

Smith & Company CPAs, PC

Report prepared for: ACME Construction - Extreme

Industry: 23611 - Residential Building Construction

Revenue: \$1M - \$10M

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



LIQUIDITY



Generally, what is the company's ability to meet obligations as they come due?

Operating Cash Flow Results

The company is generating strong cash flow from operations this period, which is positive, especially when coupled with profits on the Income Statement. In the long run, these types of results can help boost overall liquidity conditions on the Balance Sheet, which will be discussed further in the next section. Examine the sources of cash on the Cash Flow Statement and try to evaluate whether the sources will be present in future periods, beyond the periods analyzed here.

General Liquidity Conditions

In this case, the company's liquidity position is **about average for the industry** in which it competes. Having average liquidity means that, generally, there are adequate current assets on hand relative to short-term obligations. This does **not necessarily** mean that the company will never have any difficulties paying bills, but it indicates that the firm is in a reasonable position as of this specific Balance Sheet date.

However, it is always important to keep in mind that **liquidity is a volatile statistic** that can move from strong to weak very quickly. For this reason, it is generally more important to monitor trends than raw data in this key area. As of these two specific Balance Sheet dates, the company's liquidity position has declined -- the firm will probably want to examine the reasons for this downward trend and make sure that liquidity resources are being used in the best ways for the company. Remember that increasing sales (as this company has done this period) often demands cash resources.

A few specific components of overall liquidity may need some improvement. Accounts payable days is only about average, while inventory days and accounts receivable days are higher than industry standards. This means that the company may be taking a longer time than most of its competitors in selling inventory and collecting money owed by customers. Over time, it would be positive to see the company reduce values for these particular indicators, particularly AR days.

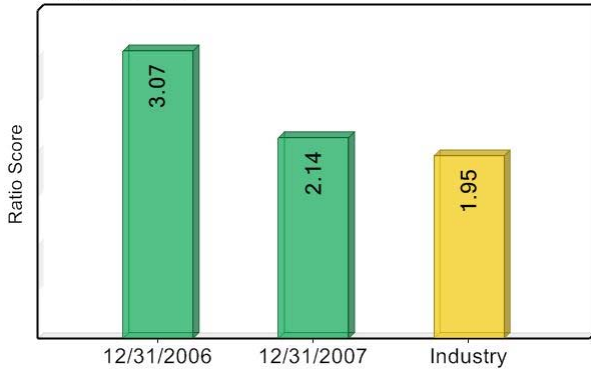
Tips For Improvement

Here are some ideas/actions that managers might consider in managing liquidity:

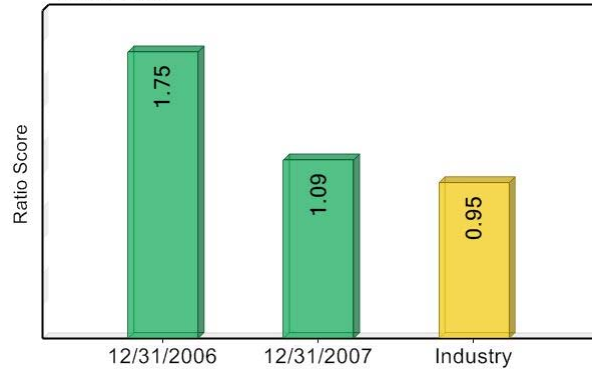
- If cash is a constraint, try to establish a sufficient line of credit from the bank. The business should obtain, but not necessarily use, as much financing as possible from the bank. If you decide to obtain external financing, structure it as long-term debt rather than short-term debt in order to decrease monthly payments.
- Eliminate or reduce some overhead or fixed costs to reduce monthly expenses. Small decreases in overhead will typically yield large cash savings over time, especially if fixed costs can be reduced (those costs which tend to stay the same over time).
- Consider providing different credit terms to different customers based upon credit-worthiness (risk) and the overall relationship involved. Make sure giving credit will increase revenues/income and be cost effective. Also, if beneficial, provide discounts to customers who pay early.
- Monitor invoicing procedures to help ensure correctness. Nothing will delay payment from a customer more than sending out an incorrect invoice.

