



*Detail Financial Analysis*

## **City Cycle Company**

*Fiscal Year Ending 2013*

Thu, August 21, 2014

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## Introduction and Report Overview

The balance sheet and income statement for the fiscal year ending 2013 for City Cycle Company (referred to as "City Cycle Company" throughout this report) were provided. Various ratios were developed from these financials and then compared to data for the "NAICS Code 441221: Motorcycle, ATV, and Personal Watercraft Dealers" industry for firms in the \$0-\$1 M Sales range. This industry benchmark information was the most recently available from the Risk Management Association (formerly Robert Morris Associates) Annual Statement Studies Financial Ratio Benchmarks 2013, a widely used reference source. In this report the Risk Management Association will be referred to simply as RMA.

This comparison process provides an indication of where the company is strong and where improvements may need to be made. It is recognized that all firms are unique and have different operating and financial characteristics. Nonetheless, comparing against industry norms can be useful in identifying possible problem areas before they get out of hand. Also, investors and lending institutions are very interested in how a given firm compares to others of similar size in the same industry.

This report contains an analysis of the ratios for City Cycle Company and results that management can consider in their efforts to improve performance. This report can be used as a tool for looking ahead, developing benchmark goals, and for ideas in helping to reach those goals.

In some cases, comparable industry data will be either unavailable or insufficient for a meaningful value. For these situations, the industry data will appear as "n/a" or "ins. data", respectively. Furthermore, "ins. data" may appear for company

figures when insufficient company data was available or supplied. Finally, all ratios are rounded to one decimal place.

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## Limitations and Disclaimer

Please note that the industry data used was compiled from a sample not necessarily statistically representative or reliable, and that reliance therefore should be limited accordingly. The data has been obtained from, or is based on, sources believed by RMA to be reliable. However, the data is provided without warranty on the understanding that any person or entity that acts upon it or otherwise changes position in reliance thereon does so entirely at such person's or entity's risk. There were 293 firms comprising the "industry" figures for your size group in this study. In rare cases where statistics are not available on a particular size group for a NAICS classification, the industry-wide statistics will be used.

Therefore, neither the Risk Management Association, Universal Accounting, Inc., the developers of the BizBench® 2013 Financial Analysis Software, nor any other individuals or parties assumes any responsibility for decisions or results arising out of the use of the presented data, calculations, interpretations, or discussion ideas included in this report. Users must employ their own business knowledge and experience in deciding what is best for their enterprise.

## Executive Summary

Financial statements for the fiscal year ending 2013 for City Cycle Company (referred to as "City Cycle Company" throughout this report) were provided. This included the balance sheet and income statement for that period. This information has been analyzed, and the results are presented in this report.

Based upon analysis of the financial information provided by City Cycle Company, the following key results were developed:

### Areas of Strength

- Gross profit percentage is above average for similar-sized firms in the industry.
- Operating profit percentage is higher than the average.
- Profit before taxes (as a percentage of sales) exceeds the average.
- The company has a higher than average level of net worth relative to assets.
- The debt level of the company relative to assets is low compared to similar-sized firms.
- The company liquidity is good.
- The company is creating an acceptable number of inventory turns.
- The company can successfully meet its interest expense.
- The return on equity for the company exceeds industry norms.
- The company's return on assets is good.
- A relatively high level of sales is being created with the existing asset base.

### Observed Areas for Improvement

- Operating expense percentage is higher than the average.
- Sales to fixed assets is at a low level.
- The company needs to trim its days in accounts receivable.

The tables on the following pages provide a summary and analysis of the balance sheet, income statement, and financial ratios for City Cycle Company. The relationships to similar sized firms in the same industry are also shown. The source of the industry data is the Risk Management Association, a respected authority on such information.

The reported net sales for City Cycle Company for the fiscal year 2013 was \$198,354. In this report, it is compared to firms in the "\$0-\$1 M Sales" range.

Balance sheet line items are shown as a percentage of total assets. Income statement items are shown as a percentage of sales. This standard approach shows the relative magnitude of these line items and allows for more direct comparison to different firms. Balance sheet and income statement items are compared to the "industry average", based upon companies submitting data to RMA with the same North American Industry Classification System (NAICS) Code and in your sales range.

For financial ratios, your company's percentiles relative to the entire industry for 441221 are shown. The higher the percentile value, the more favorably your company compares to the set of comparison firms in the industry for that ratio (note that for some ratios, having a lower numerical ratio value for that particular ratio may be better). The "Introduction" section contains information on the limitations and application of results that should be reviewed by the reader. Note that financial ratios involving profitability are "before tax" to make benchmarking results more meaningful.

### Balance Sheet Comparison Summary For City Cycle Company

	<u>Fiscal Year</u> <u>Ending 2013</u>	<u>%Assets</u>	<u>Industry Average:</u> <u>\$0-\$1 M Sales</u>	<u>% Point Difference</u>
<b><u>Assets</u></b>				
Cash & equivalents	8,614	13.9%	8%	5.9%
Trade receivables	6,930	11.2%	3.7%	7.5%
Inventory	36,022	58.2%	59.1%	-0.9%
All other current	2,080	3.4%	1.4%	2%
<b>Total current</b>	<b>53,646</b>	<b>86.7%</b>	<b>72.2%</b>	<b>14.5%</b>
Fixed assets (net)	8,220	13.3%	13.8%	-0.5%
Intangibles (net)	0.0	0.0	9.8%	-9.8%
All other non-current(net)	0	0.0	4.2%	-4.2%
<b>Total assets</b>	<b>61,866</b>	<b>100.0%</b>	<b>100.0%</b>	
<b><u>Liabilities</u></b>				
Notes payable (short-term)	13,412.0	21.7%	29.9%	-8.2%
Current maturity LTD	0.0	0.0	3.1%	-3.1%
Trade payables	1,119.0	1.8%	9.9%	-8.1%
Income taxes payable	0.0	0.0	0.1%	-0.1%
All other current	6,249.0	10.1%	11.7%	-1.6%
<b>Total current</b>	<b>20,780.0</b>	<b>33.6%</b>	<b>54.6%</b>	<b>-21.0%</b>
Long-term debt	11,324.0	18.3%	11.4%	6.9%
Deferred taxes	0.0	0.0	0.1%	-0.1%
All other non-current	252.0	0.4%	6.2%	-5.8%
<b>Total liabilities</b>	<b>32,356.0</b>	<b>52.3%</b>	<b>72.3%</b>	<b>-20.0%</b>



<b>Total equity</b>	29,510.0	47.7%	27.7%	20.0%
<b>Liabilities and equity</b>	61,866.0	100.0%	100.0%	

Source of Industry Data: Current RMA Annual Studies Financial Ratio Benchmarks. 441221: Motorcycle, ATV, and Personal Watercraft Dealers.

### Income Statement Comparison Summary For City Cycle Company

	<u>Fiscal Year Ending</u>		<u>Industry Average:</u>	
	<u>2013</u>	<u>% Sales</u>	<u>\$0-\$1 M Sales</u>	<u>% Point Difference</u>
<b>Net sales</b>	198,354	100%	100%	
<b>Gross profit</b>	71,262	35.9%	24.3%	11.6%
<b>Operating expenses</b>	52,551	26.5%	22.2%	4.3%
<b>Operating profit</b>	18,711	9.4%	2.1%	7.3%
<b>Other expense (net)</b>	0	0	0.3%	-0.3%
<b>Profit before taxes</b>	18,711	9.4%	1.8%	7.60%

	<u>Fiscal Year Ending</u>		<u>Industry Average:</u>	
	<u>2013</u>	<u>% Sales</u>	<u>\$0-\$1 M Sales</u>	<u>% Point Difference</u>
<b>Additional Data Provided</b>				
<b>Depreciation &amp; amortization</b>	644	0.3%	0.7%	-0.4%
<b>Interest paid</b>	585	0.3%	n/a	
<b>Owner's compensation</b>	8,550	4.3%	1.2%	3.1%
<b>Sales per FTE</b>	33,059			
<b>Gross profit per FTE</b>	11,877			

Source of Industry Data: Current RMA Annual Studies Financial Ratio Benchmarks. NAICS Code is 441,221.

## Financial Ratio Comparison Summary For City Cycle Company

	<u>Fiscal Year Ending 2013</u>	<u>Estimated Percentile in Industry</u> <u>\$0-\$1 M Sales</u>
<b>Liquidity Ratios</b>		
Current ratio	2.6	99
Quick ratio	0.8	99
Working capital to sales (%)	16.6	86
<b>Efficiency Ratios</b>		
Days in accounts receivable	12.8	1.0
Days in accounts payable	3.2	77.0
Days in inventory	103.5	56.0
Operating cycle	116.2	n/a
<b>Operating Ratios</b>		
Asset turnover	3.2	80.0
Sales to fixed assets	24.1	36.0
Sales to working capital	6.0	86
<b>Financing Ratios</b>		
Debt to equity	1.1	95.0
Times interest earned	33.0	99.0
Net fixed assets to equity	0.3	49.0
Financial leverage	2.1	n/a
Trade AP to inventory	0.0	n/a



**Profitability Ratios**

<b>Return on sales (%)</b>	9.4	n/a
<b>Return on equity (%)</b>	63.4	93.0
<b>Return on assets (%)</b>	30.2	99.0

Percentiles are on a 1 to 99 basis, with higher values being better. A percentile value of 50 is (by definition) the median value, with half of the companies below that ratio and half above. The percentiles are color-coded (with color printers) as follows: green represents the upper quartile (good), blue represents the middle half, and red represents the lower quartile.

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Source of Industry Data: Current RMA Annual Studies Financial Ratio Benchmarks. NAICS Code is '441,221'.

## The DuPont Model: Putting It All Together For City Cycle Company

After viewing the five basic groups of performance ratios on the Financial Ratio Comparison Summary page, the next step is to assemble these ratios into a clear picture of overall financial performance.

The two most revealing financial performance ratios for companies are Return on Assets (ROA) and Return on Equity (ROE). To graphically portray the relationship of these two ratios, and the financial elements used to calculate them, a customized DuPont model has been created for 'City Cycle Company' on the following page.

The DuPont model is an ideal platform for setting financial goals and identifying the most achievable ways to accomplishing them. This provides a strategic structure for proactive Profit Improvement planning that builds the overall strength of a business.

