

Financial Analysis

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To

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Abstract

North Company and South Company's financial data were analysed in the present research. There are various metrics to consider when comparing these two companies: current ratio, the current ratio, inventory turnover, the quick ratio, account receivable turnover, and the operational cycle. The paper's second goal is to demonstrate how to calculate ratios (for both companies along with a brief analysis of the ratios). Both firms' performance will be analysed to determine which is the most lucrative. Investors may then choose whether a firm is a better choice for their money by concluding their findings.

Dedication

I would like to dedicate my term paper to my family. I appreciate the countless amount of support that they have provided me with. I appreciate the amount of effort that they have demonstrated to me throughout this semester and for always have encourage words that make me keep going.

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Thank you!!!

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Executive summary

This paper aims to analyse North Co. and South Co. businesses' financial ratios to understand better their ability to pay debts. North Company has better working capital. The shorter the operational cycle, from the perspective of a short-term creditor, the greater the quality of the borrower's working capital. South Co.'s operational cycle is shorter than North Co.'s. South Co.'s operational cycle is 78 days shorter than North Co.'s. As a result, South Co. can transform its current assets into cash faster than import incorporations. The financial ratios in this research are relevant for benchmarking reasons when comparing a firm to its industry. According to the study's findings, North Co. has a more significant working capital and current ratio than South Company. When it comes to inventory turnover and the average number of days it takes to turn over inventory, South Company has a higher quick ratio. As a consumer, you need to know which North Co. and South Co. businesses are doing well financially.

WORKING CAPITAL

	North Co.	South Co.
Working capital =	Current Assets - Current Liabilities	Current Assets - Current Liabilities
Current assets =	(Cash + Account Receivables + Inventory) (24,000 + 120,000 + 335,000)	Cash + Account Receivables + Inventory (35,000 + 70,000 + 80,000)
Current assets =	479,000	185,000
Working capital =	479,000 – 150,000	185,000 – 70,000
Working capital =	329,000	115,000

After adding the cash, the account receivable, and the inventory the amount of assets for each company was determined. Then, I subtracted the current liabilities of each company from the current assets that they both have and by doing this I was able to find the amount each company has for working capital.

CURRENT RATIO

	North Co.	South Co.
Current ratio =	Current assets / Liabilities	Current assets / Liabilities
	479,000 / 150,000	185,000 / 70,000
Current ratio =	3.19	2.64

Current ratio is the company's ability in paying short-term obligations using its current assets. To obtain the current ratio of both companies, current assets had been divided by the current liabilities of each company.

QUICK RATIO

	North co.	South co.
Quick ratio =	Quick assets / current liabilities	Quick assets / current liabilities
Quick assets=	Cash + account receivable	Cash + account receivable
Quick assets=	24,000 + 120,000	35,000 + 70,000
Total quick assets =	144,000	105,000
Quick ratio =	144,000 / 150,000	105,000 / 70,000
Quick ratio =	0.96 = 1	1.5 = 2

Quick assets are the current assets as reduced by inventories and prepaid expenses and these can be determined by dividing the quick assets with current liabilities. In this case, I had to find the quick assets first by adding the amount of cash each company has with the balance of the account receivable of each company.

**NUMBER OF TIMES INVENTORY TURNED OVER DURING THE YEAR AND
THE AVERAGE NUMBER OF DAYS REQUIRED TO TURN OVER
INVENTORY**

	NORTH CO.	SOUTH CO.
Number of times inventory turned over during the year =	Cost of Goods sold / Inventory	Cost of Goods sold / Inventory
=	840,000 / 335,000	412,000 / 80,000
Number of times inventory turned over during the year	2.5	5.15
	NORTH CO.	SOUTH CO.
The average number of days required to turn over inventory =	Number of days / Number of times	Number of days / Number of times
	365 / 2.5	365 / 5.15
The average number of days required to turn over inventory	146 days	71 days

To determine the number of times inventory turned over during the year ratio I had to divide the cost of goods sold by the inventory of each of the company. However, to determine the average number of days required to turn over inventory I had to divide the number of days by the number of times inventory turned over during the year for each company.

