



[HILTON HOTEL]

Financial Management for the Hotel Industry BMIH5007 by Anwar Miah



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Executive Summary

The purpose of this essay is to examine the financial statements of Hilton Worldwide Holdings Inc. (HLT), using horizontal analysis to determine trends that occurred between 2019 and 2020. By calculating the differences between the years and presenting them as a percentage change, they can be easily compared.

The different types of ratio analyses will be outlined and examined, suggesting how they can be used to help make decisions in the company, both in general, as well as specifically in the hospitality industry. This essay will also summarize the certain limitations that come from using these ratios, and how they limit the ability to properly investigate.

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Introduction

It's no surprise that the hospitality industry is a financially demanding industry. With large branches and thousands of employees, short term liabilities as well as long term liabilities are everywhere. As a result company managers often have to examine and investigate their finances so that they can understand their profits and losses. Hilton is a good example of a company that strives to understand their finances. Hilton may use a technique called Ratio Analysis. A method of comparing numbers to each other in a simple format, in order to quantify changes.

Finance Statements

Income Statement	Hilton Worldwide Holdings Inc. (HLT)			
	2020 31/12/2021	2019 31/12/2020	Change	% Change
Fiscal Year Ends				
Sales	4,307,000	9,452,000	-5145000	-54.14
Cost of goods sold	3,724,000	7,017,000	-3293000	-46.93
Gross profit	583,000	2,435,000	-1852000	-76.06
Operating Expenses	702,000	859,000	-157000	-18.28
Operating income	-119,000	1,576,000	-1695000	-107.56
Interest Expense	429,000	414,000	15000	3.623
Total Other income/ expenses net	-376,000	82,000	-458000	-558.53
Income before taxes	-924,000	1,244,000	-2168000	-147.277
Net income	-715,000	881,000	-1596000	-181.158

Figure 1: Income statement for HLT

	2020	2019	Change	% Change
Current Asset	4,202,000	2,093,000	2109000	100.76
Non-Current Asset	15,810,000	12,558,000	3252000	25.90
Total Asset	16,755,000	14,957,000	1798000	12.02
Current Liabilities	2,431,000	2,871,000	-440000	-15.32
Noncurrent Liabilities	15,810,000	12,558,000	3252000	25.90
Total Liabilities	18,241,000	15,429,000	2812000	18.23
Common Stock	3,000	3,000	0	0
Retained Earnings	-6,732,000	-5,965,000	-767000	12.86
Total Stockholders' Equity	-1,490,000	-482,000	-100800	-209.13
Total Liabilities and Stockholder	16,755,000	14,957,000	1798000	12.02

Figure 2: Balance Sheet for HL

Financial Analysis Trend

From these calculations, it can be seen that the profitability ratio for HLT has generally decreased. In the time between 2019 and 2020, the income sheet shows that sales have decreased by 54%, gross profit has decreased by 76%, operating income decreased by 107% and net income has decreased by 181%. Whilst the Cost of Goods Sold and Operating Expenses have also decreased, it's not enough to offset the major decrease in income.

From Figure 2, it can be seen that Current Assets have increased by over 100%, whereas Current Liabilities have decreased by 15%. Using these numbers, it can be shown that the Current Ratio, a liquidity ratio measuring a company's ability to pay short-term debts, has changed significantly from 2019 to 2020. Equation 1 was used to calculate the Current Ratio for both years. (Fernando, 2022)

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Equation 1

In 2019, the current ratio was calculated to be 0.73, meaning that HLT's debt for that year exceeded that of its assets. However, in 2020, the ratio increased to approximately 1.73. Therefore, it would be assumed that HLT now had an abundance off assets to pay off its short-term debt. In the case of long-term debt, there was no change between the years.

It should be noted that the total stockholder's equity has fallen by over 200%, and during both years, stockholder's equity was negative. This is seen as negative, given that negative values for stockholder's equity means that the debts and liabilities are exceeding its assets. This is usually do to losses over time as well dividend payments. Given that it has fallen so much, it is safe to say that the trend may continue for the next year, with an even more negative value. (Kennon, 2022)

Importance of using Ratio Analysis

Ratio Analysis is a method in which a company's profits or liquidity can be quantified and analysed. There are several different types of ratio analyses: liquidity ratios, solvency ratios, coverage ratios, etc. These differing ratios compare their respective assets and calculate a presentable quantity in order to compare, usually in the form of a difference or percentage difference. This is usually done over a period of time, most often on a year-by-year basis. This can be used to compare how a company is performing in comparison to a previous year, with a percentage able to quantify this easily. This also means that one would be able to compare numbers between companies, for example the gross profit from the last year for two companies. (Bloomenthal, 2021).