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.

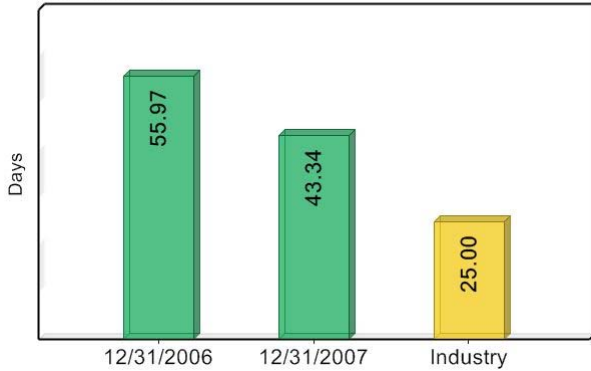
Current Ratio



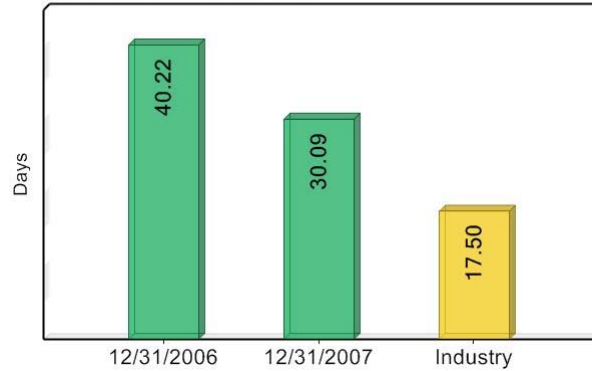
Quick Ratio



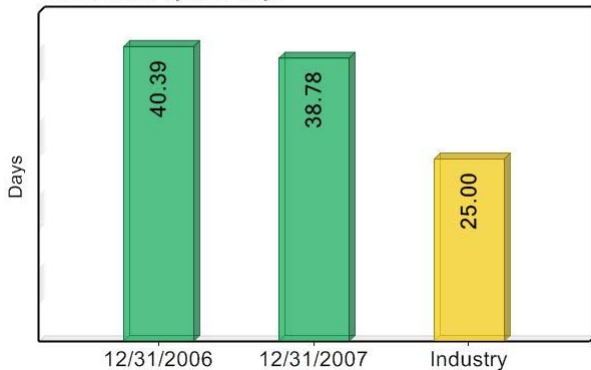
Inventory Days



Accounts Receivable Days



Accounts Payable Days



PROFITS & PROFIT MARGIN



Are profitability trends favorable in the company?

The company achieved a fairly good performance in the Profitability area this period, as both sales and net profits (in dollars) increased this period. The company's sales increased by 5.20% this period, and its net margin stayed at about the same level it was at in the previous period. As a result of this, the company was able to channel the sales increase into an increase of 7.27% to its net profit dollars. It is good to see that the company is able to increase its sales and improve its bottom line concurrently.

As was already noted, the company's net profit margin **has not changed much** since the prior period. The net margin was keeping up with the average for this industry last period, and it is still in line with what other firms are earning this period. This is illustrated in the graph area of the report. While it is certainly not bad to earn a net profit margin that is average, keep in mind that "average" is not the same as "excellent" -- the company certainly has some room for improvement in this area.

A good goal for the company at this time might be to increase its net profit margin to above-average levels by closely controlling operating and overhead costs. Companies that earn above-average net profits can build up a cushion to protect against unexpected increases in prices, and can also invest in their future growth in ways that average companies cannot. Of course, if this company is already channeling some earnings into expenses for long-term growth, it may be justified in maintaining an average net margin -- this is

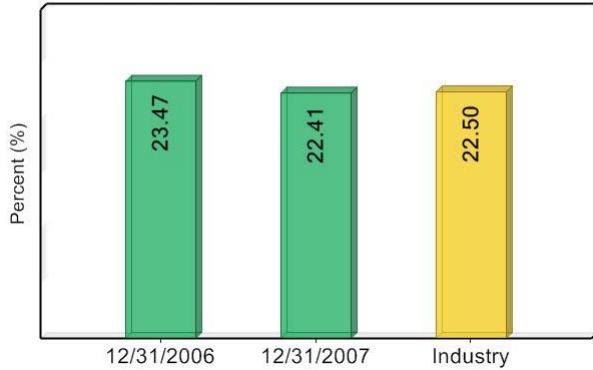
something for managers to consider at this point.