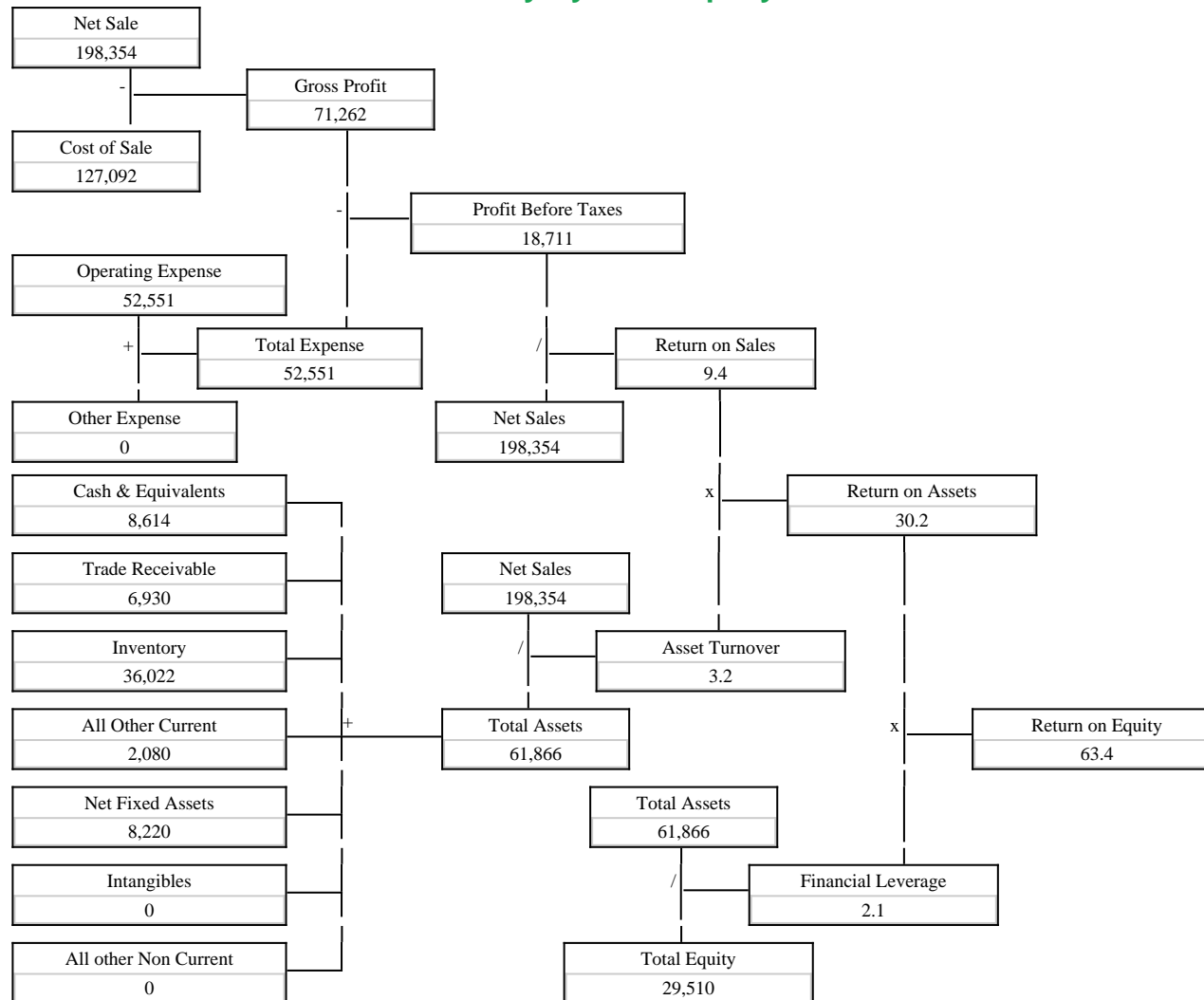
The idea is to begin at the end of the model with the desired ROE and then work backward to determine the ratio performance necessary to achieve that ROE.

Keep in mind that this may be long-term work - don't get impatient for immediate results.

- Determine ROE goal for your business
- Choose realistic combination of ROA and Financial Leverage to achieve the goal
- Present asset level will determine revenue needed for new Asset Turnover ratio
- From Asset Turnover ratio, calculate net profit % needed to reach ROA goal
- Determine components of Profit Before Taxes, Assets and Debt to reach goals
- Adjust over time as conditions change

More information about the financial ratios, and ways that performance can influence them, can be found on the pages immediately following the comparison graphs.

### Modified DuPont Model Diagram For City Cycle Company



## Z-Score Analysis

The Z-Score formula for predicting bankruptcy was developed in 1968 by Dr. Edward Altman, Ph.D., a financial economist and professor at New York University's Stern School of Business. The formula is a measurement of the financial health of a company and is a powerful diagnostic tool that forecasts the probability of a company entering bankruptcy within a two year period. Studies measuring the effectiveness of the Z-Score have shown the model to be reasonably accurate (72%-80% reliability), though not infallible, in predicting bankruptcy

The Z-Score bankruptcy predictor combines five common business ratios and

uses a weighting system created by Altman to determine the likelihood of a company going into bankruptcy. Slightly different bankruptcy risk assessment boundaries are used for privately-held manufacturers and privately held non-manufacturers (retail, wholesale, distribution, etc.). Calculating the Z-Score for publicly-held firms involves a different set of weighted multipliers and is not included in this report

The Z-Score for City Cycle Company was calculated on the basis of annual financial data provided for 2013. Thus, the score is not an absolute predictor of bankruptcy, and should be used primarily as a guide.

### Altman Z Score Reference

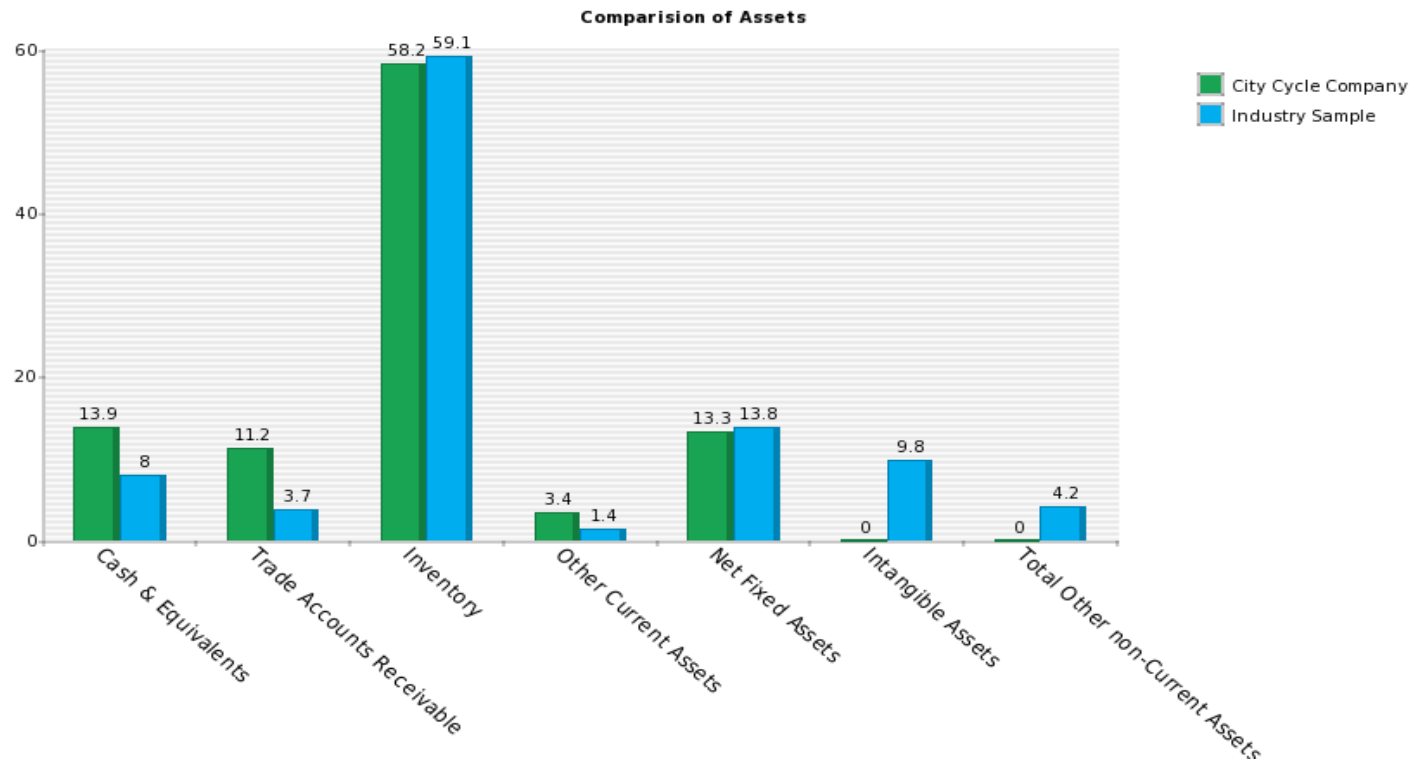
>3	Low Risk
2.7 to 2.99	On Alert, exercise caution
1.8 to 2.69	Good chance of failure within two years
<1.8	Bankruptcy is highly likely

<b>Business Ratio and Altman's Weighted Multiplier Calculation</b>		<b>Score</b>
(Working Capital ÷ Total Assets) X 0.717	(32,866.00 ÷ 61,866.00) X 0.717	0.38
(Retained Earnings ÷ Total Assets) X 0.847	(18,710.00 ÷ 61,866.00) X 0.847	0.26
(Net Profit Before Taxes ÷ Total Assets) X 3.107	(18,711.00 ÷ 61,866.00) X 3.107	0.94
(Equity ÷ Total Liabilities) X 0.420	(29,510.00 ÷ 32,356.00) X 0.420	0.38
(Net Sales ÷ Total Assets) X 0.998	(198,354.00 ÷ 61,866.00) X 0.998	3.20
<b>Total Z-Score</b>		<b>5.20</b>

**Conclusion:** The Z-Score for City Cycle Company is above the range of 1.100 to 2.600 for privately held non manufacturers.

According to the Altman Z-Score formula, and based on the financial statement values provided, there is little likelihood that City Cycle Company will experience bankruptcy within the next two years.

## Comparison of Asset Components for City Cycle Company

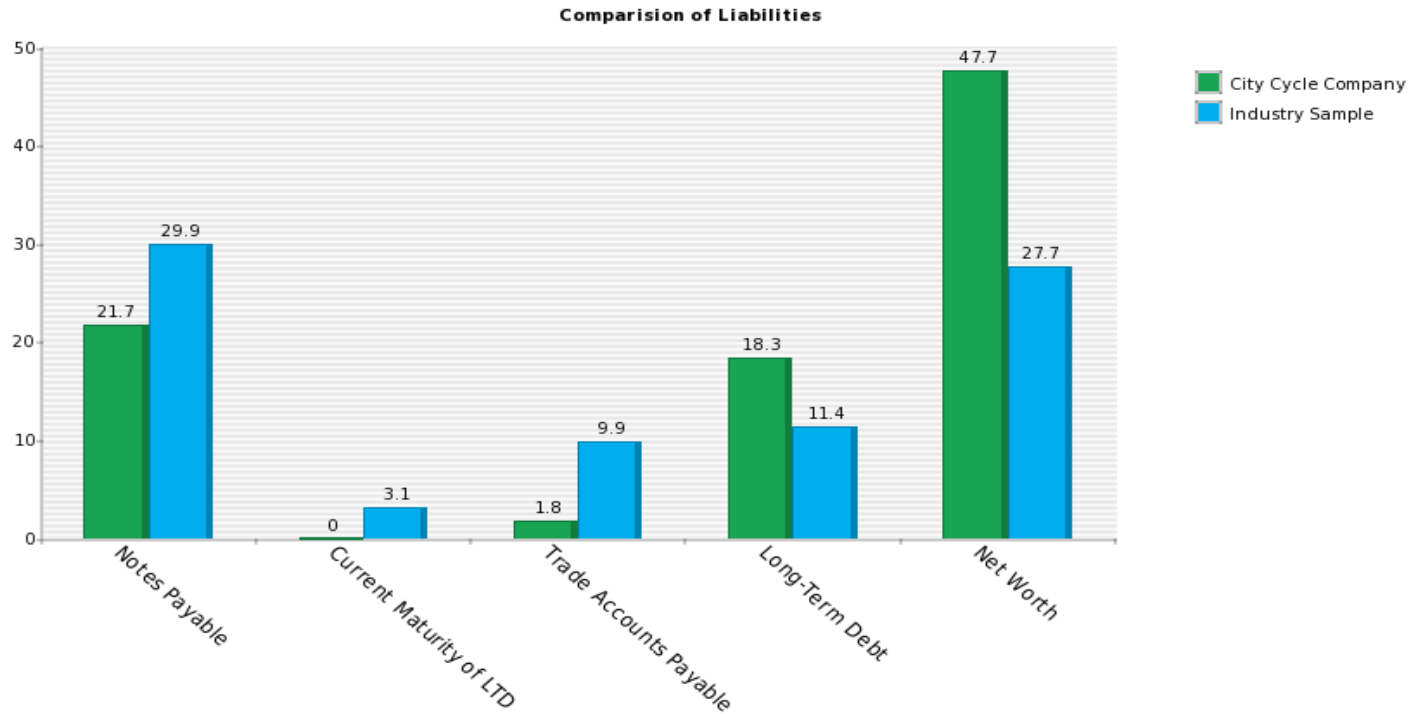


Y Axis = % of Total Assets

Note: Above industry figures are averages for the entire industry.