Performing these ratio analyses benefits decision making in a number of ways. As stated before, it can be used to compare one company to another, therefore, a company could use a ratio analysis to see how it's doing against its competitor. Using Hilton as an example, it could use the income statement above and compare it to that of another hotel franchise and seeing which areas specifically should change. The ratios that are usually compared in this sense would be the profitability ratios; these determine the company's ability to earn whilst spending. These measure the values of the gross profit, as well as return-on-equity. (AccountingTools, 2022)

The analyses can also be used in conjecture to this, to identify gaps and problems within the company to a minor degree. By analysing the major differences between years, one could differentiate the different factors that could've led to these changes. Whether it be the current economic climate, number of employees and so on. (Kota, 2020)

The specific ratios can be used to determine what changes are to be made. The liquidity ratio can help determine how much of its assets are used to pay off liabilities, and therefore can sort out what changes are to be made when paying these liabilities, should the company be in debt. (GoCardless, 2020). Solvency ratios do a similar job, but instead cover more long-term fiscal commitments. Coverage ratios are similar too, in the way that they assess the ability to cover debts.

All three of these different ratios are important in helping a company dictate how much is going in each direction, therefore allowing them to see where they're able to adjust the numbers.

Another way that ratio analyses influence decisions is via predictions. Multiple ratio analyses over the span of several years help in making predictions for how the company will perform in the upcoming years, by analysing the trends in the data. These can also be used by investors to help predict future stock prices, guiding their own decisions in whether to invest or not. (Salleh, 2021)

Limitation of Ratio Analysis

Whilst ratio analysis of finance statements can be extremely beneficial for finance auditors and investors, it comes with its own set of limitations.

Firstly, the problem of all the information being used in the ratio calculations being past/previous information, labelled as the 'Historical Basis'. When reviewing statistical trends, one of the glaring problems is that nothing in the future is for certain, therefore, it is impossible to predict how the trend will continue in the following years. Taking the finance statement in Figure 1 as an example, if one were to calculate the ratios for the past five years, which would display a certain trend, there is no way for one to perfectly predict the next year, even if the trend is extremely likely. (AccountingTools, 2022)

Another major limitation is the fact that ratio analysis doesn't take inflation into account. When assets are recorded initially when they're first brought, they're taken at their initial rates. When doing ratio analyses by year, it's likely that these values will shift due to inflation.

Another problem that could arise whilst doing a ratio analysis is window dressing. Sometimes, a company will present its finances in a better way, to appeal more to investors. When done right, it can often go unnoticed by investors, and can be achieved in a number of different ways, such as delaying payment to the supplier to make numbers look bigger or selling off bad stock and buying higher-value stock at the end of the period in order to attract new investors. Of course, this is a problem for

anyone attempting to ratio analyse the finance statements, as doing anything with false numbers would be useless. (Alamgir, 2018)

As with any other business, ratio analyses are extremely important in management. As stated before, liquidity ratios are used to measure capability for repaying short term debts, which is a major part of the hospitality sector, with salaries and equipment leasing. Often, a current ratio greater than 1 is a sign that hotel company is going strong. This, combined with the regular ratio analyses will give insight into a companies performance over the years in terms of its liquidity, and could be used to see how they might fare in the coming years, should there be a negative event like an economic downturn.

Similarly, debt ratios also play a major part in analysing a hotel company's performance. Debt ratios are similar to liquidity ratios, but instead cover long-term commitments. The equation for calculating debt ratios is found below in Equation 2.

$$\text{Debt Ratio} = \frac{\text{Total Liability}}{\text{Total Assets}}$$

Equation 2 (Finance Formulas, n.d)

Hotel franchises like Hilton have a lot of long-term commitments, including branch locations and transportation fleets (buses for guest transportation, for example). The long-term assets are crucial, so quantifying how well they're able to meet the debt is just as crucial. Understanding this ratio as well as the liquidity ratio is necessary, including how much they fluctuate year-by-year. Gauging a hotel's ability to pay these debts, as well as spotting a possible decline is important. It means a company can get ahead of the problem, and find where changes can be made, before it becomes a critical problem.

Of course, the profitability ratios are also important for management, especially the gross and net profit margins. In hotel businesses, cost comes from operations more than anything else, therefore, a high gross profit margin is a given for hotel businesses. The net profit margin is important for different reasons. The profits of a hotel company aren't too high, because of the high operating costs. However, the net profit margin should be surveyed and compared to the average in order to make sure it meets the requirements.

Conclusion

To conclude, it appears as though Hilton is having an overall downfall. There has been a large decrease over the years of sales, gross profits, and overall income, with a small decrease in expenses and costs of goods. Not only that, but the stockholder equity has declined rapidly. Both of these points would suggest HLT is in decline. However, the debt ratio shows that as of 2020, Hilton is able to pay its liabilities using its assets with money to spare, which was not the case in the previous year, which would show a positive trend for the hotel.

Should someone want to perform a more in-depth examination, they can use many different ratio analyses to check the different aspects of the finance statements. Whilst a horizontal analysis describes how the company has differed over a period of time, one could calculate several other ratios per year, such as the profitability ratios to see how the company is earning, and the liquidity and debt ratios to learn how well the assets can pay of liability. These investigations can be used to compare against rival companies, to see if they're being outperformed or not. As well as this, one could find trends over the years to predict how the company will perform in the near future and make decisions on what should change should the predictions come up with negative results.

However, there are some limitations to a ratio analysis, which come with most statistical investigations. These have to do with the lack of certainty when predicting the future, even if the trends are likely to continue in the coming years. Not only that, but should the data have false numbers due to embellishment and window dressing, then the ratio analyses would impractical. Most finance statements and ratio analyses don't take inflation into account either, meaning that the data might be skewed.

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