



FFION LIMITED RATIO ANALYSIS

Financial Management for the Hotel Industry



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Executive summary

The aim of this report is to analyse the financial reports and to underline the game play that the financial data has within a company. It is essential to be known that there are important aspects regarding the key-elements of a performance which is needed to be driven in an uprising direction. The environment plays its part too in an organization, but the financial data could raise different question over the trends of the company.

In other words to be said, this report undertakes analysis for the Ffion Limited, a company in which the profitability, liquidity and gearing are put under a spectre of analyzation. The performance will be measured and compared between the 2017 and 2018 data. Further analysis will be taken in order to suggest a positive performance in the next years.

Introduction

The purpose of this report is to analyse the fluctuation, trends of Ffion Limited on a two year period. However, a clear conclusion could be given if there are more than 5 years of analysis in order to give a better perspective. The game that a ratio analysis plays within a company, enables the organization to check whether the situation is in a positive situation or not. The calculation of ratios, in a complex manner, would lead the organization into taking decision based on the previous years' results. Under these circumstances, it is most likely to predict a future on a long term trend diagram. However, the last two years of the company's reports may show unclear data.

As hotels cannot rely on financial data, it is also necessary to take into consideration the external factors represented by the PESTLE analysis and Porter's 5 forces analysis. However, the purpose of the report is to put under a spectre of analysis the spreadsheets of the company's last 2 years of development and results and draw a conclusion upon the whole analysis of the financial data. The investments, however, could be controlled based on the recent acquisitions/debts etc. (Kirli, 2016)

The hospitality industry is an important and leading industry which contributes to the economy, but the key players are the managers of the hotels who know how to take decisions. The cost and management decisions are a challenge in this sector, but it is a market strength when it comes to promoting the success of the industry. (Briciu & Scorte, 2012) Thus, in a context of evaluation of the profit and loss account of Ffion Limited, there is a large perspective which could be analysed formed by eleven elements described in the next section.

Financial analysis

	2017	2018
Gross profit	$(2100/9000)*100 = \mathbf{23.3}$	$(1850/9500)*100 = \mathbf{19.47}$
Net profit	$(623/9000)*100 = \mathbf{6.92}$	$(307/9500)*100 = \mathbf{3.23}$
ROCE	$(623+10)/2684*100 = \mathbf{25.58}$	$(307+9)/3014*100 = \mathbf{10.48}$
Total Assets Turnover	$9000/2684 = \mathbf{3.35 \text{ times}}$	$9500/3014 = \mathbf{3.15 \text{ times}}$
Working Capital Turnover	$9000/984 = \mathbf{9.15}$	$9500/1264 = \mathbf{7.52}$
Current ratio	$1839/855 = \mathbf{2.15}$	$2152/888 = \mathbf{1.58}$
Quick ratio	$(1839-700)/855 = \mathbf{2.15}$	$(2152-750)/888 = \mathbf{1.58}$
Debtor days	$(649*365)/9000 = \mathbf{26.32}$	$(870*365)/9500 = \mathbf{33.43}$
Creditor days	$(660*365)/6500 = \mathbf{37.06}$	$(690*365)/7700 = \mathbf{32.71}$
Debt ratio	$(855+150)/(1839+1700) = \mathbf{0.28}$	$(888+150)/(2152+1750) = \mathbf{0.27}$
Interest cover	$(623+10)/10 = \mathbf{63.3}$	$(307+9)/9 = \mathbf{35.1}$

Financial analysis trends

Financial analysis trends could be developed through the profitability, liquidity and gearing sections discussed further in an in-depth manner.

Profitability

Generating a profit is the main goal of any company. Basically, the profit of any company stands for the amount of money made by the organization in time. (Rutkowska-Ziarko, 2015) The profitability is represented by the gross profit margin, net profit, return on capital employed (ROCE) etc. Each of these terms will be discussed and compared throughout the reports of years 2017 and 2018 given. The said before, the occupancy rate of a hotel may differ because of external forces as there are fluctuations which are dependable on the seasonality or on the legislative/political issues. "Profitability is an economic category of expressing business financial performance. Achieving profitability is, in fact, reaching the first level of performance of a business." (Bondoc & Dumitru, 2018, p. 169) Thus, Ffion Limited is keen to achieve a positive profitability in the future years.