If no bar appears, there is insufficient data available for representation in the graph.

## Comparison of Liabilities & Net Worth Components for City Cycle Company (% of Total Assets)

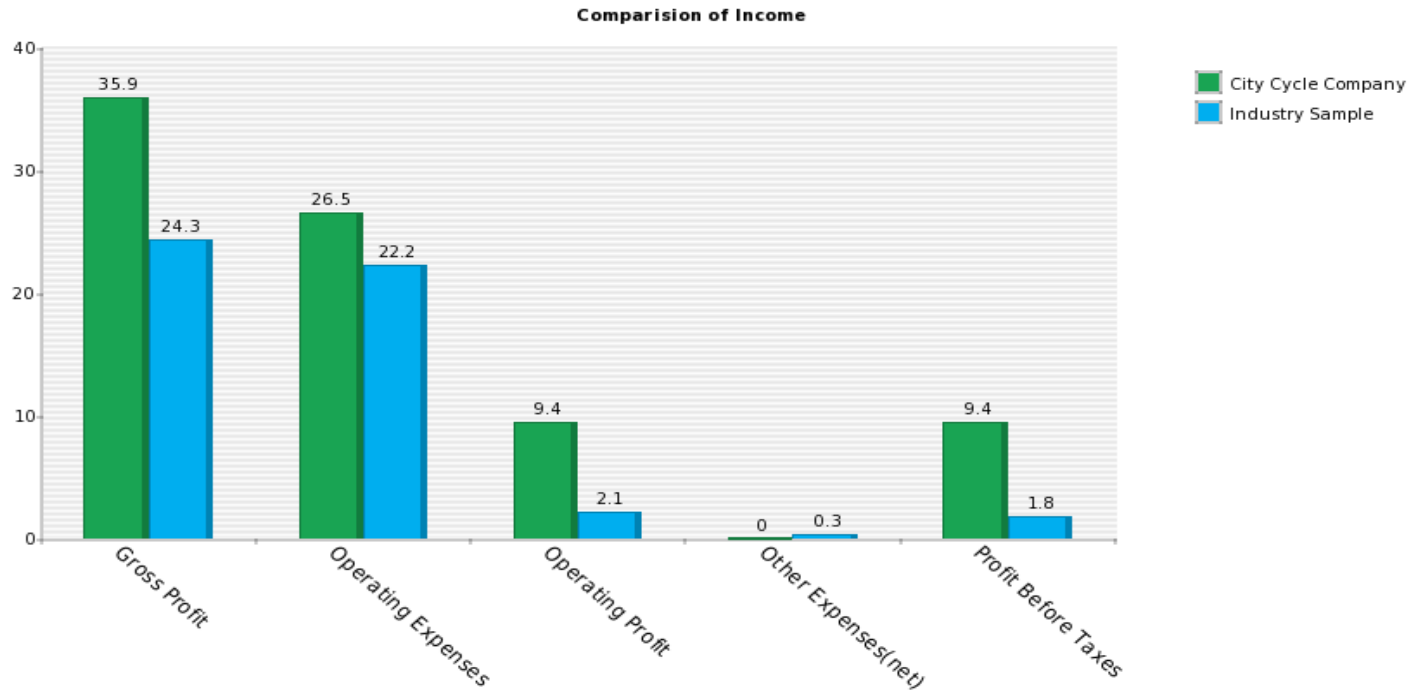


Y Axis = % of Total Assets

Note: Above industry figures are averages for the entire industry.

If no bar appears, there is insufficient data available for representation in the graph.

### Comparison of Net Income Components for City Cycle Company (% of Net Sales)



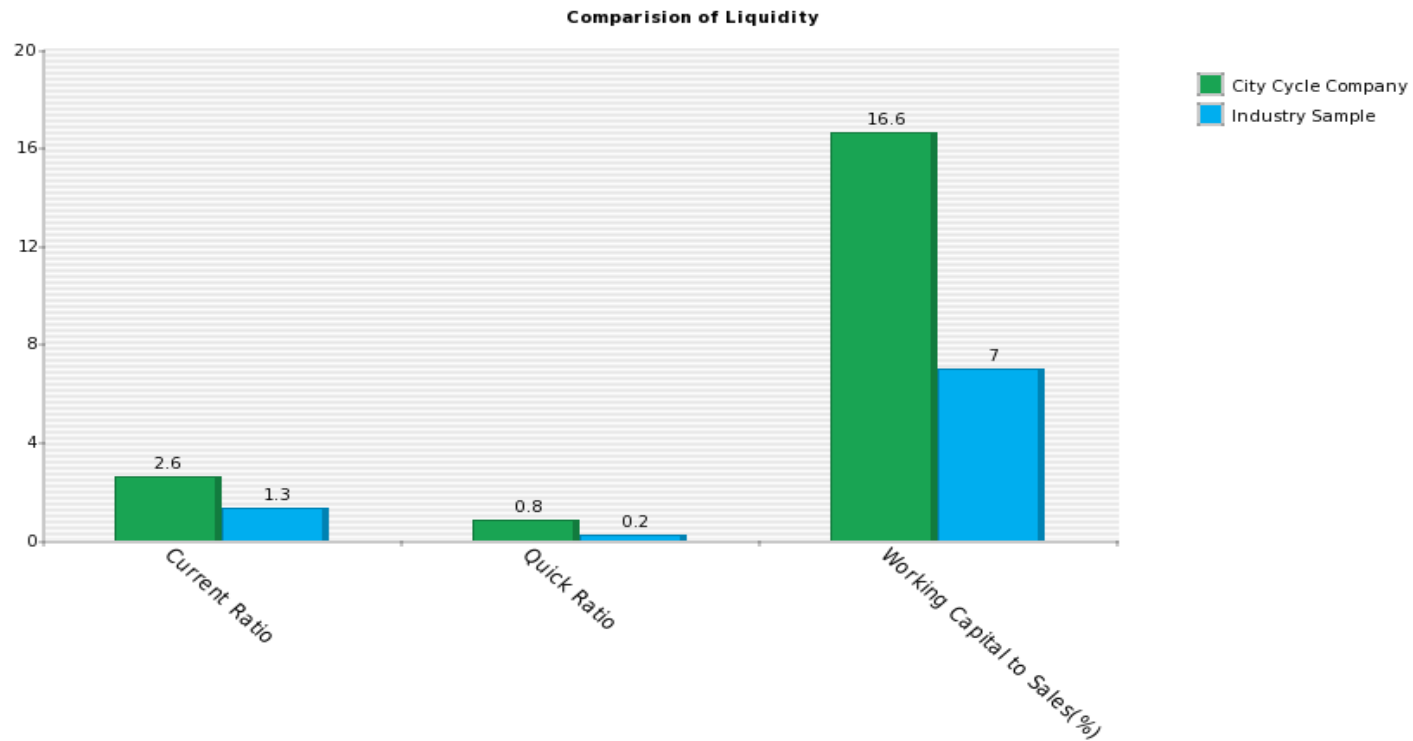
Y Axis = % of Net Sale

Note: Above industry figures are averages for the entire industry.

If no bar appears, there is insufficient data available for representation in the graph.



## Comparison of Liquidity Ratios for City Cycle Company

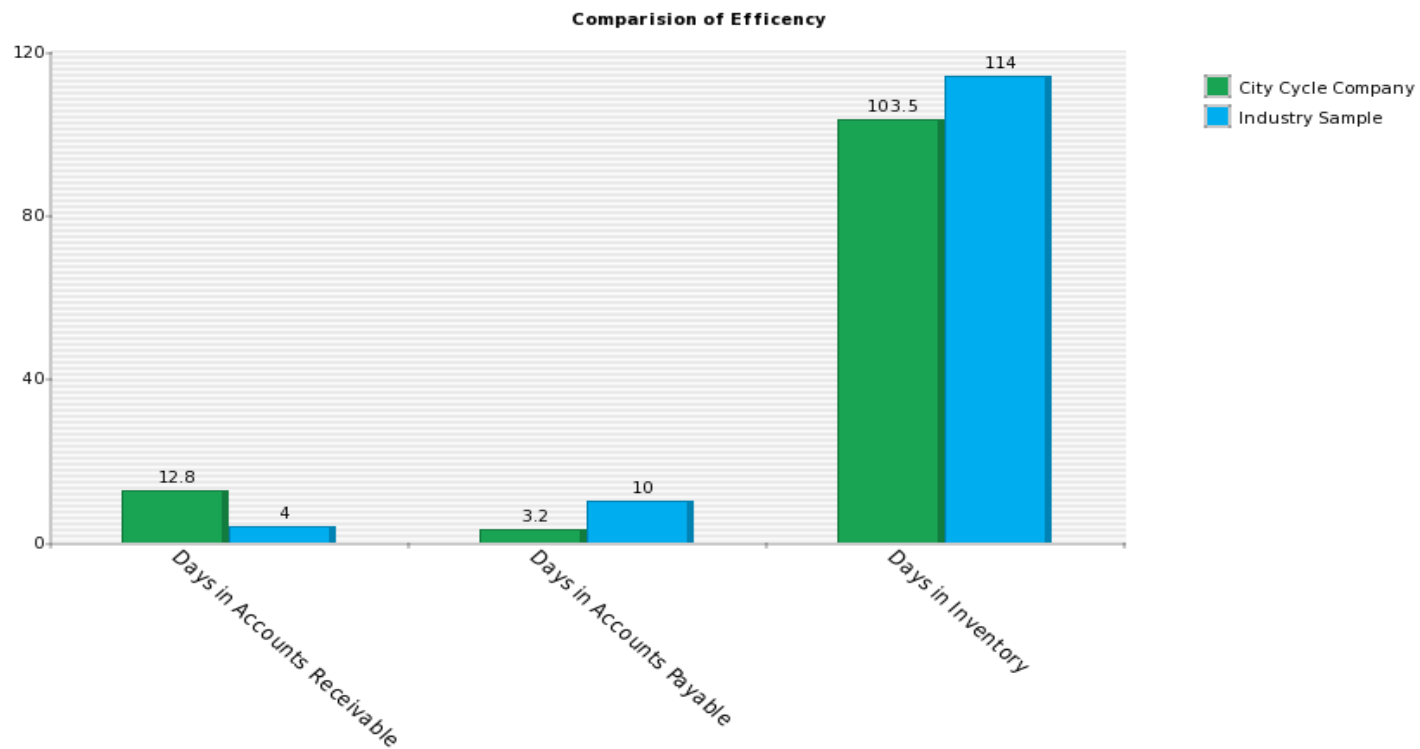


Y Axis = % of Total Ratio Values

Note: Above industry figures are averages for the entire industry.

If no bar appears, there is insufficient data available for representation in the graph.

