

# Cranston Financial Analysis

## **1. Liquidity Ratios:**

Liquidity ratios measure Cranston's ability to pay its short-term debts with its short-term assets. The current ratio is a basic liquidity test that determines the ability of current liabilities/debts to be covered by current assets, and a ratio greater than or equal to 1.0 indicates that a company's current assets should cover their short-term obligations. The industry average is 2.10, and Cranston has seen a below industry average current ratio for the past three years. Compared to 2012's ratio of 1.48, in 2013 it decreased by 0.20 and in 2014 it increased back up to 1.41. Cranston's current assets only slightly cover their current liabilities. This isn't alarming at this point, as by looking at the income statement you see that revenue continues to increase year over year and looking at the balance sheet total assets continue to increase year over year (despite the asset management ratios suggesting an inefficient use of current assets). If current liabilities ever became higher than current assets, Cranston may have the ability to borrow against their revenue streams in the short-term.

The quick ratio is a more detailed test of liquidity, eliminating certain assets such as inventory. A ratio greater than or equal to 1.0 indicates that liquidity shouldn't be a problem for the company. The higher the ratio, the more liquid it is. The industry average is 1.10. All three years Cranston has seen a quick ratio below 1.0, though compared to 2013's ratio of 0.82 Cranston's 2014 ratio has increased by 0.08. While they are slowly improving, they are below the industry average and may have a hard time if there was any sort of downturn in the business.

The cash ratio is a conservative liquidity ratio. It simply measures the ability of a company's cash to pay its short-term debt. A higher cash ratio means that the company is in better financial shape. While still below the industry average, Cranston's 2014 ratio has grown from 0.25 in 2013 to 0.29 in 2014 which is a favorable increase.

We do believe that Cranston can meet its obligations over the short-term. Their current assets exceed their current liabilities, which is favorable. While both their 2014 quick ratio and 2014 cash ratio are below the industry average, the ratios have grown since 2013 which is promising. Cranston should evaluate their policies surrounding their current assets and how to more efficiently manage them. An increase in assets and cash will be favorable to the company.

## **2. Solvency Ratios:**

Leverage ratios look at how much debt a company has on its balance sheets and measures the company's financial health. The higher the debt the higher the risk. The debt ratio looks at the company's total liabilities over their total assets. A high debt ratio can indicate that the company does have debt and is therefore riskier than a company that has a low debt ratio. With an industry average of 0.25 times, Cranston's debt ratio has increased year to year and their 2014 debt ratio is more than double (0.52 times) the industry average. This backs up our opinion in the liquidity analysis that Cranston needs to more efficiently manage and increase their current assets. It will be very important to decrease the debt ratio and interrupt the trend we see from 2012 to 2014, as relying on debt financing cannot sustain a company in the long-term.

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The times interest earned ratio measures the ability for a company to make its debt and interest payments. If a company can't make its payments then it will be very hard for them to stay in business. This ratio looks at how many times a company could make its interest payments on a pretax earning basis. Cranston had a 7.80 decrease from 2012 to 2013, but in 2014 they increased back to 20.40 times. With an industry average of 19.00 times, 20.40 times is a great position for Cranston to be in. If Cranston needed to take a loan, this is a favorable number for the creditor to view.

The cash coverage ratio measures how much cash is available versus the amount of interest to be paid for borrowing. The industry average is 35.00 times. Cranston has always been below this average since 2012, though there was a 12.48 decrease from 2012 to 2013 and in 2014 it raised back up to 32.46 times. This means that Cranston has \$32.46 of EBITDA for every dollar of interest expense. Their risk of financial distress is low, though it's certainly in their interest to continue to increase their cash coverage ratio.

We do believe that Cranston can meet its obligations over the long-term. While their debt ratio has seen an increasing trend and in 2014 is more than double that of the industry norm, if Cranston can increase and more efficiently manage their current assets this will help improve their debt ratio situation. Despite their debt, their times interest earned and cash coverage ratios are favorable and show that the company is in a good position to pay their bills over the long-term.