Tips For Improvement

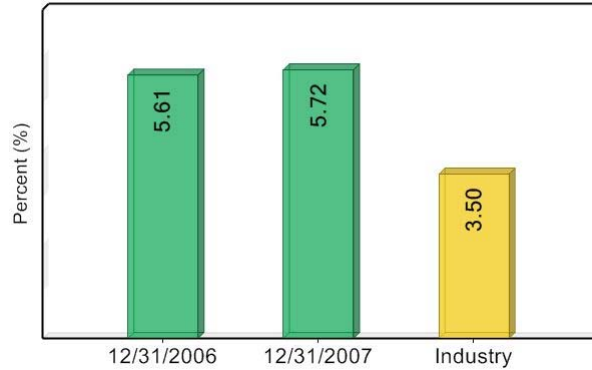
The following ideas to improve profitability might be useful and can be thought-through by managers:

- Showcase past work to catch the attention of potential customers. For example, create a DVD that could be sent to clients which illustrates some of the past projects that the business has completed. Post signs outside of job sites and advertise awards won in trade magazines to help attract attention and customers.
- Conduct a gain/fade analysis to review performance. Trends in gain/fade can indicate areas of concern regarding bidding and job management as well as track whether the business is on target to meet projected profit goals.
- Increase prices selectively where possible. Done effectively, this can boost cash flow and profitability. Good Income Statement management helps Balance Sheet performance.
- Rent rather than buy equipment and other resources where appropriate. In the long term, this can help achieve an acceptable level of Balance Sheet obligations relative to liquid assets.

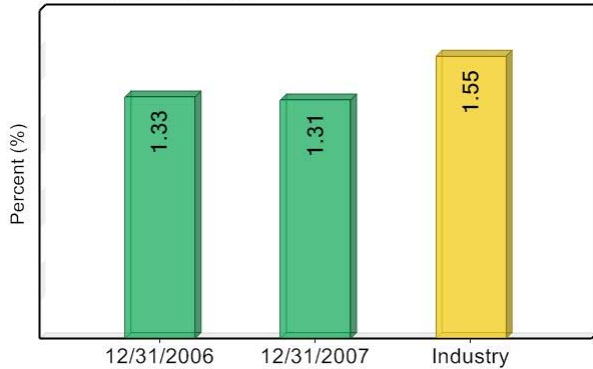
Gross Profit Margin



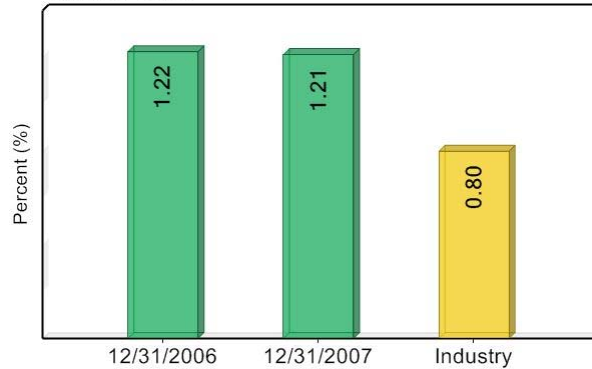
Net Profit Margin



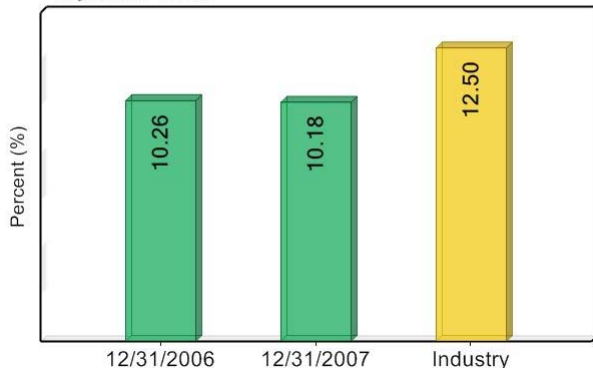
Advertising to Sales



Rent to Sales



Payroll to Sales



SALES



Are sales growing and satisfactory?