As seen from the financial data spreadsheet, the gross profit is 23.3 in 2017 and 19.47 in 2018. The gross profit is represented by the profit after the deductions of costs associated with the services of the hotel. Another definition would be that the gross profit is calculated from the cost of services provided subtracted from the revenue. (Investopedia, 2019) The gross profit is usually resulted from the 'input value' from the Value Chain diagram. The input values considered within a hotel are the direct labour (staff delivering the services), materials used (different products bought by the company to ensure a smooth running of the company), fees of the credit card payments (variable factor) etc. The difference between the years is a decrease and this decrease could be registered because of a change in internal processes which made the company lose percentages of gross profit. These internal processes could be identified as a raise in wages rate for an example. However, the report of an internal operations processes could be undertaken in order to have a better understanding of the fall of the gross profit in 2018 compared to 2017. The net profit is defined as a profitability ratio which is obtained by the subtraction of the expenses from the gross profit. (Patriot software, 2018) However, it is associated and explained within the context of the gross profit. In other words, the net profit depends on the gross profit.

“The ROCE can be deconstructed into its constituent elements and into the well-known ‘pyramid of ratios’” (Andersson et al., 2006, p.25) (Figure 1) Thus, the

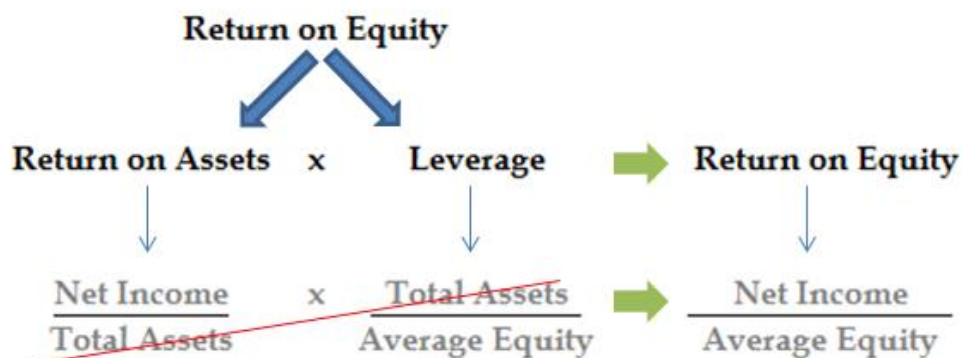


Figure 1: DuPont model, ROE

return on capital employed could be described as how efficiently the money of the business are used in order to generate a bigger amount of money. After an analyzation taken on the financial data given, the ROCE for 2017 was 25.58, whereas in 2018 it was 10.48. This difference is caused by the net profit of the year mostly and the total assets less current liabilities. For a better understanding, the ration need to be as big as possible to show a good use of resources of the hotel. In order to have this, the net profit should be as big as possible, whereas the liabilities (obligations of a business whether they are financial or not). The reason for the wall will not be inspected, however, it could be generated as said before from an internal inspection. The bigger the percentage is, the greater the company is doing. Ffion could, for example, compare their ROCE to other companies' ROCE in order to determine how useful they are using their resources in order to generate profit.

The total assets turnover is put into light by the sales generated and the total assets less current liabilities. “This indicator is a financial performance ratio that measures a company’s ability to generate sales from its assets. This variable also contributes to the explanation of the industry factor for the research model as each industry has a different total asset turnover.” (Nguyen et al, 2019, p.311) The assets could be various and some examples within a hospitality industry could be: the hotel itself, the equipment, furniture, food etc. (Xotels, n.d.) These items could either appreciate or depreciate in time. This is why it is important to keep the track of the value of the hotel.

The working capital turnover, represented in the financial spreadsheet by 9.15 in 2017 and 7.52 in 2018, has met a fall in the number too. This element is symbolized by the sales and the net current assets. In a broader explanation, the definition could be how well the hotel is using its own resources to generate sales. A high percentage would represent that the management of assets is extremely efficient. Again, in this case as big is the percentage, as well the company manages to have a big profitability. Even though the sales were higher in 2018 than in 2017,

the net current assets was higher. Therefore, the assets were not used at their previous-year's capacity.

