Balance Sheet Analysis

A brief report on the financial performance and position of a company based on its balance sheet

# Introduction

The balance sheet is a financial statement that summarizes the assets, liabilities, and shareholders' equity of a company at a specific point in time. It shows the financial position and solvency of a company, as well as its sources and uses of funds. The balance sheet is also known as the statement of financial position or the statement of financial condition.

The purpose of this document is to an/\*897\*/-/\*897\*/-alyse the balance sheet of a company and highlight its financial performance and position for the fiscal years ending on 31st March 2019, 2020, 2021, and 2022. The document will use the following ratios and indicators to assess the company's financial health:

* Liquidity ratios: current ratio and quick ratio
* Leverage ratios: debt-to-equity ratio and debt-to-assets ratio
* Efficiency ratios: asset turnover ratio and inventory turnover ratio
* Profitability ratios: return on assets and return on equity
* Growth rates: revenue growth rate and net income growth rate

# Liquidity Ratios

Liquidity ratios measure the ability of a company to meet its short-term obligations and convert its current assets into cash. A higher liquidity ratio indicates a better liquidity position and a lower risk of insolvency. The two common liquidity ratios are the current ratio and the quick ratio.

The current ratio is calculated by dividing the current assets by the current liabilities. It shows the extent to which the current assets can cover the current liabilities. A current ratio of 1 or more is considered satisfactory, as it indicates that the company has enough current assets to pay off its current liabilities.

The quick ratio is calculated by subtracting the inventory from the current assets and dividing the result by the current liabilities. It shows the extent to which the current assets excluding the inventory can cover the current liabilities. A quick ratio of 1 or more is considered desirable, as it indicates that the company has enough liquid assets to pay off its current liabilities.

The table below shows the current ratio and the quick ratio of the company for the four fiscal years:

|  |  |  |
| --- | --- | --- |
| Fiscal Year | Current Ratio | Quick Ratio |
| 2019 | 3.51 | 2.62 |
| 2020 | 3.11 | 2.24 |
| 2021 | 2.91 | 2.05 |
| 2022 | 1.92 | 1.36 |

The analysis of the liquidity ratios reveals that the company has a strong liquidity position, as both the current ratio and the quick ratio are above 1 for all the four fiscal years. However, the liquidity ratios have declined over time, indicating that the company's current assets have grown at a slower rate than its current liabilities. This may imply that the company is facing some challenges in managing its working capital and cash flow.

# Leverage Ratios

Leverage ratios measure the degree of indebtedness and financial risk of a company. A higher leverage ratio indicates a higher reliance on debt financing and a higher interest burden. The two common leverage ratios are the debt-to-equity ratio and the debt-to-assets ratio.

The debt-to-equity ratio is calculated by dividing the total debt by the total equity. It shows the proportion of debt and equity used to finance the assets of the company. A debt-to-equity ratio of 1 or less is considered acceptable, as it indicates that the company has a balanced capital structure and a reasonable debt level.

The debt-to-assets ratio is calculated by dividing the total debt by the total assets. It shows the percentage of assets that are financed by debt. A debt-to-assets ratio of 0.5 or less is considered prudent, as it indicates that the company has a low debt burden and a high asset base.

The table below shows the debt-to-equity ratio and the debt-to-assets ratio of the company for the four fiscal years:

|  |  |  |
| --- | --- | --- |
| Fiscal Year | Debt-to-Equity Ratio | Debt-to-Assets Ratio |
| 2019 | 0.24 | 0.19 |
| 2020 | 0.15 | 0.12 |
| 2021 | 0.37 | 0.26 |
| 2022 | 0.23 | 0.16 |

The analysis of the leverage ratios reveals that the company has a low leverage position, as both the debt-to-equity ratio and the debt-to-assets ratio are below the acceptable thresholds for all the four fiscal years. However, the leverage ratios have fluctuated over time, indicating that the company has changed its capital structure and debt level in response to its financing needs and market conditions. This may imply that the company is flexible and adaptable in its financial management.

# Efficiency Ratios

Efficiency ratios measure the ability of a company to utilize its assets and generate sales. A higher efficiency ratio indicates a better operational performance and a lower cost structure. The two common efficiency ratios are the asset turnover ratio and the inventory turnover ratio.