## Comparison of Efficiency Ratios for City Cycle Company

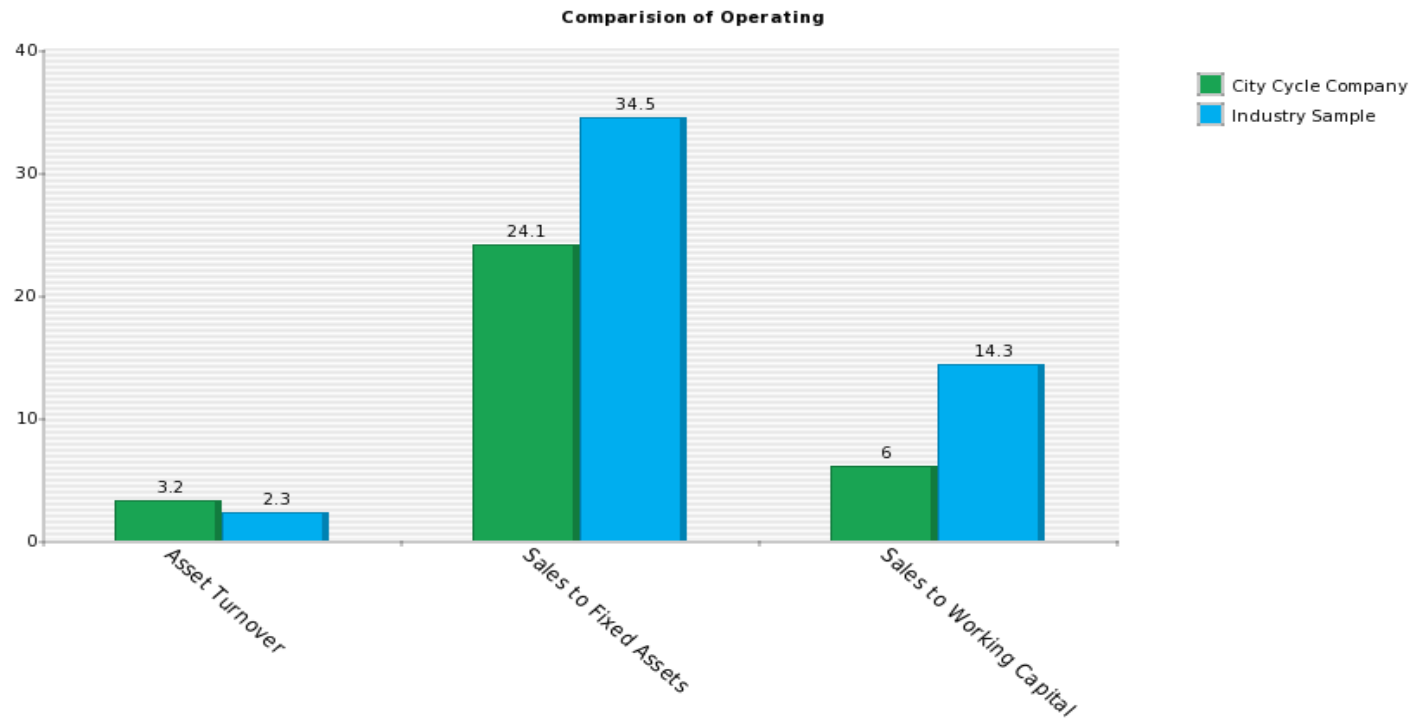


Y Axis = % of Ratio Values

Note: Above industry figures are averages for the entire industry.

If no bar appears, there is insufficient data available for representation in the graph.

## Comparison of Operating Ratios for City Cycle Company

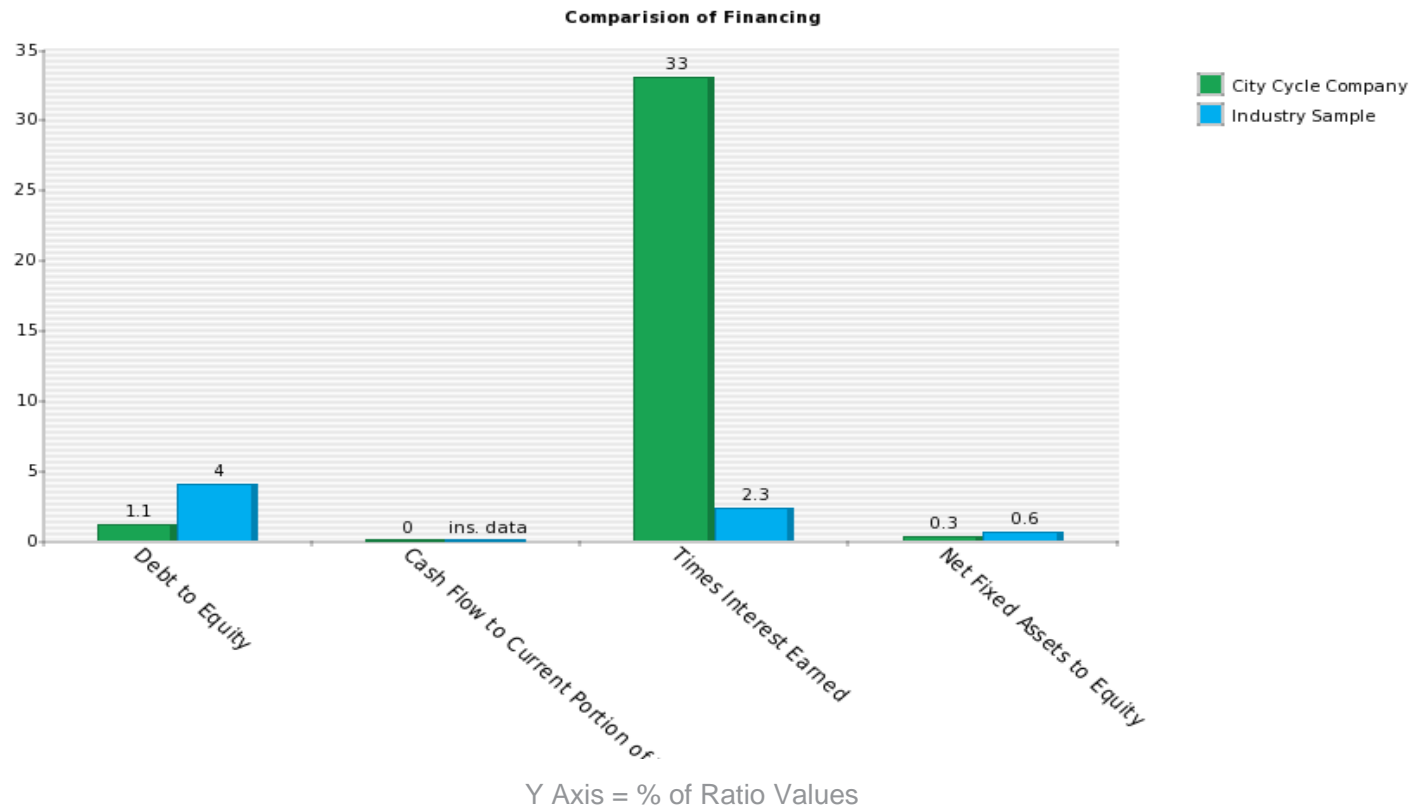


Y Axis = % of Ratio Values

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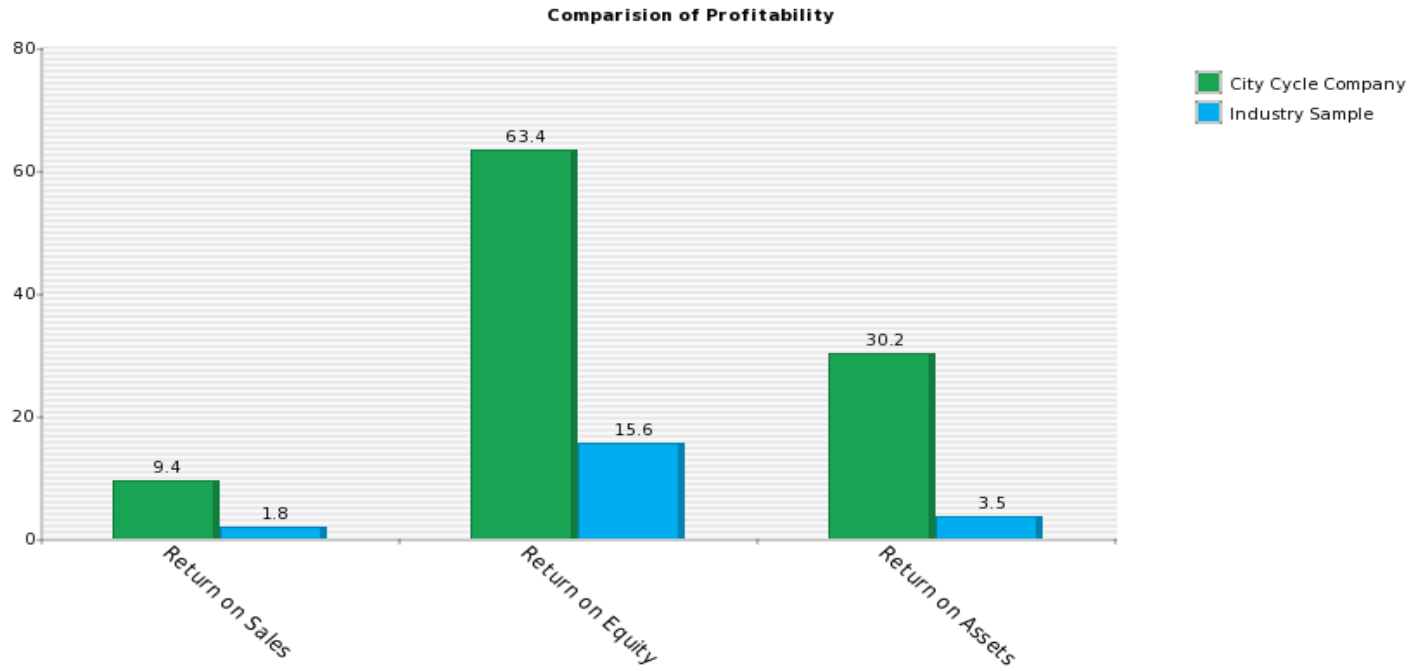
## Comparison of Financing Ratios for City Cycle Company



Note: Above industry figures are averages for the entire industry.

If no bar appears, there is insufficient data available for representation in the graph.

## Comparison of Profitability Ratios for City Cycle Company



Y Axis = % of Ratio Values

Note: Above industry figures are averages for the entire industry.

If no bar appears, there is insufficient data available for representation in the graph.

## Balance Sheet

The balance sheet, often called the statement of financial position, provides information that describes the financial standing of a company at a given point in time. The company's balance sheet for the latest fiscal year has been used in this analysis.

Just as a snapshot shows the cumulative effect of physical changes since birth, the balance sheet reflects the cumulative effect of the financial changes that have occurred in a business since it began. It is particularly useful in understanding how the business is financed, how successful it has been, and what decisions management has made to create company growth.

The balance sheet, of course, has two sides. On one side are the assets of the firm, and on the other are the company's liabilities and net worth (the sum of which equal the assets). There are several components of the balance sheet, and the Appendix contains detailed definitions. The components are often expressed as a percentage of assets to make more meaningful comparisons to other firms.

Assets components that are significantly different than the industry average for similar type firms (values shown are the company's percentage minus the industry average):

**Total Current Assets** 14.5%

Liability components that are significantly different than the industry average for similar type firms (values shown are the company's percentage minus the industry average):

**Total Current Liabilities** -21%

**Total Liabilities** -20%

**Total Liabilities** -20%

Net worth for City Cycle Company is 47.7% of Total Assets. This compares to an average of 27.7% for similar-sized firms in the same industry.

Note that there are typically wide variations between firms in terms of their balance sheet structure. It is not at all unusual to be much higher or lower than other firms on specific items. The key individual components making up the balance sheet are analyzed further in this report when financial ratios are discussed.

### Balance Sheet Comparison Summary For City Cycle Company

	<u>Fiscal Year</u> <u>Ending 2013</u>	<u>%Assets</u>	<u>Industry</u> <u>Average:</u> <u>\$0-\$1 M Sales</u>	<u>% Point</u> <u>Difference</u>
<b>Assets</b>				
Cash & equivalents	8,614	13.9%	8%	5.9%
Trade receivables	6,930	11.2%	3.7%	7.5%
Inventory	36,022	58.2%	59.1%	-0.9%
All other current	2,080	3.4%	1.4%	2%
<b>Total current</b>	<b>53,646</b>	<b>86.7%</b>	<b>72.2%</b>	<b>14.5%</b>
Fixed assets (net)	8,220	13.3%	13.8%	-0.5%
Intangibles (net)	0	0.0	9.8%	-9.8%
All other non-current(net)	0	0	4.2%	-4.2%
<b>Total assets</b>	<b>61,866</b>	<b>100%</b>	<b>100%</b>	
<b>Liabilities</b>				
Notes payable (short-term)	13,412	21.7%	29.9%	-8.2%
Current maturity LTD	0	0	3.1%	-3.1%
Trade payables	1,119	1.8%	9.9%	-8.1%
Income taxes payable	0.0	0.0%	0.1%	-0.1%
All other current	6,249	10.1%	11.7%	-1.6%
<b>Total current</b>	<b>20,780</b>	<b>33.6%</b>	<b>54.6%</b>	<b>-21%</b>
Long-term debt	11,324	18.3%	11.4%	6.9%
Deferred taxes	0	0	0.1%	-0.1%
All other non-current	252	0.4%	6.2%	-5.8%
<b>Total liabilities</b>	<b>32,356</b>	<b>52.3%</b>	<b>72.3%</b>	<b>-20%</b>



<b>Total equity</b>	29,510	47.7%	27.7%	20%
<b>Liabilities and equity</b>	61,866	100%	100%	

Source of Industry Data: Current RMA Annual Studies Financial Ratio Benchmarks. NAICS Code is 441221: Motorcycle, ATV, and Personal Watercraft Dealers.



