense	12%	12%	11%	23%
Rent	2%	2%	2%	3%
Advertising	0%	0%	0%	1%
Depreciation	2%	2%	2%	1%
Interest Expense	2%	2%	2%	1%
Net Profit Before Taxes	14%	15%	15%	5%
Adjusted Net Profit before Taxes	14%	15%	15%	5%
EBITDA	18%	19%	19%	7%
Net Income	9%	10%	10%	4%
<b>Balance Sheet Data</b>	<b>12/31/2011</b>	<b>12/31/2012</b>	<b>12/31/2013</b>	<b>Industry* (2879)</b>
Cash (Bank Funds)	6%	6%	6%	10%
Accounts Receivable	20%	20%	19%	26%
Inventory	24%	23%	20%	22%
Total Current Assets	58%	57%	51%	66%

Gross Fixed Assets	46%	51%	60%	60%
Total Assets	100%	100%	100%	100%
Accounts Payable	9%	9%	7%	14%
Total Current Liabilities	16%	15%	14%	39%
Total Liabilities	86%	82%	80%	65%
Total Equity	14%	18%	20%	35%

\*The industry common size figures shown above were taken from all private company data for companies with industry code 33911 for all years in all areas in all sales ranges.

# Industry Scorecard

Financial Indicator	Current Period	Industry Range	Distance from Industry
<b>Current Ratio</b> = Total Current Assets / Total Current Liabilities  <b>Explanation:</b> Generally, this metric measures the overall liquidity position of a company. It is certainly not a perfect barometer, but it is a good one. Watch for big decreases in this number over time. Make sure the accounts listed in "current assets" are collectible. The higher the ratio, the more liquid the company is.	3.55	1.60 to 2.90	+22.41%
<b>Quick Ratio</b> = (Cash + Accounts Receivable) / Total Current Liabilities  <b>Explanation:</b> This is another good indicator of liquidity, although by itself, it is not a perfect one. If there are receivable accounts included in the numerator, they should be collectible. Look at the length of time the company has to pay the amount listed in the denominator (current liabilities). The higher the number, the stronger the company.	1.71	1.00 to 2.20	0.00%
<b>Inventory Days</b> = (Inventory / COGS) * 365  <b>Explanation:</b> This metric shows how much inventory (in days) is on hand. It indicates how quickly a company can respond to market and/or product changes. Not all companies have inventory for this metric. The lower the better.	65.09 Days	60.00 to 90.00 Days	0.00%
<b>Accounts Receivable Days</b> = (Accounts Receivable / Sales) * 365  <b>Explanation:</b> This number reflects the average length of time between credit sales and payment receipts. It is crucial to maintaining positive liquidity. The lower the better.	34.59 Days	30.00 to 60.00 Days	0.00%
<b>Accounts Payable Days</b> = (Accounts Payable / COGS) * 365  <b>Explanation:</b> This ratio shows the average number of days that lapse between the purchase of material and labor, and payment for them. It is a rough measure of how timely a company is in meeting payment obligations. Lower is normally better.	22.40 Days	20.00 to 50.00 Days	0.00%
<b>Gross Profit Margin</b> = Gross Profit / Sales  <b>Explanation:</b> This number indicates the percentage of sales revenue that is not paid out in direct costs (costs of sales). It is an important statistic that can be used in business planning because it indicates how many cents of gross profit can be generated by each dollar of future sales. Higher is normally better (the company is more efficient).	42.00%	35.00% to 46.00%	0.00%
<b>Net Profit Margin</b> = Adjusted Net Profit before Taxes / Sales  <b>Explanation:</b> This is an important metric. In fact, over time, it is one of the more important barometers that we look at. It measures how many cents of profit the company is generating for every dollar it sells. Track it carefully against industry competitors. This is a very important number in preparing forecasts. The higher the better.	15.14%	1.00% to 8.00%	+89.25%
<b>Interest Coverage Ratio</b> = EBITDA / Interest Expense  <b>Explanation:</b> This ratio measures a company's ability to service debt payments from operating cash flow (EBITDA). An increasing ratio is a good indicator of improving credit quality. The higher the better.	10.10	4.00 to 15.00	0.00%
<b>Debt-to-Equity Ratio</b> = Total Liabilities / Total Equity  <b>Explanation:</b> This Balance Sheet leverage ratio indicates the composition of a company's total capitalization -- the balance between money or assets owed versus the money or assets owned. Generally, creditors prefer a lower ratio to decrease financial risk while investors prefer a higher ratio to realize the return benefits of financial leverage.	3.99	1.00 to 2.50	-59.60%
<b>Debt Leverage Ratio</b> = Total Liabilities / EBITDA  <b>Explanation:</b> This ratio measures a company's ability to repay debt obligations from annualized operating cash flow (EBITDA).	2.14	N/A	N/A

<b>Return on Equity</b> = Net Income / Total Equity	99.20%	8.00% to 20.00%	+396.00%
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**Explanation:** This measure shows how much profit is being returned on the shareholders' equity each year. It is a vital statistic from the perspective of equity holders in a company. The higher the better.

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<b>Return on Assets</b> = Net Income / Total Assets	19.89%	6.00% to 10.00%	+98.90%
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**Explanation:** This calculation measures the company's ability to use its assets to create profits. Basically, ROA indicates how many cents of profit each dollar of asset is producing per year. It is quite important since managers can only be evaluated by looking at how they use the assets available to them. The higher the better.

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<b>Fixed Asset Turnover</b> = Sales / Gross Fixed Assets	3.27	6.00 to 18.00	-45.50%
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**Explanation:** This asset management ratio shows the multiple of annualized sales that each dollar of gross fixed assets is producing. This indicator measures how well fixed assets are "throwing off" sales and is very important to businesses that require significant investments in such assets. Readers should not emphasize this metric when looking at companies that do not possess or require significant gross fixed assets. The higher the more effective the company's investments in Net Property, Plant, and Equipment are.

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**NOTE:** Exceptions are sometimes applied when calculating the Financial Indicators. Generally, this occurs when the inputs used to calculate the ratios are zero and/or negative.

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**READER:** Financial analysis is not a science; it is about interpretation and evaluation of financial events. Therefore, some judgment will always be part of our reports and analyses. Before making any financial decision, always consult an experienced and knowledgeable professional (accountant, banker, financial planner, attorney, etc.).

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