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Homework 3

Question 1:

Ratios		
	2011	2010
Profitability Ratios		
Profit Margin	0.13	0.05
Return on Assets	0.15	0.06
Return on Equity	0.19	0.07
Liquidity Ratios		
Current Ratio	5.20	3.22
Quick Ratio	2.25	1.87
Average Days Receivable	27.38	58.40
Average Days Inventory	165.65	107.76
Asset Management Ratios		
Asset Turnover	1.16	1.15
Fixed-Asset Turnover	2.94	2.68
Long-Term Solvency Ratios		
Debt-Equity Ratio	0.30	0.21
Leverage	1.30	1.21
Long-Term Debt-Equity	0.15	0.00
Debt-Service Coverage	20.47	22.25
Times-Interest-Earned	14.16	10.38

Question 2:

- Profit margin tells us how much of each dollar received in revenue becomes net income. Due to the relatively low profit margin of EDI, we can assume that they operate in an industry with a commodity-like product, relying on a high volume of sales relative to assets. The increase from 2010 to 2011 shows improvement on EDI's end.
- Return on assets measures the ability of EDI to use its assets to earn profits. EDI's average to high ROA in both years shows that EDI can replace its assets under conditions of inflation, implying stability. The increase in ROA between years shows that EDI is even improving in this regard.
- Return on equity allows investors to compare earnings on their investment in one company to others. EDI seems to be holding an average ROE over 2010 and 2011, making them somewhat appealing for investment.
- Current ratio measures the ratio of a company's current assets to current liabilities. EDI's is high in 2010 and very high in 2011 compared to the 2.0 figure stated in the reading. This implies that EDI may not be making the most out of its assets, as assets counted as current assets aren't directly making money.
- The quick ratio is like the current ratio, but eliminates current assets that may not be readily convertible into cash. EDI has high quick ratios, which have the same pitfalls as having a high current ratio, but it shows that the organization will easily be able to meet its current liabilities when they're due.
- Average days receivable tells us how quickly EDI is collecting its accounts receivable. This ratio tells us how often customers abide by the company's expectations on average. EDI seems to have a high average days receivable in 2010, which decreases to around average in 2011, which makes their assets appear more liquid.
- Average days inventory tells us how often EDI's inventory takes to be sold on average. EDI's inventory seems to take around ⅓ - ½ of a year to sell, which is a very long period of time. This seems to conflict with the information gotten from the profit margin, as this implies EDI doesn't have a high volume of sales.
- Asset turnover tells us how many dollars of revenue EDI has earned for each dollar invested into assets. EDI's asset turnover seems to be very high for a company that is presumably in the utilities sector. This matches with the balance sheet, as EDI has more current assets than fixed assets, implying that their asset base is used up many times a year.
- Fixed-asset turnover allows us to assess the relative productivity of new plant and equipment, compared to those that are highly depreciated. EDI's high and rising fixed-asset turnover numbers tell us that the company's fixed assets are relatively productive, including when compared to past performance.

- The debt-equity ratio tells us about EDI's leverage. EDI's debt-equity ratio increasing from 2010 to 2011 tells us that they are relying more on debt relative to equity.
- Leverage is the same as the debt-equity ratio plus 1 and, therefore, provides the same information as the debt-equity ratio.
- Long-term debt-equity reveals the extent to which an organization is relying increasingly on long-term debt to finance asset acquisition. In 2010, EDI didn't rely on any long-term debt to finance asset acquisition but this changed in 2011 with the added bonds payable. This shows an increased reliance on long-term debt, which EDI should be wary of.
- Debt service coverage provides an indication of the extent to which debt obligations are covered by available cash. The high values of EDI's debt service coverage are promising and show that the company doesn't need to be too worried about its debts, as they are well covered by their available cash.
- Times-interest-earned is similar to debt-service coverage, however, it doesn't take principal into account, and can therefore be misleading. The general information that it gives us, however, is similar to that of debt service coverage.

Question 3:

What additional information would you like to have about EDI to better analyze its financial statements?

It would be helpful if we can have the company's balance sheets and income statements for years before 2010 so that we can measure the previous 14 ratios and understand whether the trends are temporary changes or continuous market tendencies. Moreover, additional historical trends and data could very well give more insight on whether the 2010 and 2011 balance sheets and income statements have newfound growth or that this is simply the typical trend that the company has been undergoing.

Cash flow statements of the company can also give more detail on the company's assets, liabilities, and equity as opposed to larger overarching statements or categories. Leverage and role of profit are also needed to draw better conclusions from the company. Leverage will reveal whether EDI holds a certain amount of financial risk in respect to the overall business risk. Additionally, higher business risk would otherwise discredit some of the aspects of the cash flow due to reflecting a higher degree of uncertainty in the numbers.