## Income Statement

**Net Sales** is total gross sales less any returns, allowances, and general customer incentives. Net sales is used in a wide variety of financial ratios. On the income statement, line items are often expressed as a percentage of net sales (defined as 100%) to make comparisons between companies more meaningful. The comparison data represents averages of income statements.

**Gross Profit** is computed by subtracting Cost of Sales (or Cost of Goods Sold) from Net Sales. Generating good net profits is nearly impossible to achieve without first producing a good gross profit. Gross profit dollars can be divided by net sales and expressed as a percentage of sales.

The gross profit percent for City Cycle Company is 35.9%. This compares to the industry average of 24.3%. Maintaining this performance depends on continuing to control the cost of sales and achieving the optimum selling price the market will bear.

**Operating Profit** is the measurement of gross profit remaining after operating expenses are deducted and can be expressed as a percentage of sales. If gross profit is acceptable and operating profit is below average, the firm should analyze operating expenses for cost reductions.

The operating profit for City Cycle Company is 9.4% of sales. This compares to the industry average of 2.1%. Maintaining this solid performance depends on continuing to achieve good gross profit margins and reasonable control of operating costs

**Net Profit Before Taxes** is computed by subtracting interest costs and other expenses (income) from operating profit, and can be expressed as a percentage of sales, before taxes (net profit % or return on sales). The net return on sales for

City Cycle Company is 9.4%. This compares to the industry average of 1.8%. The company's results exceed the industry average for the reported year and management should work to continue the company's effective performance. The company's results exceed the industry average for the reported year and management should work to continue the company's effective performance..

**Depreciation and Amortization % of Sales** is computed by dividing annual depreciation and amortization by net sales. This ratio depends upon the amount of fixed assets that a company has and how quickly they are being depreciated or amortized, relative to the sales base. Any depletion, if it exists, should also be included.

The Depreciation and Amortization % of Sales for City Cycle Company is 0.3. This compares to the industry median of 0.7. This may indicate a lower-than-normal amount of fixed assets being used to generate sales and/or a conservative depreciation schedule.

**Owner's Compensation % of Sales** is computed by dividing the total owner's, officer's, and director's compensation (salary plus any bonuses) by annual net sales. This is obviously a measure of how much these individuals are taking out of the business relative to the sales level. It can vary widely among companies, depending upon the goals of the owner(s), tax ramifications, and so forth. It should be viewed in context with the return on sales discussed earlier in this section.

The Owner's Compensation % of Sales for City Cycle Company is 4.3. This compares to the industry median of 1.2.

Please refer to the 'Discussion Ideas' section for possible action steps for improving ratios.



## Liquidity Ratios

Liquidity is a company's ability to meet its maturing short-term obligations. Liquidity is essential to a business when confronted with unforeseen events, such as a strike, recession, supply interruption, natural disaster, and so forth. Favorable liquidity is also necessary for taking advantage of certain business opportunities that may develop. Determining the liquidity of a company is particularly important to creditors, since it may affect timely payment of principal and interest obligations, and payment of trade debt, as well as overall solvency.

From the firm's perspective, the liquidity ratios measure the management of working capital, which includes activities with current assets and current liabilities.

There are three major measures of liquidity in this report. These are the current ratio, quick (or acid test) ratio, and net working capital (often expressed relative to sales). The ratios are defined below, with a brief discussion of the firm's relative ranking with its industry.

**The Current Ratio** is defined as total current assets divided by total current liabilities. It provides an idea on how well the company can service its current obligations. Higher values, within limits, are better.

The current ratio for City Cycle Company is 2.6 This compares to the industry median of 1.3. The cash strength relative to liabilities for the firm is above average, trade receivables is above average, and inventory is below average. The current portion of long-term debt is above average and trade payables is below average.

**The Quick (Acid Test) Ratio** is similar to the current ratio, but it includes only cash, cash equivalents and accounts receivable as current liabilities, which are

then divided by total current liabilities. It specifically excludes "inventory" in the numerator, and is therefore a more conservative measure of liquidity. The quick ratio indicates a firm's more immediate capability for paying current obligations, since it would take some time to convert inventory into cash. As in the case of the current ratio, higher values (within limits) are better.

The quick ratio for City Cycle Company is 0.8 This compares to the industry median of 0.2. The firm's inventory position is below the industry average. Both the current and quick ratios are less than the industry medians. Action steps to improve liquidity should be developed and implemented..

**Working Capital to Sales Ratio** is computed by subtracting current liabilities from current assets (equivalent to calculating working capital), and then dividing the result by net sales. This measures the working capital a company is carrying relative to its sales volume, and is an indicator into how much working capital is required for a certain sales level. It also provides insight into the degree of protection afforded current creditors.

Although there are differences of opinion, it is generally accepted that the higher this value the better, because it means that the company is doing a good job of creating working capital for day-to-day operations and to guard against any sudden downturns in business. Extremely high values, however, may indicate that the company could be generating higher sales with the available working capital.

For City Cycle Company this ratio is 16.6%. This compares to the industry median of 7.0%. The company ratio is negative since current liabilities exceed current assets. On-going liquidity and ability to support sales may be an issue.

**Financial Ratio Comparison Summary  
For City Cycle Company**

	<u>Fiscal Year Ending 2013</u>	<u>Estimated Percentile in Industry</u> <u>\$0-\$1 M Sales</u>
	<b>Liquidity Ratios</b>	
<b>Current ratio</b>	2.6	99
<b>Quick ratio</b>	0.8	99
<b>Working capital to sales (%)</b>	16.6	86

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Source of Industry Data: Current RMA Annual Studies Financial Ratio Benchmarks. NAICS Code is 441221: Motorcycle, ATV, and Personal Watercraft Dealers.

## EFFICIENCY RATIOS

Efficiency ratios usually indicate how well a firm is managing its accounts receivable, accounts payable, inventory and operating cycle. Because these ratios are based upon a snapshot of certain balance sheet accounts (to total annual sales), they will not reflect seasonal fluctuations. The "Discussion Ideas" section contains potential action steps for further improvement in any ratios occurring below the industry median for that ratio.

**Days in Accounts Receivable** is defined as the average number of days required to collect an account receivable. The ratio is calculated by dividing (Trade) Accounts Receivable by average Daily Net Sales and is expressed in days. Firms should strive for a low number of days in accounts receivable, because it means receiving payments quicker and enhancing cash flow.

Accounts receivable turnover is sometimes used as another benchmark in this area, and is defined as Annual Net Sales divided by Accounts Receivable.

The days in accounts receivable for City Cycle Company is 13 days. This compares to an industry median of 4 days. Prompt collection performance provides timely cash to the firm and reduces the need for expensive borrowing to finance receivables and payables. The firm's ratio suggests need for improvement.

**Days in Accounts Payable** is defined as the average number of days required for the firm to pay an account payable. The ratio is calculated by dividing (Trade) Accounts Payable by average Daily Cost of Sales (cost of goods sold) and is expressed in days.

Accounts payable turnover is sometimes used as another benchmark in this area, and is defined as Annual Cost of Sales divided by (Trade) Accounts Payable.

The days in accounts payable for City Cycle Company is 3 days. This compares to the industry median of 10 days. Careful management of purchased inventory and accounts receivable are important in having a reasonable ratio. The ratio for the firm indicates good performance.

**Annual Inventory Turnover** is defined as the average number of times a company's inventory (if applicable) has been sold during the year. The ratio is calculated by dividing cost of sales (cost of goods sold) by inventory valued at cost. Having a high number of inventory turns during the year is beneficial to a company, as long as customer requirements are being met (that is, few shortages, back-orders, and so forth). Unfortunately, seasonal fluctuations are not examined with this ratio, but it does provide some general indication on how well the firm is moving its product through the system.

The inventory turnover figure for City Cycle Company is 3.5 times. This compares to the industry median of 3.2. Slow-moving inventory makes poor use of the firm's resources. Maintaining the current good inventory turnover is important for profitable use of those resources.

An alternative expression of this annual inventory turnover is **Days in Inventory**, which expresses the average number of days required to sell the company's inventory. This ratio is calculated by dividing 365 days by the inventory turnover figure. Obviously, the lower this value, the better. The days in inventory for City Cycle Company is 103.5 days. This compares to the industry median of 114

**Operating Cycle** is defined as the average number of days between the purchase of raw or saleable inventory and the collection of cash from the sale of that inventory. The ratio is calculated by adding days in inventory to days in accounts receivable. The lower this value, the better.

The firm's operating cycle is 116.2 days. The industry operating cycle is not available through survey ratios.

For companies with significant inventory: Efficient management of the operating cycle is an important element of resource utilization, since the firm's capital is employed for the entire cycle. Careful management attention should be given to the cycle time by closely monitoring the turnover of inventory and accounts receivable. Such companies should build a history of (annual) operating cycle measurements so the most recent ratio can be evaluated against historical



performance.

### Efficiency Ratios For City Cycle Company

	<u>Fiscal Year Ending 2013</u>	<u>Estimated Percentile in Industry</u> <u>\$0-\$1 M Sales</u>
<b>Days in accounts receivable</b>	12.8	1.0
<b>Days in accounts payable</b>	3.2	77.0
<b>Annual inventory turnover</b>	3.5	56.0
<b>Days in inventory</b>	103.5	56.0
<b>Operating cycle</b>	116.2	n/a

Source of Industry Data: Current RMA Annual Studies Financial Ratio Benchmarks. NAICS Code is 441221: Motorcycle, ATV, and Personal Watercraft Dealers.

## OPERATING RATIOS

Operating ratios are designed to assist in the evaluation of management performance and its effectiveness in utilizing the resources available. Possibilities for improving any operating ratios that are below the industry median are contained in the Discussion Ideas section at the end of this report.

**Asset Turnover** is calculated from Net Sales divided by Total Assets. This ratio measures a firm's ability to generate sales from the total asset base. Higher ratios suggest a greater capacity to create sales with given assets. This ratio is particularly helpful in conjunction with other asset utilization measurements.

The Asset Turnover for City Cycle Company is 3.2. This compares to the industry median of 2.3. The firm appears to be making effective use of its total asset base to produce sales.

**Sales to Fixed Assets** indicates management's relative productive use of its fixed assets to produce sales. The ratio is computed by dividing Net Sales by Net Fixed Assets. It is similar in concept to asset turnover, but it excludes current assets, intangibles, and miscellaneous other non-current assets in the denominator. Essentially, this ratio tests the efficiency of management in keeping production assets employed.

Note that operations that are very labor intensive or that are using significant plant and equipment that is mostly depreciated, will have less meaningful comparisons.

The Sales to Fixed Assets ratio for City Cycle Company is 24.1. This compares to the industry median of 34.5. The utilization of fixed assets is in need of improvement. The use of fixed assets should be analyzed to determine if excess capacity exists.

**Sales to Working Capital Ratio** is computed by dividing net sales by working capital (working capital is current assets minus current liabilities). This measures a company's ability to generate sales with its working capital. Note that it is the inverse of the Working Capital/Sales ratio discussed in the Liquidity section.