The goal of this report is to highlight financial results that are not always obvious. Not much analysis is dedicated to the sales section because sales trends are generally straightforward. This company performed well here by increasing sales, although it should be noted that fixed asset levels grew at a faster rate than sales this period. This means that "asset turns" (or the amount of revenue driven through each dollar of fixed assets on the books) has dropped from last period. **Over time** companies prefer to see sales increase faster than increases in the asset base. However, this is a minor issue that should simply be monitored in future reports. For example, it is

possible that the assets purchased require time to start generating more sales.

BORROWING



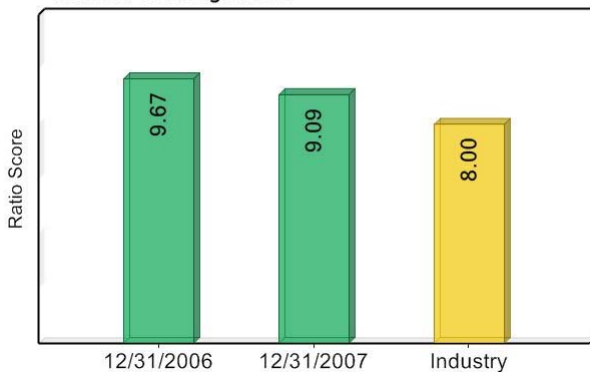
Is the company borrowing profitably?

The goal with borrowing is to leverage borrowed funds to earn more money for the company. The idea, for example, is to borrow at 10% interest and earn 20% on the borrowed funds. The company should make more money from borrowing than from not borrowing. This concept is counterintuitive because it is easy to think that borrowing would lower profitability because of the interest that must be paid. Actually, if borrowing is done effectively, profitability will improve, because the company will earn more money on its investments than it pays in interest.

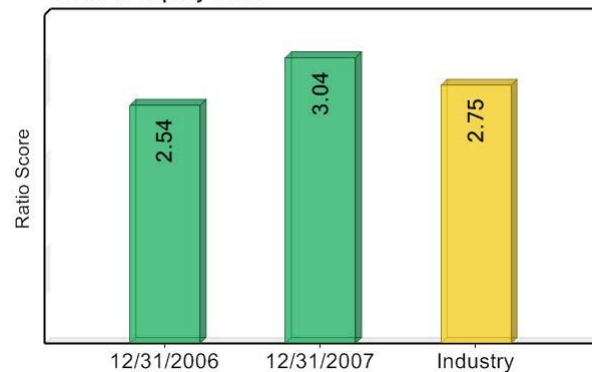
The issue with these results is that the company does not seem to have added debt most effectively. It is true that the company improved profitability with the addition of debt, which is positive. However, total debt has grown at a faster rate than profitability. As a one time event, this is not overly concerning. However, over time, profitability should improve more quickly than debt increases, or the company risks an imbalance of debt with respect to the level of profitability. Look for long-term trends in this important area.

With regard to this company's ability to meet its interest expenses from its earnings and its level of debt in relation to its total equity, there is not too much to report -- both of these statistics are about in line with the industry averages. In cases like this, look for future trends. Basically, we need to balance the fact that the company is receiving mixed results in this area.