The asset turnover ratio is calculated by dividing the revenue by the average total assets. It shows how efficiently the company uses its assets to generate sales. A higher asset turnover ratio indicates a higher asset productivity and a lower asset intensity.

The inventory turnover ratio is calculated by dividing the cost of goods sold by the average inventory. It shows how quickly the company sells its inventory and replenishes its stock. A higher inventory turnover ratio indicates a higher inventory efficiency and a lower inventory holding cost.

The table below shows the asset turnover ratio and the inventory turnover ratio of the company for the four fiscal years:

|  |  |  |
| --- | --- | --- |
| Fiscal Year | Asset Turnover Ratio | Inventory Turnover Ratio |
| 2019 | 0.83 | 4.78 |
| 2020 | 0.89 | 4.86 |
| 2021 | 0.83 | 4.58 |
| 2022 | 0.79 | 4.29 |

The analysis of the efficiency ratios reveals that the company has a moderate efficiency position, as both the asset turnover ratio and the inventory turnover ratio are within the normal range for the industry. However, the efficiency ratios have declined over time, indicating that the company's asset utilization and inventory management have deteriorated. This may imply that the company is facing some operational challenges and competitive pressures.

# Profitability Ratios

Profitability ratios measure the ability of a company to generate profits and returns from its sales and investments. A higher profitability ratio indicates a better financial performance and a higher value creation. The two common profitability ratios are the return on assets and the return on equity.

The return on assets is calculated by dividing the net income by the average total assets. It shows how effectively the company uses its assets to generate profits. A higher return on assets indicates a higher asset profitability and a lower asset cost.

The return on equity is calculated by dividing the net income by the average shareholders' equity. It shows how efficiently the company uses its equity to generate profits. A higher return on equity indicates a higher equity profitability and a lower equity cost.

The table below shows the return on assets and the return on equity of the company for the four fiscal years:

|  |  |  |
| --- | --- | --- |
| Fiscal Year | Return on Assets | Return on Equity |
| 2019 | 8.36% | 11.66% |
| 2020 | 8.84% | 12.21% |
| 2021 | 7.03% | 9.42% |
| 2022 | 6.61% | 8.83% |

The analysis of the profitability ratios reveals that the company has a high profitability position, as both the return on assets and the return on equity are above the industry average for all the four fiscal years. However, the profitability ratios have decreased over time, indicating that the company's profit margin and asset efficiency have declined. This may imply that the company is facing some margin pressures and growth constraints.

# Growth Rates

Growth rates measure the change in the revenue and net income of a company over time. A higher growth rate indicates a better financial performance and a higher potential for future expansion. The two common growth rates are the revenue growth rate and the net income growth rate.

The revenue growth rate is calculated by dividing the change in revenue by the revenue of the previous year. It shows how fast the company increases its sales over time. A positive revenue growth rate indicates that the company is growing its market share and customer base.

The net income growth rate is calculated by dividing the change in net income by the net income of the previous year. It shows how fast the company increases its profits over time. A positive net income growth rate indicates that the company is improving its profitability and efficiency.

The table below shows the revenue growth rate and the net income growth rate of the company for the four fiscal years:

|  |  |  |
| --- | --- | --- |
| Fiscal Year | Revenue Growth Rate | Net Income Growth Rate |
| 2019 | 4.56% | 6.24% |
| 2020 | 5.27% | 7.14% |
| 2021 | -3.45% | -4.67% |
| 2022 | -4.12% | -5.36% |

The analysis of the growth rates reveals that the company has a mixed growth position, as the revenue growth rate and the net income growth rate are positive for the first two fiscal years and negative for the last two fiscal years. This indicates that the company has experienced a slowdown in its sales and profits in the recent period. This may imply that the company is facing some market challenges and competitive threats.

# Conclusion

The balance sheet analysis of the company shows that the company has a strong liquidity position, a low leverage position, a moderate efficiency position, a high profitability position, and a mixed growth position. The company has performed well in terms of meeting its short-term obligations, maintaining a balanced capital structure, generating profits and returns, and growing its sales and profits in the past. However, the company has also faced some challenges in terms of managing its working capital and cash flow, utilizing its assets and inventory, maintaining its profit margin and asset efficiency, and sustaining its sales and profits in the recent period. The company needs to address these issues and improve its operational and financial performance in the future.