Liquidity

Liquidity ratios involve the hotel to measure its capability to generate cash quickly to pay the debts. An acceptable ratio would be 1.5. "Liquidity ratios are an important class of financial metrics used to determine a debtor's ability to pay off current debt obligations without raising external capital. Liquidity ratios measure a company's ability to pay debt obligations and its margin of safety through the calculation of metrics including the current ratio, quick ratio, and operating cash flow ratio." (Investopedia, 2019) As the fall continues, the hotel is registered a decrease of the ratio in 2018, 1.58, compared to 2017, 2.15. The cash in hand and the closing stock together with the bank overdraft is taken into consideration to measure the quick ratio which is also lower in 2018 than in 2017. The debtors have been increased and the stocks as well. Therefore, the capability of the hotel to pay back the debts is lower. The debtor days have been increased from 26.32 days to 33.43 days (7 days, a full week) whereas the creditor days were lowered. The creditor days are measured by the trade creditors (690), number of days in one year and the purchases made which was increased as well from the previous year. "The terms 'creditor days' and 'debtor days' describe the average number of days a company allows to pass before its creditors are paid, and the average number of days that pass before its debtors pay. They are also called 'accounts receivable days'." (CBS News, 2007)

Gearing

"Firms with low debt and high equity can increase their gearing level by issuing more debt for future growth." (Tsai et al, 2011, p. 951) The business performance could be measured, then, in the context of how the Ffion is capable of financing itself either through debts (borrowing) or through shareholders (equity). The proportion of borrowing or equity needs to be understood in order to ensure credibility of the company. The debt ratio is defined by the formula of total debts (855+150, liabilities in 2017) and the total assets (current assets and fixed ones, 1839+1700 in 2017). As the debt ratio has decreased, it could mean for the hotel that the hotel is much more eligible to receive loans with lower interests.

Knowledge from Ratio Analysis

An understanding of ratios is needed within any company in order to identify the issues in a higher pace from the trends and analysis rather than struggling later. "Ratio analysis compares line-item data from a company's financial statements to reveal insights regarding profitability, liquidity, operational efficiency, and solvency. Ratio analysis can be used to look at trends over time for one company or to compare companies within an industry or sector." (Investopedia, 2019) The ratio analysis enables the manager and decision makers to have a better understanding of the situation of a company and to make immediate changes based on the financial data. Even though that the data is shown in the spreadsheets, the causes may vary and more investigation such as PESTEL, SWOT etc. analyses could be undergone in order to identify the internal and external issues of the data generated.

Benefits and limitations of the Ratio Analysis

The forecasting is the main benefit of the ratio analysis. More, a diagram which could be shown to the managers or to the decision makers could be designed using the data and could offer a wider range of options if the issues are identified faster. If there are publications of the reports of other competitors, Ffion Limited could benefit from this by checking whether they were progressing or not in the run of leading. Other benefits might be understanding better the customers' needs, having an increased risk awareness, improved flexibility, reducing costs and increase the profit of a company (Infogram, n.d.)

The financial health of a company is limited through some facts which are: the incapacity to measure the financial data from a company within an industry with one from other industry. Furthermore, as it is only data, the qualitative aspects is negligible and could not be assessed. The ratio analysis is, then, based only on historical data and numbers only, whereas the other aspects are not taken into consideration. (Efinancemanagement, 2019)

Recommendations

The recommendations for Ffion Limited would be mainly taking investigations on the internal aspects since the data analysed recommends that the assets are being managed in a poor manner in 2018 rather than in 2017. The internal issues might arise from either the satisfaction of personnel, time management etc. Basically, the business operations conducted within the company are run using a method which is not favourable for the business. The liquidity's result shows that it has increased in the second year because of the circumstances in which the company could not pay its debts. An evaluation of its assets is needed in order to see whether the company is using efficiently its resources. The gearing information is rather paradoxical because they are situated in a contradictory phase. Where the debt ratio is lowering, the interest cover is raising causing Ffion Limited to have financial problems.

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