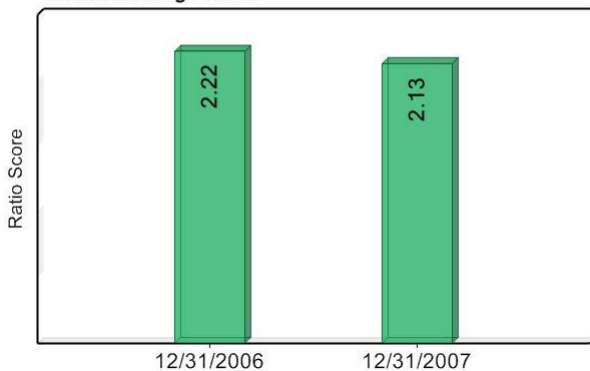
Interest Coverage Ratio



Debt-to-Equity Ratio



Debt Leverage Ratio



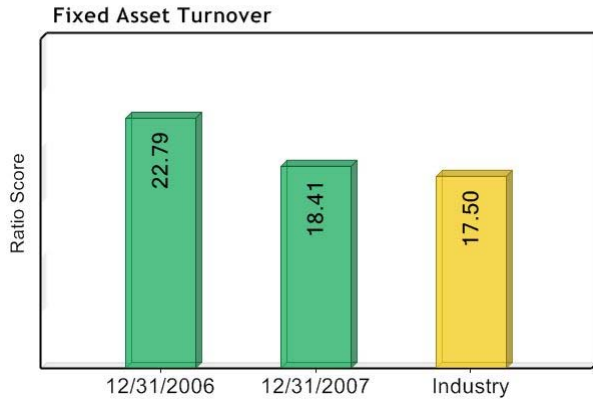
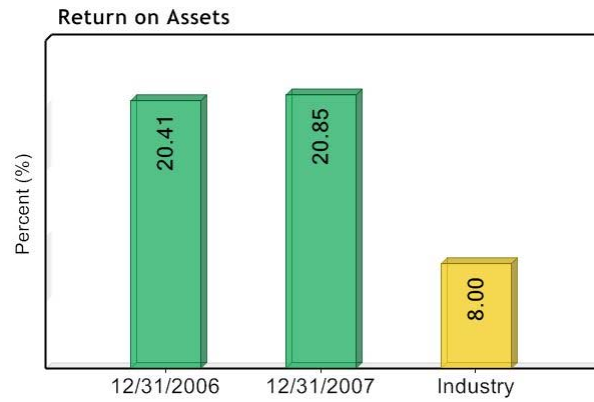
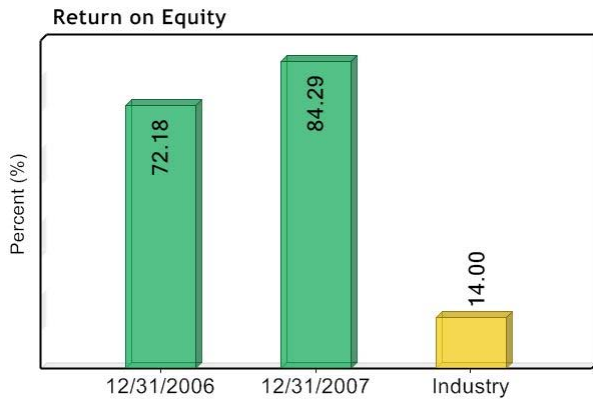
ASSETS



Is the company using gross fixed assets effectively?

It is true that profitability improved by 7.27% from last period, which is a positive result. However, the rate of fixed asset growth exceeded the rate of profitability improvement. Not only is it important to improve profitability as fixed assets are added, it is also important to improve profitability **at a higher rate** than the rate by which assets are increased. Assets are a form of cost, and as costs, they should be minimized while the best level of profitability possible is pushed through them.

It is also important to highlight critical components that are positive. For example, the company has generated above average returns on equity and assets. While it is true that the changing relationship between operating profits and assets will guide long-term returns, in this case, real economic returns in assets and equity are excellent, a fact that needs to be balanced against the overall unfavorable trend.