Running Head: NORTH CO. & SOUTH CO.

**NUMBER OF TIMES ACCOUNT RECEIVABLE TURNED OVER DURING THE YEAR
AND THE AVERAGE NUMBER OF DAYS REQUIRED TO TURN OVER ACCOUNT
RECEIVABLE.**

	NORTH CO.	SOUTH CO.
Number of times account receivable turned over during the year =	Credit sales / account receivable	Credit sales / account receivable
=	960,000 / 120,000	595,000 / 70,000
Number of times account receivable turned over during the year =	8 times	8.5 times
The average number of days required to turn over account receivable =	365 days / Number of times account receivable turned over during the year	365 days / Number of times account receivable turned over during the year
	365 / 8	365 / 8.5
The average number of days required to turn over account receivable =	46 days	43 days

To determine the number of times account receivable turned over during the year I had to divide the credit sales by the account receivable of each of the company. But, to determine the average number of days required to collect accounts, I had to divide the number of days which were 365 days, by the number of times account receivable turned over during the year.

OPERATING CYCLE.

	North Co.	South Co.
Operating cycle =	365 / (COGS / average inventory) + 365 / (credit sales / average accounts receivable)	365 / (COGS / average inventory) + 365 / (credit sales / average accounts receivable)
	$365 / (840,000 / 335,000) = 2.5$ $365 / 2.5 = 146 +$ $365 / (960,000 / 120,000) = 8$ $= 45.6$ $146 + 45.6 = 191.6 = 192$	$365 / (412,000 / 80,000) = 5.15$ $365 / 5.15 = 70.8 = 71 +$ $365 / (595,000 / 70,000) = 8.5$ $365 / 8.5 = 42.9 = 43$ $71 + 43 = 114$
	192 days	114 days

Operating cycle is the period in which the complete operations of producing a finished product are made. To determine the operating cycle, I had to add the average number of days required to turn over inventory plus the number of times account receivable turned over during the year.

Viewpoint of a short-term creditor

From the viewpoint of a short-term creditor, I would prefer to sell 50,000 in goods on account on 30 days credit period to South Co. because the shorter the operating cycle, the higher the quality of the borrower's working capital. North Co. has a larger dollar amount of working capital and a higher current ratio. Whereas the South Co. has the higher quality working capital because quality working capital will depend on the current assets involving the working capital and the length of time required to convert these assets into cash. Therefore, North Co. can sell its inventory and collect its receivable more quickly than South Co. because North Co. only requires 2.5 days selling its inventory while South Co. requires 5.15 days. However, the operating cycle for South Co. is 78 days shorter than for North Co. Thus, South Co. was able to convert its current assets into cash more quickly than North Co.

Results Analysis

South Company's quick ratio measures the organization's capacity to pay its present creditors without liquidating its inventory or acquiring additional financing. Having a higher quick ratio result indicates that the company's liquidity and financial health are superior to North Company which has a lower ratio.

An organization's inventory turnover is the number of times it can replace the inventory it has sold in a particular period (Altman, 2018). This means North Company has a sluggish turnover rate

Running Head: NORTH CO. & SOUTH CO.

since it has the least inventory quantity, whereas a quicker turnover rate suggests great sales or inadequate inventory.

As a measure of a firm's liquidity and asset usage, the operational cycle length indicates a company's profitability. The longer operational cycle of the North Company needs a greater return on sales to compensate for the higher opportunity cost of the cash held in inventory and receivables.

Conclusion

Looking at South Co. rationally, a shorter operating cycle indicates better working capital quality. Compared to North Co., South Co. has a much shorter operational cycle. Thus, South Co.'s working capital is of more outstanding quality. Compared to North Co., South Co.'s operational cycle is 78 days shorter. As a result, South Co. can turn its current assets into cash and pay off its short-term liabilities more rapidly than North Co.

References

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