Since having adequate working capital is important as an operating "cushion", lower values are generally advantageous for this ratio. However, extremely low values may indicate that insufficient sales are being generated relative to working capital.

The Sales to Working Capital for City Cycle Company is 6. This compares to the industry median of 14.3.



### Operating Ratios For City Cycle Company

	<u>Fiscal Year Ending 2013</u>	<u>Estimated Percentile in Industry</u> <u>\$0-\$1 M Sales</u>
<b>Asset turnover</b>	3.2	80.0
<b>Sales to fixed assets</b>	24.1	36.0
<b>Sales to working capital</b>	6.0	86.0

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Source of Industry Data: Current RMA Annual Studies Financial Ratio Benchmarks. NAICS Code is 441221: Motorcycle, ATV, and Personal Watercraft Dealers.

## FINANCING RATIOS

Financing ratios analyze the relationship between a firm's debt load, its fixed asset base and net worth. Essentially, they explore the financial structure of a company.

A high level of debt can make a firm vulnerable to business downturns for reasons beyond the firm's control. Two ratios are commonly used for this analysis: Debt to equity and cash flow to current maturities of long-term debt. As usual, possible action steps are presented in the Discussion Ideas section for any ratios which fall below the industry median.

**Debt to Equity Ratio** is computed by dividing Total Liabilities by Net Worth. This ratio expresses the relationship of capital contributed by creditors and capital contributed by stockholders. The ratio reflects the way the business is financed. There are specific implications of this ratio. A high ratio is less favorable to existing/potential creditors (riskier for them), while a low ratio may be less favorable to stockholders.

Firms with a high debt to equity ratio are more restricted in the amount of money they can borrow. Most companies try to keep their ratio within industry norms.

The debt to equity ratio for City Cycle Company is 1.1. This compares to the industry median of 4. The level of debt relative to equity is less than the industry. The ratio may also indicate a good historical profit performance, which has helped growth of retained earnings and therefore equity.

**Cash Flow to Current LT Debt Ratio** is computed by dividing Cash Flow (as measured by net income before taxes plus depreciation, amortization, and depletion) by Current Maturities of Long-Term Debt. This ratio provides insight into how well the company is able to meet its current obligations on long-term debt through its cash flow. The higher the value, the better.

**Times Interest Earned** is calculated by dividing Net Profit before Taxes plus

Interest Paid (that is, the sum) by Interest Paid. This ratio measures the ability to meet interest payments, as well as take on additional debt. Higher values indicate a more favorable condition.

The ratio for City Cycle Company is 33. This compares to the industry median of 2.3. The company appears to be able to meet interest payments, and can do so more easily than the typical company in this industry.

**Net Fixed Assets to Equity Ratio** is computed by dividing Net Fixed Assets by Equity (Net Worth). The ratio measures stockholder investment in fixed assets, and can reflect over-investment or under-investment by owners. A lower (positive) ratio value is more favorable for creditors in case of liquidation of the company (note that negative values indicate negative equity, usually the result of negative retained earnings). If most of the assets are leased or if the assets are essentially depreciated, this ratio becomes less meaningful. Note that for businesses that operate with no fixed assets, this ratio value will be zero.

The ratio for City Cycle Company Company is 0.3. This compares to the industry median of 0.6. The company has a lower ratio than the industry median, partly as a result of a higher than normal level of net worth.

**Financial Leverage** is Total Assets divided by Equity (Net Worth). This is a measure of the extent to which assets are financed by Owner's Equity. Although information is not directly available from RMA on the industry value, the ratio is important as an indicator of exposure to debt. Firms should be careful to not become too leveraged (too much debt) for the sake of creating a higher ROE. A sudden downturn in sales could leave a highly-leveraged firm unable to pay the interest on its debt. The value for City Cycle Company is 0.

**Trade Accounts Payable to Inventory** is defined as the trade accounts portion of payables divided by inventory. This is a measure of how much inventory is being financed by vendors. Like Financial Leverage, this information is not directly available from RMA on the industry value, it remains an important ratio to consider. The value for City Cycle Company is 0.

### Financing Ratios for City Cycle Company

	<u>Fiscal Year Ending 2013</u>	<u>Estimated Percentile in Industry</u> <u>\$0-\$1 M Sales</u>
<b>Debt to equity</b>	1.1	95
<b>Times interest earned</b>	33	99
<b>Net fixed assets to equity</b>	0.3	49
<b>Financial leverage</b>	2.1	n/a
<b>Trade AP to inventory</b>	0	n/a

Source of Industry Data: Current RMA Annual Studies Financial Ratio Benchmarks. NAICS Code is 441221: Motorcycle, ATV, and Personal Watercraft Dealers.

## Profitability Ratios

Profitability ratios are useful in expressing the company's earnings relative to what created them, whether it is sales, owners equity, or total asset base. All ratios presented here are based on pre-tax net profit.

**Return on Sales (Net Profit Before Taxes)** measures a company's ability to generate profits relative to the sales volume. It is definitely one of the key indicators of the success of a business. Return on Sales is calculated by dividing Net Income before Taxes by Net Sales, and expressing the result as a percentage. Obviously, the higher the value, the more successful the company is at generating profits from its sales.

The Return on Sales for City Cycle Company is 9.4%. This compares to the industry average of 1.8%. The firm's ratio indicates net profit relative to sales compares favorably to the industry.

Other key figures to examine include Owner's, Officer's, and Director's Compensation relative to Sales, as well as Return on Assets. For City Cycle Company, the Owner's, Officer's, and Director's Compensation relative to Sales is 4.3%. This compares to the industry median of 1.2. The Return on Assets results are covered below.

**Return on Equity (ROE)** or Return on Net Worth measures management's performance in producing a rate of return on the equity capital employed. It is calculated by taking Pre-tax Net Profit and dividing by Equity or Net Worth (with the ratio expressed as a percentage). Equity is equivalent to Net Worth. Higher values of this ratio are better. Note that start-up or young companies frequently have widely varying returns on equity because of how the business is financed and a short time span for accumulated retained earnings.

The Return on Equity for City Cycle Company is 63.4%. This compares to the industry median of 15.6%. The firm's ratio indicates net profit relative to equity compares favorably to the industry median.

There are two other important ratios to consider in conjunction with Return on Equity: The Equity (Net Worth) % of Assets and the Debt to Equity ratio, both of which have been discussed. For City Cycle Company, the Equity (Net Worth) % of Assets is 47.7%. This compares to the industry average of 27.7%. The Debt to Equity ratio for the firm is 1.1. This compares to an industry median of 4.

**Return on Assets (ROA)** more specifically measures management's effective use of the entire asset base to generate profit. The ratio is computed by dividing Pre-tax Net Profit by Total Assets, and then expressing that number as a percentage.

This is an extremely important ratio where the higher the return, the more effectively all assets are being used to generate profits. This ratio is a good indicator of management's ability to conduct profitable operations. It is particularly critical for company's initial growth phase that they have a high return on assets.

The value of Return on Assets for City Cycle Company is 30%. This compares to the industry median of 3.5%. The company is above the industry median for this ratio and is laying the foundation for continued growth and competitiveness.

Please refer to the Discussion Ideas section for potential ways to further improve this ratio, or for any of the profitability ratios discussed above.

### Profitability Ratios for City Cycle Company

	<u>Fiscal Year Ending 2013</u>	<u>Estimated Percentile in Industry</u> <u>\$0-\$1 M Sales</u>
<b>Return on sales (%)</b>	9.4	n/a
<b>Return on equity (%)</b>	63	93
<b>Return on assets (%)</b>	30.2	99

Source of Industry Data: Current RMA Annual Studies Financial Ratio Benchmarks. NAICS Code is 441221: Motorcycle, ATV, and Personal Watercraft Dealers.

## Financial Area Percentiles

The individual financial ratios for City Cycle Company have been discussed in this report. It is possible to develop some "sense" of a company's general financial strengths and weaknesses by viewing the firm's standing in each of the major grouping of ratios (liquidity, efficiency, operating, financing, and profitability).

Although it is possible to take the simple arithmetic averages of the percentiles for individual ratios within each major financial area, a more sophisticated approach is to take a weighted average of the percentiles. This takes into account the fact that some ratios may be more important than others.

Based upon the opinions of knowledgeable professionals, default "weighting factors" (in the software) were developed for each of the individual ratios. The analyst can modify these. In this section is a listing of the major financial ratio areas and the individual weighting factors on a 1-10 scale, with 10 indicating "extremely important".

The weighting factors are then applied to individual percentiles, and a combined

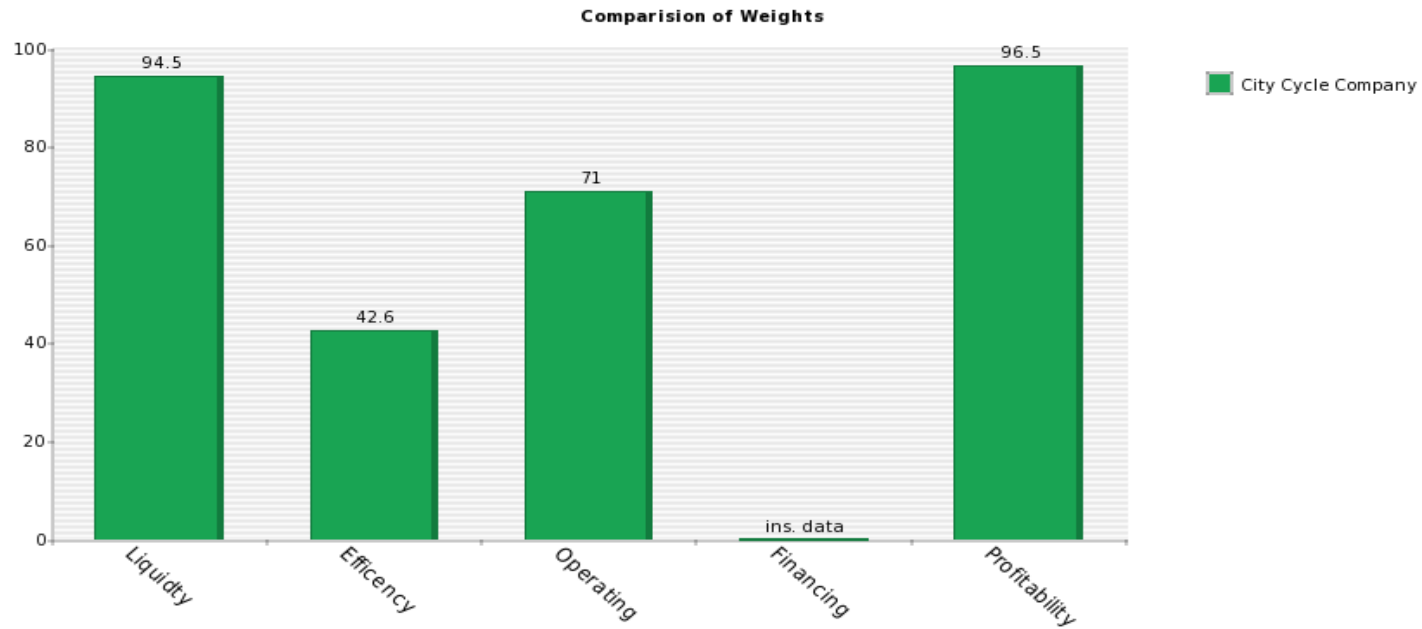
weighted average is developed for that financial area. The purpose of this calculation is to consider both the percentiles of the company, as well as the relative importance of certain ratios. It can therefore provide a general guide to the overall performance in various financial areas. The Appendix provides the detailed methodology.

