Financial analysis report for Acton Cleaning

Introduction

This report is provided for Emma in terms of Acton Cleaning which is a service business starting from 1st July 2020. This report will discuss and compare the business after this first month of operations between Acton Cleaning and the cleaning industry average level from three perspectives including profitability, liquidity and financial position. In order to be capable of achieving more precise comparison, it is imperative to calculate five separate ratios: current ratio, debt-to-equity Ratio, debt-to-assets ratio, profit margin and rate of return on total asset.

Profitability Analysis

In light of profitability, there are two ratios will be measured, profit margin and rate of return on total asset. Van den Berg, Van Marrewijk and Tamminen (2018) point out that profit margin refers to a profitability ratio which enables to measure the degree of a company or a business activity making money. As the cleaning industry average is 0.8, which is significantly higher than 0.34, the profit margin of Acton Cleaning. Thus, it represents that compared with total revenue produced by company, the proportion of net profit is small, which means probably due to the company's incomplete management system or inefficient operation mode, the company's profitability is relatively low compared with the average level of the cleaning industry. Precisely predicting the company's future sales situation exerts a profound influence for company's development and profitability, however, accomplishing this goal requires a wealth of valuable information to support (Cheng, Chu, & Ohlson 2020). Therefore, for Acton Cleaning, it is vital to collect information so that the management is capable of making corresponding measure and adjustments. Thus, the profitability of Acton Cleaning will increase accordingly.

In terms of rate of return on total asset, according to Selling and Stickney (2018), the return on total assets ratio is an significant measure of profitability for a business since it illustrates how effectively a company is using its asset to generate earnings. Based on this case, Acton Cleaning’s rate of return on total asset shows 0.296, which is slightly lower than the cleaning industry average (0.35). Being similar to profit margin, this ratio indicates the amount of net financial and operational profit a company receives in a financial year as compared to the company's total assets. Hence, in order to increase the rate of return on total asset, Acton Cleaning ought to decrease overinvesting on assets and increase net profit, which enables the company can take full advantage of the value of assets and attract more investment to improve profitability (Selling & Stickney 2018).

Liquidity

The current ratio is a kind of index to reflect the if a company has ability to pay short-term debts(Alarussi & Alhaderi 2018). Acton Cleaning has a higher current ratio(9.27) than the industry average(2.00), which suggest that this company has potential to pay short-term debts. Either too high current ratio or too low current ratio(less than 1) is not a good phenomenon. Relatively high current ratio indicates that Acton Cleaning exist the problem of not effectively using its' current assets, which might influence its' profitability(Pordea, David & Mateș 2020). Acton Cleaning could appropriately reduce its' current ratio through consume some cash in field such as advertising, upgrade cleaning equipment, etc.

Financial position

Debt-to-equity ratio measures the extent to which a company finances its operations through debt relative to a sole proprietorship fund, in part, it reflects the company's ability to repay all outstanding debt in the event of a downturn in business (Liu 2005). If a company's debt-to-equity ratio continues to grow, it means an increase in common equity risk (Khadafi, Heikal & Ummah 2014). Khadafi, Heikal and Ummah (2014) stated that DER can be used to measure the risk of a company's common stock, when the risk is unknown or cannot be calculated from the information. Often a high ratio represents a high risk, meaning that the company has been actively financing its growth through debt. The average debt-to-equity ratio of industry is 0.50, but the ratio of Acton Cleaning company is only 0.09, which is much lower than the average ratio, so Acton Cleaning company has lower risk, and it invests a lot of debt in growth financing which will generate more profits. Due to 0.09 is much less than 1, so total liabilities are much less than total equities.

Debt-to-asset ratio is a measure of a company's financial leverage, and it shows the percentage of a company's total assets financed by creditors (Khawaja 2018). Generally, the balance sheet is used to analyze how the company acquires assets over time. The higher the ratio, the greater the financial risk (WELCH 2011). Through the information provided, we know that the industry average debt-to-assets ratio is 0.30, Acton Cleaning company's ratio is 0.08, which is much lower than the average ratio. It means that Acton Cleaning company's total liabilities are much less than total assets and the ability to prevent the risk of is very strong, much stronger than the average ability of the entire industry.

Conclusion

In conclusion, Acton Cleaning company’s current ratio is higher than the industry average, debt-to-equity ratio and debt-to-assets ratio is lower than the industry average. These data show that Acton Cleaning company has more assets and less liabilities, so the risk is low. However, profit margin and rate of return on total assets are both lower than the industry average, this shows that the net profit is lower than average net profit, it indicates that Acton Cleaning company is not well managed. The company needs to find out the reason of low profit as soon as possible and correct it as soon as possible in order to operate for a longer time.

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