EMPLOYEES

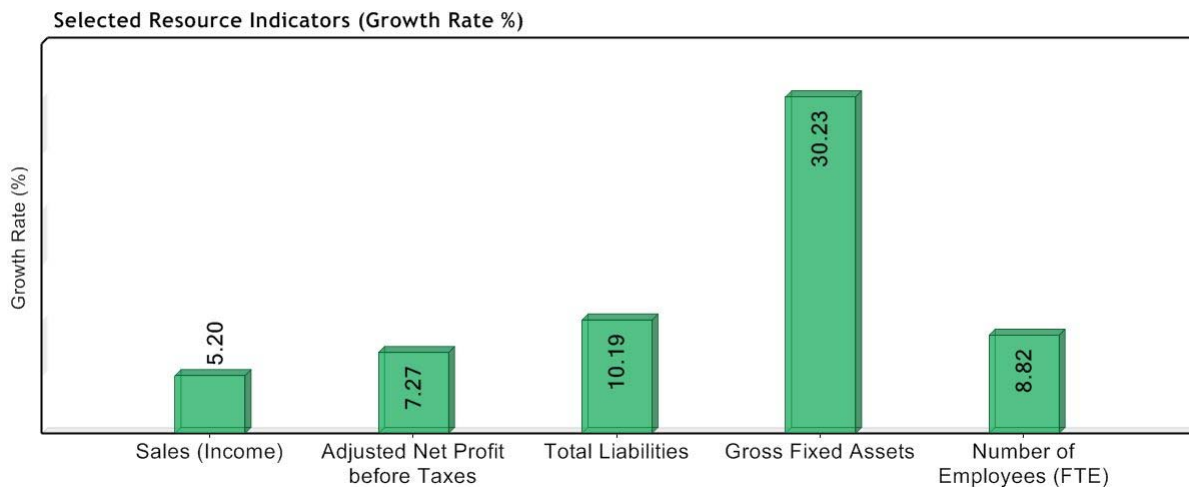


Is the company hiring effectively?

Since the prior period, this company has hired employees and improved net profitability, which is quite positive. However, it is unfavorable that the employee base has grown faster than net profitability. This is an undesirable situation **in the long run**, because it can potentially depress net profitability. It is generally unfavorable for the company to increase a resource (and thus a cost) without seeing a corresponding profitability increase.

Managers may still want to consider hiring people, but at this point they might want to only hire for positions that will contribute directly to the bottom line. This is especially true given that the company has also increased its fixed assets, as mentioned earlier in this report. It is important to keep in mind that these comments are based on analyzing a limited amount of data. Good hiring decisions are made based on solid financial projections and an analysis of the company's business needs.

"Every man acts directly in accordance with his own nature. Therefore, if you understand the nature of a man, you will anticipate all actions he will take." -- Marcus Aurelius



A NOTE ON SCORING: Each section of this report (Liquidity, Profits & Profit Margin, etc.) contains a star rating which measures the company's overall performance in the area at the time of the report's generation. One star indicates that the company is below average or may possibly need improvement in the area. Three stars indicate that the company is about average for the area. Five stars indicate that the company is above average or performing quite well in the area.

RAW DATA

	12/31/2006	12/31/2007
Income Statement Data		
Sales (Income)	\$980,000	\$1,031,000
Cost of Sales (COGS)	\$750,000	\$800,000
Gross Profit	\$230,000	\$231,000
Gross Profit Margin	23.47%	22.41%
Payroll / Wages / Salary	\$100,500	\$105,000
Rent	\$12,000	\$12,500
Advertising	\$13,000	\$13,500
Depreciation	\$23,000	\$30,000
Interest Expense	\$9,000	\$11,000
Net Profit before Taxes	\$55,000	\$59,000
Adjusted Net Profit before Taxes	\$55,000	\$59,000
Net Profit Margin	5.61%	5.72%
EBITDA	\$87,000	\$100,000
Net Income	\$55,000	\$59,000
Balance Sheet Data		
Cash (Bank Funds)	\$44,000	\$13,000
Accounts Receivable	\$108,000	\$85,000
Inventory	\$115,000	\$95,000
Total Current Assets	\$267,000	\$193,000
Gross Fixed Assets	\$43,000	\$56,000
Total Assets	\$269,500	\$283,000
Accounts Payable	\$83,000	\$85,000
Total Current Liabilities	\$87,000	\$90,000
Total Liabilities	\$193,300	\$213,000
Total Equity	\$76,200	\$70,000
Number of Employees (FTE)	17.0	18.5