Not all individual ratios are used in these calculations. Inventory turnover is already represented by days in inventory, and industry percentile data is not available on return on sales, operating cycle, and trade accounts payable to inventory. **All other percentile values are required for a given area to generate the weighted average percentile.**

Based on this assessment, the top areas of performance are profitability and liquidity ratios. The areas needing the most improvement are operating and efficiency ratios. The results for each area appear on the graph following this section. The higher the percentile, the more effective your company is in that particular area. Any "missing bars" indicates that there were an insufficient number of ratio percentiles to generate a meaningful weighted average.

	default	In Use			
<b>LIQUIDITY RATIOS</b>			Sales to fixed assets	5.0	5.0
Current Ratio	6.9	6.9	Sales to working capital	7.2	7.2
Quick ratio	6.5	6.5	<b>FINANCING RATIOS</b>		
Working capital to sales (%)	7.2	7.2	Debt to equity	6.2	6.2
<b>EFFICIENCY RATIOS</b>			Cash flow to current LT debt	5.0	5.0
Days in accounts receivable	7.1	7.1	Times interest earned	6.6	6.6
Days in accounts payable	5.8	5.8	Net fixed assets to equity	4.5	4.5
Annual inventory turnover	7.2	7.2	Financial leverage	n/a	
Days in inventory	n/a		Trade AP to inventory	n/a	
Operating cycle	n/a		<b>PROFITABILITY RATIOS</b>		
<b>OPERATING RATIOS</b>			Return on sales (%)	n/a	
Asset turnover	7.5	7.5	Return on equity (%)	6.1	6.1
			Return on assets (%)	8.7	8.7

## Performance Analysis of Financial Ratio Areas for City Cycle Company



Y Axis = % of Total Assets

Scale is from 1 to 99 with the higher values representing better performance.



Note: Above industry figures are averages for the entire industry.

If no bar appears, there is insufficient data available for representation in the graph.

## Discussion Ideas

This section contains discussion ideas on possible ways to improve key areas. The purpose of these listings is to stimulate thought and discussion with your company and management team. Following this section of the report is a worksheet for you to record the best and most appropriate ideas for your company, along with responsibility and timeline information. Note that these ideas are just that, ideas for possible consideration. You will want to use your own business sense and knowledge to determine what is appropriate for your company.

### Operating expense percentage is higher than the average.

- Express and track cost categories as a percentage of sales.
- Examine individual operating cost categories to see if any are out of line.
- For detailed operating budgets, consider history and realistic growth, but periodic zero-based budgets may make sense.
- Strive for easily understood, actionable reporting systems. Avoid broad cost categories where possible, except for summary reports and subtotals.
- Ensure that operating cost information is reported in a timely fashion. Obviously, the quicker problems are solved, the better.
- Have "exception reporting" which highlights unusual expenses. Be able to track to the exact source.
- Follow-up on recurrent (chronic) problem areas in operating expenses (and have a system to identify them).
- Work on feedback from employees: suggestion box, meetings with management, and so forth. Are your current methods successful?
- Reward improvements in reducing operating expenses through incentives and recognition. Solicit ideas from managers in the functional areas.
- Track % of employee suggestions implemented and annual savings derived from them.
- Make sure the chart of accounts is capturing operating costs the way management needs to see them.
- Focus on those operating expenses which may yield the largest increase in savings (labor, utilities, etc.).
- Make individuals accountable for controlling certain operating costs. Every cost should have a person responsible for it.
- Consider implementing functional area or departmental accounting if not already doing so.
- Attend state and national association meetings to learn ways to reduce operating costs.
- All managers should have a "situational awareness." This awareness is based on knowing what work has been completed, what needs to be done, what should be done later, and what can't be done.
- Examine your criteria for "special orders" or "special service" -- are they becoming routine? Does the system need to be changed?
- Create a system for separating customers who always demand emergency service from those who deserve it.
- Paperwork should be done when people are alert. Too often, it's done when people are tired and prone to make errors.
- Take into account any needs of new products or services. Does the benefit of the new product or service exceed the cost of meeting these requirements?
- Work on ways to reduce "firefighting" problems through developing good operations planning. Firefighting is very expensive.
- Use Activity Based Costing methods to determine the true cost of providing services or carrying certain products.
- Work towards having a truly integrated information system.
- Strive to have real time access to customer information.
- Never be satisfied with the status quo. There is always room to improve.
- Have flexibility in your strategic plan. Changes are bound to occur. Have contingency plans.
- Evaluate specific software tools, even small applications, that could be beneficial to your business.
- Involve upper management in selected employee meetings to demonstrate

management's interest in, and understanding of, employee perspectives and to share input on management's perspectives.

- Consider buying used rather than new equipment, but do your homework (establish your required specs, consult specialist as needed, find out the equipment history, etc.).
- Realize the high price of unresolved problems of any type.
- Have a solid "infrastructure" that allows for rapid, accurate handling of routine business activities (for example, billing, accounts receivable, etc.).
- Where possible, use e-mail in the organization.
- Promptly resolve any conflicts and problems within the workforce, and have a formal system for grievances. Keep two-way communication going.
- Consider automation or improved technology, where appropriate. Know when to bring on new technology.
- Realize that upper management will need to be heavily involved in any new major automation project.
- Consider setting an action plan review at least once a month as part of a total face-to-face operations review.
- Set quarterly reviews of operating budgets and goals. Communicate success in meeting or exceeding goals.
- Establish performance standards for all company resources (human and plant & equipment). Update annually.
- Have periodic employee reviews. Discuss not only past performance but develop plans for continued improvement. Encourage constructive dialogue in these sessions.
- Consider termination of any non-productive employees unwilling or unable to change.
- Make available company training programs to increase efficiency and lower unit labor costs.
- Keep track of training needs. Develop ways to identify training requirements and the training that employees have actually received.
- Cross-train employees to the extent practicable to increase operational flexibility.
- Establish a climate of high expectations within the organization. Encourage and expect quality performance.
- Promote from within whenever possible. Have training programs which allow such promotions (along with experience). Employees should have input in their career plans.
- Managers should be encouraged to delegate to allow more time for considering and acting on key issues.
- Perform periodic employee attitude surveys. Remember that labor is likely the largest expense item.
- Remember that people improve what is measured and rewarded.
- Manage the human resources asset--don't just let things "happen".
- Track employee turnover rate trends.
- Review all wage rates. Also take a look at management compensation. Is there anything unusual or out-of-line?
- Reduce the number of meetings by combining them, eliminating unnecessary ones, and always having a written agenda and goal for each meeting.
- You may want to test how well your employees know procedures. It is often assumed that everything is OK when there is actually a need to improve training or procedures.
- In hiring the "right person" consider an initial screening interview, an interview with a supervisor, an interview with peer workers, and aptitude testing (at the minimum).
- Consider medical exams and drug screening before hiring applicants.
- Remember that diversity of opinions in developing new approaches is an asset.
- Continually reinforce in employees the old-fashioned (but appropriate) notion that "time is money". Keep a sense of urgency about getting things done.
- Keep in mind ergonomics and its impact on job performance. All equipment should fit the physical characteristics and needs of the employees.
- Workplace innovation that includes the involvement of employees can

boost productivity significantly. For example, workplace teams have been successful in many firms.

- Make sure managers realize that part of their job is the on-going development of their employees.
- Check if your temporary employment agency offers a guarantee of employee reliability.
- Spot managerial talent by keeping an eye open for employees that consistently deliver more than expected.
- Interview employees who are leaving the firm. They can help pinpoint major problems.
- Recognize that employee attitude is critical to employee performance.
- Two general guidelines for outsourcing: The process/activity cannot be performed effectively in-house, or the process/activity is not core to your business.
- If using outsourcing, make sure objectives are well understood, but give providers room to perform their jobs.
- Use of a "blended workforce" made up of full-time, part-time, temporary workers, and outsourced workers may help control costs and boost productivity.
- To be competitive in hiring good employees, present your total package of salaries, benefits, incentive programs, transportation, child care, flextime, etc.
- Some companies use "job sharing", where two employees each work half-time to do one full job. This can attract part-time workers in tight labor market.
- Research has shown that key motivators include: recognition for outstanding work, adequate break times, good safety/security, and opportunity for challenging work.
- Recycle where possible and practicable.
- Emphasize safety to reduce lost time and insurance premiums.
- Evaluate current marketing strategies and costs. Determine ROI for various programs. Consider (and occasionally try) alternatives, such as

outsourcing the sales effort vs. company direct sales force.

- Computer modeling can often be used to evaluate and improve processes and procedures.
- Use the dual test of necessity and reasonability in amount before making expenditures.
- Negotiate with outside firms on key services you receive.
- Set appropriate limits on what managers can approve without higher authority.
- Consider providing employees with a set of well-explained financial statements that can help them understand what is taking place within the business, and in turn motivate better performance.
- Employees can increase productivity and aid in the management and training of others by providing updates on the latest industry information they have read/studied or trade shows they have attended.
- Payroll expenses should be closely monitored, since it is usually the greatest single business expense.
- A "peak-time pay" system pays a premium wage for regular part-time employees who work during periods when the full-time staff is overburdened. This can allow for fewer full-time employees/benefits and thus reduce payroll expense.
- Consider accepting bids from current employees to complete tasks such as janitorial or maintenance services rather than contracting the work out. It can often be a big savings and the employees may appreciate the opportunity to earn the extra cash.
- Often, expenses can be reduced by having systems set up to catch mistakes in an early manufacturing stage instead of inspecting just the final product.
- Bonus programs that are linked to profitability and efficiency can help in the area of cost control. Employees feel as though the success of the company directly affects their success.
- Short-term incentives (daily, weekly, or monthly) rather than long-term ones can often be more effective at improving morale and productivity.

- Ask employees about operational bottlenecks. They usually know where they are.
- Consider using outside professional consultants for particularly difficult challenges.

### **Sales to fixed assets is at a low level.**

- Evaluate the usage of key depreciable assets. If any are being used only part of the time, consider using them to earn money from outside sources during idle times (certain vehicles or extra space, for example).
- Evaluate the relative contribution to sales by all assets and whether any under-performing assets can be rehabilitated or if they should be replaced.
- Include a full evaluation of all alternatives when planning a capital budget.
- Always evaluate whether a capital investment will increase sales sufficiently to raise the fixed asset turnover rate.
- Require a detailed plan and justification for any major fixed asset purchase.
- Meet with key employees at least once per month to share ideas, update each other, and review operating performance.
- Evaluate the condition of fixed assets each year before developing the capital budget.
- Every company should have key short-term (such as quarterly) sales and operating goals. Have a way to disseminate information on meeting those goals.
- Establish performance standards for all company resources. Identify where resources are not pulling their weight and why.
- Reports should be designed to provide easy-to-understand, yet high quality, information. Reports that provide a mountain of data are useless.
- Always be thinking of ways to leverage the existing asset base to increase sales.
- Keep sales people up-to-date on all new and updated products and policies.
- Have a reward/commission structure which appropriately recognizes top

performance in sales. These are the people that are creating growth in the company.

- Have a well-developed system to follow-up on sales leads, possibly using available inexpensive software packages.
- The people most knowledgeable about the best ways to build sales are likely already working for the company. Conduct routine meetings to share what works and what doesn't.
- Make sure major new equipment purchases are based on actual need rather than one person's opinion. Ideally, the purchase should help support increased sales.
- Analyze the long-term needs and uses of a fixed asset before investing. Consider the advantages of short-term leasing.
- Use promotions to boost sales.
- Carefully monitor and record the performance of each sales promotion and seek to find the reasons for those that are successful.
- Liquidate (if owned) or return (if leased) any unused asset.
- When deciding between different equipment options, make a comparison matrix of key characteristics, benefits, and costs.
- Recognize that accumulated depreciation can have a major influence on this ratio. The ratio may be artificially inflated because major old or obsolete equipment needs to be replaced.
- Records should be kept on all assets that are leased and those that are owned.
- Keep in mind that all assets should help produce revenue. Lavish or super-plush furnishings, for example, is a luxury few can afford.
- Consider renting idle space or equipment to produce revenue.
- Be cautious of "trading up" certain assets currently in use. Always compare the full cost effectiveness of buying new rather than used equipment.
- Activity-based Costing (ABC) methods can identify and ultimately help reduce operating expense and improve asset utilization.
- Recognize the importance of thoroughly teaching employees how to use new technology, software, and equipment. Problems, errors, and possible

avoidance of use can occur otherwise.

