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Financial analysis of Gatsby Grange

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Executive summary

The following paper represents an analysis over the financial data of a company named Gatsby Grange. After calculating the ratios and evaluating the performances, a comparison was made between the financial data from 2018 and 2019. Definitions and theory were provided for a support when affirming the hypothesis that the company needs to revise the efficiency. The inventory represents a problem within the company as described in the paper, but suggestions were made in order to aid the decision-making processes. The report analyzes the profitability, efficiency, liquidity, and capital structure of the business. The importance of understanding financial ratios from a managerial perspective or even from a stakeholder's perspective was also taken into consideration and discussed while drawbacks were also noted. Financial analysis is the core idea of the whole report and it shows an in-depth analysis over the decisions based on the ratios.

Introduction

The purpose of this report is to analyze the financial situation of Gatsby Grange for the financial year of 2018 and 2019. Thus, a conclusion would be drawn based on the in-depth analysis and comparison of the two financial years. The trends would be discussed alongside a subjective recommendation which would support the current financial year in decision making. The understanding of the ratios would be approached to highlight the importance of understanding the financial terms as well as the results of profitability, liquidity and gearing for the hotel chain. Moreover, the benefits and limitations of using a method of managerial accounting into the companies would be considered in order to enhance the core idea of a well-understanding of the financial information particularly for a manager of a hotel chain.

The hospitality industry is a service-based business that relies on the experience of our guests. Making sure that they are experiencing the ultimate experience requires continuous improvements, analyses and decision-making processes based on the performance of the business. Key-performance factors will be discussed to process the cost and management decisions of this particular business which contributes to a market strength as well. This report represents an analysis on how Gatsby Grange is performing alongside explanations on the resulted differences between the financial years 2018 and 2019. Plus, theory would be provided to support the definitions of the ratios and the conclusion followed up by a list of references to support the findings regarding the theoretical part.

Financial analysis

The financial analysis would provide a better in-sight of the company as the cashflow can be analysed alongside with the performance over the years identifying where issues could be addressed.

Profitability

In definition, profitability would be referred as the “the ability of a given investment to earn a return from its use.” (Tulsian, 2014, p.19) Ultimately, this is the goal of any business to return the investment back and a surplus. The profitability is represented by different ratios such as the gross profit margin, net profit, ROCE (return on capital employed) etc. However, as these are only internal factors, the external ones could also impact the profitability as unpredicted environment changes could lead to a descending profitability, but in real there is only the external factor. For example, recently there has been the pandemic situation of the coronavirus which would definitely have an impact on Gatsby Grange and recording a smaller profitability in this period whereas the situation has an indirect impact on the business.

Gross Profit

The gross profit margin is calculated from the gross profit divided by the turnover. The business has recorded a percentage of 91.81% in 2018 and 85.83% in 2019 as seen in Appendix 1. The cost of goods sold is subtracted from the sales resulting in the gross profit which is then divided. Basically, the gross profit represents a margin that could pay afterwards the expenses such as rent, advertising, repairs, salaries etc. From a percentage of 100% only 91.81% is represented by pure profit from where it is then subtracted all of the expenses. Comparing the years, 2019 recorded a smaller gross profit margin due to the numerous purchases that have been made (in 2018 there were only £500,000 and in 2019 there were £850,000). Explained broader, the gross profit margin is represented by the percentage of gross profit from the cost of sale of a product or service.

Net profit

Furthermore, the net profit of the business in 2018 is consisted of a percentage of 79.37% and 79.09% in 2019. There is no big difference between the two percentages as the expenses were similar (1,047 respectively 1,077).

ROCE

Return on capital employed (ROCE) is the net profit for the year divided by the total assets (both current and non-current). Explained, ROCE is referring to the profitability of a business in terms of how well it is managing its own resources to generate profit. (Kenton, 2020) As higher the ROCE is, as better the profitability is for the business. In particular, in 2018 the ROCE is 64.69% whereas in 2019 it is to be found at a percentage of 65.07%.

Assets turnover

Assets represent anything that could be converted into cash. Either that the company is using assets to benefit from them, or it is selling them to get cash, assets are always listed on the company's balance sheet. The asset turnover represents the ratio that measures the profitability of a company to use its assets in order to generate profit. Broadly explained, the asset turnover is represented by the sales divided with the total assets (both current and non-current) less liabilities. Thus, the company recorded a ratio of 0.88 times in 2018 rather than 0.95 times in 2019.

Efficiency

The efficiency ratios measure the ability of a company to use the assets and manage the liabilities in a short time period. Specifically, the company analyses how it can manage its own inventory to generate cash over the financial year and how it can collect the receivables and take care of the payables.

Inventory turnover

The inventory turnover for the company in 2018 is of 1,176 days and in 2019 is 610. A very efficient progress of 566 days was made. This ratio analysis "how many times the total average inventory has been sold over the course of a period". (Nickolas, 2019) As low the ratio is, as better it is for the company to sell it. A big ratio would indicate that our company is acquisitioning too much stock.

Debtor days

The debtor days refers to the days that it takes for a company to receive the payments from the customers after invoices were being made. (AccountingTools, 2018) For example, Gatsby recorded in 2018 an average of 106 days whereas in 2019 it is an average of 109 days. Therefore, it takes for Gatsby approximately three months to collect the payments from its customers.