COMMON SIZE STATEMENTS

	12/31/2006	12/31/2007	Industry (3190)
Income Statement Data			
Sales (Income)	100%	100%	100%
Cost of Sales (COGS)	77%	78%	78%
Gross Profit	23%	22%	23%
Payroll / Wages / Salary	10%	10%	8%
Rent	1%	1%	1%
Advertising	1%	1%	1%
Depreciation	2%	3%	1%
Interest Expense	1%	1%	1%
Net Profit before Taxes	6%	6%	4%
Adjusted Net Profit before Taxes	6%	6%	4%
EBITDA	9%	10%	6%
Net Income	6%	6%	4%

Balance Sheet Data

Cash (Bank Funds)	16%	5%	10%
Accounts Receivable	40%	30%	15%
Inventory	43%	34%	11%
Total Current Assets	99%	68%	79%
Gross Fixed Assets	16%	20%	35%
Total Assets	100%	100%	100%
Accounts Payable	31%	30%	16%
Total Current Liabilities	32%	32%	58%
Total Liabilities	72%	75%	81%
Total Equity	28%	25%	20%

INDUSTRY SCORECARD

Financial Indicator	Current Period	Industry Range	Distance from Industry
Current Ratio = Total Current Assets / Total Current Liabilities	2.14	1.50 to 2.40	0.00%
Explanation: 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.			
Quick Ratio = (Cash + Accounts Receivable) / Total Current Liabilities	1.09	0.60 to 1.30	0.00%
Explanation: 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.			
Inventory Days = (Inventory / COGS) * 365	43.34 Days	10.00 to 40.00 Days	-8.35%
Explanation: 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.			
Accounts Receivable Days = (Accounts Receivable / Sales) * 365	30.09 Days	5.00 to 30.00 Days	-0.30%
Explanation: 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.			
Accounts Payable Days = (Accounts Payable / COGS) * 365	38.78 Days	10.00 to 40.00 Days	0.00%
Explanation: 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.			
Gross Profit Margin = Gross Profit / Sales	22.41%	15.00% to 30.00%	0.00%
Explanation: This number indicates the percentage of sales revenue that is 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 future sales. Higher is normally better (the company is more efficient).			
Net Profit Margin = Adjusted Net Profit before Taxes / Sales	5.72%	1.00% to 6.00%	0.00%
Explanation: 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 = Advertising / Sales	1.31%	0.90% to 2.20%	0.00%
Explanation: This metric shows advertising expense for the company as a percentage of sales.			
Rent to Sales = Rent / Sales	1.21%	0.40% to 1.20%	-0.83%
Explanation: This metric shows rent expense for the company as a percentage of sales.			
Payroll to Sales = Payroll Expense / Sales	10.18%	9.00% to 16.00%	0.00%
Explanation: This metric shows payroll expense for the company as a percentage of sales.			
Interest Coverage Ratio = EBITDA / Interest Expense	9.09	4.00 to 12.00	0.00%
Explanation: 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.			
Debt-to-Equity Ratio = Total Liabilities / Total Equity	3.04	1.50 to 4.00	0.00%
Explanation: 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.			
Debt Leverage Ratio = Total Liabilities / EBITDA	2.13	N/A	N/A
Explanation: This ratio measures a company's ability to repay debt obligations from annualized operating cash flow (EBITDA).			
Return on Equity = Net Income / Total Equity	84.29%	8.00% to 20.00%	+321.45%
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.			
Return on Assets = Net Income / Total Assets	20.85%	6.00% to 10.00%	+108.50%

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.

Fixed Asset Turnover

= Sales / Gross Fixed Assets

18.41

10.00 to 25.00

0.00%

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.

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.

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.).