- Many analysts favor the discounted cash flow internal rate of return (DCF-ROR) to evaluate competing capital projects. This considers the timing and magnitude of cash flows.
- Have each department keep a "wish list" of major equipment and use it to help develop alternatives for the capital budget.
- Evaluate any surplus or obsolete inventory for a tax-deductible donation.
- Solicit competitive bids before purchasing major new equipment.
- Move out discontinued items quickly. Contact previous buyers and offer a generous discount for large-quantity purchases.
- Determine if any production/distribution inefficiencies are affecting sales.
- Analyze asset base to be sure it is appropriate for optimum product/service mix.
- Properly maintain equipment to get the maximum usage possible from it. Keep maintenance logs for all equipment.
- Sales growth may require increases in current assets. Be sure this process will not threaten cash flow required for normal operations.
- Going through the files and contacting previous customers who have not recently used your products/services can increase business in down times.
- Boost sales by encouraging non-sales employees, through a bonus plan, to pass along names of prospective customers.
- Trade shows usually showcase new equipment that can increase productivity. Assign someone to gather information.

**The company needs to trim its days in accounts receivable.**

- Review existing credit terms and make appropriate adjustments.
- Have a system which can easily "age" accounts. Periodically review all accounts.
- Develop ways to appropriately communicate to delinquent accounts at various points in time (e.g., at 30, 60, 90 days) with increasingly more pressure.

- Find ways of encouraging prompt payment (e.g., small discount, freight discount, or extra product).
- Develop policies on when to ultimately drop major problem accounts. Stick to them.
- Consider using "credit scoring" for different customers to assign them a credit rating (affects their sales and collection treatment).
- Use performance measures to select and monitor outside collection agencies if they are used.
- Also use performance measures for internal collections specialists as a way to motivate, monitor, and reward them.
- Track billing rate errors (errors as a % of total billings to clients).
- Have a truly integrated information system which keeps payment information current. Keeping the information "on-line" and available to order takers can be particularly valuable.
- Prioritize delinquent accounts from collections follow-up and be sure to have sufficient resources for the collections activity.
- Remember that many accounts that are past due are still good customers--avoid making them feel harassed.
- Have well-defined plans for dealing with delinquent accounts (that is, a strategy).
- Keep a ready list of chronic problem accounts, preferably with historical information (and make available to key people). Use this information in negotiating/dealing with customers in the future.
- Recruit and train people who can interact well with all customers and resolve problems.
- Have an easily understood and explained pricing structure. Avoid complex, hard-to-understand invoices.
- Try offering a discount (2-5%) to slow-paying customers to settle up. If that, or even a more generous discount doesn't work, consider retaining an aggressive collection firm.
- Consider selling or factoring your receivables for quick cash, if needed.
- To improve cash flow, coax your customers to buy for cash by offering a

small discount if they pay that way.

- Evaluate the credit that is extended to every customer. Is the customer worthy of risking money on accounts receivable? You may not want to have the same policy for every customer.
- Your credit policies must balance sales and cash flow objectives.
- Look for quality or customer satisfaction problems that customers may be using as a justification for delaying payments.
- Plan for customers' possible seasonal cash flow fluctuations. Some good customers may be slow in paying simply because it is a very slow time of the year for them.
- Insist on credit references for all new customers.
- When appropriate, involve sales reps in collection efforts.
- Use industry credit reports when prioritizing potential sales targets.
- Be very proactive with problem account resolution and solve them as

quickly as possible.

- Set credit limits annually for all customers.
- Consider moving the product/service mix in the direction that appeals to the most valuable credit customers.
- For products, are orders being shipped completely and on schedule? This may affect payment priority for customers.
- Determine if invoices are being sent promptly after shipment.
- Withhold sales commissions, where possible, on delinquent accounts.
- Stress that a good long-term partnership and relationship between a company and its customer is beneficial to both parties.
- Educate the credit/collection staff on how to calculate the effect of longer collection periods on interest costs and cash flow.
- There should be well-defined responsibility for collection of accounts.



**Action Plans  
for City Cycle Company**

**Actions**

**TimeLine**

**Person(s)**

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*customized financial analysis*

## *Detail Financial Analysis*

### **Appendix**

**Definition of Percentiles**

***Definitions for Balance Sheet Items***

***Methodology for Calculating Financial Area Percentiles***

***Summary of Ratio Formulas***

## Definition of Percentiles

Percentiles are a way of expressing where a particular value exists in the total range of ordered data. The minimum value is 1 and the maximum is 99. The percentile shown indicates where a company is for a particular ratio or value in relation to other similar-sized companies in the same industry.

The percentile figure indicates the percentage of companies in the sample that have a less favorable ratio. As an example, a percentile value of 70 would indicate that a firm has a "better" value for that item than 70% of the other comparable firms, but a "worse" value than 30% of them. In some cases, having a higher magnitude ratio value is better (such as the current ratio). In other cases, having a lower magnitude ratio value is preferable (such as days in accounts receivable). In this report it is true that the higher the percentile value, the better.

A value of 50 is defined as the "median", where half of the companies are below that value and half are above. Importantly, the median reduces the effect of very low or high values in the data set compared to just looking at the overall average where a few "unusual" values can distort it.

The percentiles referred to in this report are based upon information from the latest information submitted by companies of similar size in the same industry. Therefore, results for the subject firm are being compared to other similar companies. An algorithm is used to estimate company percentile values based upon the 25th, 50th (median), and 75th percentiles available within the data set.

Balance sheet and income statement information available through RMA are averages of the data provided in the samples. All other financial ratios (with the exception of operating cycle days and trade accounts payable to inventory) have percentile value distributions.

## Definitions for Balance Sheet Items

### Assets

**Cash and equivalents:** Actual cash on hand, balances in bank accounts, checks, bank drafts, money orders, demand deposits, time deposits, bearer bonds, and other near-cash items. It excludes any sinking funds.

**Trade receivables (net):** Amounts claimed against another company or party that arise from the sale of goods or services. It is net of any allowance for doubtful accounts.

**Inventory:** This amount represents costs incurred in the acquisition or production of goods that are held for sale. These costs include raw materials, work-in-process, and finished goods. Note that inventory amounts are usually shown at cost unless the market value is lower than the cost.

**All other current assets:** Amounts that relate to near-term (usually less than one year), excluding the above items, for which the intended benefits to the firm have not been fully realized.

**Total current assets:** The sum of the above listed items. The term "current" usually means that the asset can be liquidated (turned into cash) in less than one year.

**Fixed assets (net):** This item is sometimes referred to as property, plant, and equipment. It includes assets that are not intended for sale, but rather to create the product or service offering. It includes land, buildings, machinery, furniture, fixtures, equipment of all types, and vehicles. Net fixed assets means that it is net of accumulated depreciation, depletion, or amortization.

**Intangibles (net):** Such assets includes goodwill, trademarks, patents, catalogs, brands, copyrights, formulas, franchises, and mailing lists, net of accumulated amortization.

**All other non-current assets:** Any other assets not previously listed above that cannot be liquidated in less than one year.

**Total assets:** The sum of all of the above listed asset items.

### Liabilities

**Notes payable (short-term):** Any short-term note obligations, including bank and commercial paper.

**Current maturity of long-term debt:** The portion of the long-term debt that will need to be paid within the next fiscal year. This figure excludes any trade payables.

**Trade payables:** Total amount owed on open accounts related to the trade of the business.

**Income taxes payable:** The debt that is due to the Internal Revenue Service or other taxing authorities. It includes the current portion of deferred taxes.

**All other current liabilities:** Any current liabilities not listed above. It includes accrued expenses.

**Total current liabilities:** The sum of the above items.

**Long-term debt:** Amounts owed by the company that are due after one year. It includes any bonds, debentures, bank debt, mortgages, deferred portions of long-term, and capital lease obligations.

**Deferred taxes:** Any tax liabilities that are deferred beyond one year.

**All other non-current liabilities:** Any other liabilities and obligations due beyond one year that are not listed above.

**Total liabilities:** The sum of all of the liabilities listed above.

**Equity (Net Worth)**

**Capital stock:** The amount is typically stated at par value of the outstanding stock. For stock that is without par value, it is normally the stated value of the stock as determined by the board of directors.

**Treasury stock:** This is stock that has been issued, reacquired, and not cancelled by the company. It is normally valued at the par value or stated value.

**Paid-in capital:** This measures the amount invested in the company in excess of par or stated value of the stock.

**Retained earnings:** This item represents the cumulative total net profits after taxes of the company since it began operations, minus the cumulative amount of these profits that have been paid in dividends. Negative retained earnings means that the company has not generated a cumulative profit since inception.

**Equity:** This represents the amount equal to total assets minus total liabilities. It is the equity of the shareholders of the company.

**Liabilities and net worth:** The sum of liabilities and equity. It is equal to the total assets of the firm.

## Methodology for Calculating Financial Area Percentiles

In the table provided in the early part of this report, percentiles were provided for each of the financial ratios. These financial ratios were grouped in the following general financial areas:

**Liquidity Ratios**

**Efficiency Ratios**

**Operating Ratios**

**Financing Ratios**

**Profitability Ratios**

The graph in the Key Results section of the report provided "weighted average" percentiles for each of the above financial areas. The methodology is described below.

Weighting factors are applied to each of the ratios. These weighting factors

are somewhat subjective, but based upon a poll of knowledgeable professionals. Simply stated, it is believed that the importance of some of the ratios is greater than for others, therefore they should be given greater weight and consideration. The methodology used does just that. The weighting factors for the financial ratios are stated on a 1-10 basis.

For each of the main financial areas (such as liquidity), the company percentile for each financial ratio was multiplied by the above weighting factors and the sum of the products then divided by the sum of the weighting factors in that area to yield the weighted average percentile.

For example, assume the company's current ratio has a percentile of 35, the quick ratio a percentile of 17, and a working capital to sales percentile of 65. Also assume that the respective weighting factors are 6.9, 6.5, and 7.2. For the overall liquidity score then, the value would be calculated as:

$$(35)(6.9) + (17)(6.5) + (65)(7.2) / (6.9 + 6.5 + 7.2) = 820 / 20.6 = 40$$

Note that a sufficient number of percentile values must be available to determine a meaningful overall weighted average for that financial area.

## Summary of Ratio Formulas

Several ratios are presented in this report. As a quick reference source, below are the calculations used for each of the ratios.

### Liquidity Ratios

#### Current ratio

Current assets / current liabilities

#### Quick ratio

(Current assets - inventory) / current liabilities

#### Working capital to sales (%)

[(Current assets - current liabilities) / sales] X 100%

### Efficiency Ratios

#### Days in accounts receivable

Accounts receivable / (sales / 365 days)

#### Days in accounts payable

Accounts payable / (cost of sales / 365 days)

#### Annual inventory turnover

Cost of sales / inventory

#### Days in inventory

365 days / annual inventory turnover

#### Operating cycle

Days in inventory + days in accounts receivable

### Operating Ratios

#### Asset turnover

Annual net sales / total assets

#### Sales to net fixed assets

Annual net sales / net fixed assets

#### Sales to working capital

Annual net sales / (current assets - current liabilities)

### Financing Ratios

#### Debt to equity

Total liabilities / equity

#### Cash flow to current LTD

(Net profit + depr. & amort.) / current portion of long-term debt

#### Times interest earned

(Net profit + interest) / interest

#### Net fixed assets to equity

Net fixed assets / equity Total assets / equity

#### Financial Leverage Trade AP to Inventory

Trade accounts payable / inventory

### Profitability Ratios

#### Return on sales

(Net profit / annual net sales) X 100%

#### Return on equity (net worth)

(Net profit / equity) X 100%

#### Return on assets

(Net profit / total assets) X 100%

Note that all net profit figures used in this report and the formulas above are "before tax".