Creditor days

The creditor days refers to the trades that are payables and the cost of sales. Basically, it is a ratio that calculates how much it takes for the business to pay its own suppliers. The company recorded an average of 584 days in 2018 whereas in 2019 there was a progress to 373 days. Paying the suppliers on time without risking a penalty would strengthen the boundaries and would effectively improve the B2B relationship. (Rangaswami, 2018)

Capital structure

The capital structure is a tool that combines the capital and the equity to determine how well a company funds the operations and processes to deliver the outcomes. (Tuovila, 2020) Interest cover, leverage and debt to capital ratios are the ones most used to determine the structure of the capital. It is the best for a company to find a balance between the debt and equity to finance their operations.

Interest cover

The interest cover indicates how much the company can repay the interest and how easily it can meet the obligations. For Gatsby, in 2018 there is a cover of 252.2 times whereas in 2019 there is a cover of 286.11 times. The performance recorded shows that the profit generated can easily cover the interest paid.

Gearing ratios

The two gearing ratios are the leverage and the debt to capital one. The leverage one has been recorded at a level of 8.69% in 2018 and of 8.92% in 2019 whereas the debt to capital one recorded a 7.99% in 2018, respectively 8.19%. The use of borrowed money and equity are compared in order to identify the financial risks.

Importance of the financial analysis

The decision making in any business relies on the internal and external factors that lead to a profitable business. Beside the decision-making process, there is also the importance to inform the shareholders and stakeholders about the progress of the company and to find solutions on how to improve the situation. Thus, Durcevic (2019) states that financial reporting is used by “owners, managers, employees, investors, institutions, government, and others to make important decisions about a business.” The hotel industry is based on the tangible assets mostly and it has been developing through the years. It is not only the accountant that needs to keep

the track of the acquisitions, expenses and other payments, but also the stakeholders need to understand the concepts of the financial analysis for a better perspective over the well-being of the business. Moreover, there are five aspects why financial analysis is important:

- For any investor, shareholder, and other company – The vital information of the financial aspects of any business is important for any future investment. It gives an outlook on the current situation of the business and it enhances the chances to get financed.
- Internal vision – As explained before, the internal aspect is to be taken into consideration by managers mostly as they are operating and managing the resources available.
- Internal decision-making – The health of the business relies on the decision-making processes that are aided by the managerial accounting.
- Raising capital
- Taxes

However, there are also limitations when it comes to using ratio analysis within the tourism and hotel industry. Financial analysis uses past data and cannot be based on a present situation or a current issue, it is not taking into consideration the inflation or the current value of money and it ignores the external environment which is indirectly or directly impacting the business.

(AccountLearning, n.d.)

Conclusion

Gatsby Grange has recorded a very good financial analysis; however, the drawbacks are constituted in the creditor and debtor days as it takes three months for the company to collect the payments from the customers whereas it takes over than a year to pay back the suppliers. The figures are very high, and it does not show a well-managed cash flow as most of the companies have an average of 80 days compared to 584 days in 2018 respectively 373 days in 2018. This is because of the purchases that have been made (500 in 2019 and 850 in 2018). Having a lower stock rather is more beneficial in the current situation rather than holding them. The inventory turnover also shows a lower figure represented by the average of days in which the inventory is being sold. However, numbers still remain high as it takes a lot of time for the company to sell the stocks. As a subjective recommendation, Gatsby should focus on selling the inventory that it has for a better cashflow in order to be able to make use of the money in a more efficient manner. The gross profit margin is excellent, but it needs to focus more on the selling process rather than cutting the costs for a higher margin.

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APPENDIX 1 – Ratios

Ratios	2018		2019		Difference	Performance	Family
	Formulae	Result	Formulae	Result			
Gross Profit Margin	$5050/5500*100$	91.82%	$5150/6000*100$	85.83%	-5.98%	-5.98%	Profitability
Net Profit Margin	$4008/5050*100$	79.37%	$4073/5150*100$	79.09%	-0.28%	-0.28%	Profitability
ROCE	$(4008+20)/6226*100$	64.70%	$(4073+10)/6274*100$	65.08%	0.38%	0.38%	Profitability
Assets Turnover	$5500/6226$	0.88	$6000/6274$	0.95	0.07	7.37	Profitability
Working Capital Turnover	$5500/1726$	3.18	$6000/1624$	3.69	0.51	13.82	Efficiency
Current Ratio	$3065/1339$	2.29	$3240/1616$	2	-0.29	-14.50	Liquidity
Acid Test	$(3065-1450)/1339$	1.2	$(3240-1420)/1616$	1.12	-0.08	-7.14	Liquidity
Debtor Days	$1600*365/5500$	106.18	$1800*365/6000$	109.5	3.32	3.03	Liquidity and Efficiency
Creditor Days	$800*365/500$	584	$870*365/850$	373.58	-210.42	-56.33	Liquidity and Efficiency
Debt Ratio	$(1339+150)/(3065+4500)$	0.20	$(1616+145)/(3240+4650)$	0.22	0.02	9.09	Capital Structure
Interest Cover	$5050/20$	252.5	$5150/18$	286.11	33.61	13.31	Capital Structure
Inventory turnover	$1450*365/450$	1,176	$1420*365/850$	610	-566	-48.12	Efficiency