### **3. Asset Management Ratios:**

Asset management ratios measure how efficiently a company uses its assets to generate sales, as well as how well it manages their liabilities. The inventory turnover ratio shows how well a company manage its inventory levels. A higher inventory turnover ratio is better, as it indicates that a company is not overstocking or having issues sellings its products. Though Cranston saw a 0.08 increase from 2013 to 2014, 4.32 times is still below the industry average of 5.20 times. A higher number is preferred, as it would indicate a greater generation of sales. Cranston had a favorable decrease of 1.35 from 2013 to 2014 in day's sales in inventory, but 84.69 days is significantly higher than the industry average of 70.19 days. A lower day's sales in inventory is preferred, as it shows investors how many days its takes a company to turn its inventory into sales.

The receivables turnover ratio measures how effective a company's credit policies are (the number of times receivables are collected in a given time period). A higher receivables turnover ratio is better, as it indicates that a company isn't having difficulty collecting from its customers. Though Cranston saw a 0.25 increase from 2013 to 2014, 5.24 times is still below the industry average of 6.81 times. Though Cranston had a favorable decrease of 3.52 from 2013 to 2014 in their day's sales in receivables, 69.66 days is significantly higher than the industry average of 53.60 days.

Total asset turnover measures how well a company is effectively managing their short and long-term assets. The higher the ratio, the better the company is doing. Though their ratios remain stable year to year, 1.09 times in 2014 is below the industry average of 1.80 times. It has been discussed previously that Cranston needs to increase and more efficiently manage

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their current assets, as the inefficient use can lead to Cranston's total asset turnover being below the industry average.

Cranston is not efficiently managing their assets and generating sales. Their inventory and receivables turnover ratios saw slight increases from 2013 to 2014, but both continue to be below the industry average. It is taking them longer to sell their products and collect payments than compared to their competitors, and their total asset turnover shows that they are inefficiently using their current assets. Cranston needs to increase and more efficiently manage their current assets, as well as evaluate their current credit policies to see how they can sell more of their products and collect payments sooner.

## **4. Profitability Ratios:**

Profitability ratios measure a company's effectiveness in turning their sales or assets into profits. These ratios can help determine if a company is efficient and making money. The gross margin ratio is the amount of each dollar of sales that a company gets to keep in gross profit. The higher the gross margin the more profit for the company. The industry average is 8.60%. Cranston is below the industry norm, but very close, at 7.37% in 2014 (that's a 0.87 increase since 2013).

The return on assets ratio measures a company's ability to specifically turn assets into profit. With a significantly lower ratio than the industry average of 15.48%, Cranston needs to focus on increasing and more efficiently managing their assets. Though they increased by 1.35 from 2013 to 2014, their 8.02% 2014 return on assets ratio is nearly half that of the industry average. Cranston is not efficient in managing their assets to generate profit compared to their competitors.

The return on equity ratio measures the company's return on its investments by shareholders. The higher the ratio the better for the company. Though Cranston's ratio remains under the industry average of 20.59%, from 2013 to 2014 they saw a favorable increase of 3.14. Their 2014 ratio of 16.75% is below the industry average, but not by much.

Though the profitability ratios appear to all be below the industry averages, all three ratios saw a positive trend from 2013 to 2014 and don't appear to fluctuate significantly year to year. The company has been able to effectively turn their sales or assets into profits and is overall performing well. There is room for improvement compared to the industry average, especially on their return on assets. As already previously stated, they need to increase and more efficiently manage their current assets. This will improve their return on assets and improve their profitability.

## **5. Market Value Ratios:**

Market value ratios are used to evaluate how reasonable a company's current price is relative to its earnings, growth rate, and book value. Current and potential investors pay attention to these ratios to determine if a company's shares are overvalued. The price-to-earnings ratio shows how much investors are willing to pay per dollar of current earnings. Cranston was above the average industry of 21.00 in 2012 and 2013, but in 2014 they saw a 9.13 decrease that put them significantly below the average industry at 16.98. In 2014, Cranston's earnings per share ratio increased by 0.49 which caused such an increase in the

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price-to-earnings ratio. Earnings per share shows the portion of the company's profit that is allocated to each outstanding share of common stock. In 2014, it was 1.95 compared to 1.39 in 2012.

The PEG ratio evaluates the relationship between the price of a stock, the earnings generated per share, and the company's expected growth. A higher PEG ratio would indicate a higher growth rate. The industry average is 1.17. In 2012, Cranston was slightly above the industry average at 1.32 and in 2013 they significantly increased to 5.45 (4.13 increase). From 2012 to 2013 the company had favorable growth, however, in 2014 their PEG ratio significantly decreased to 0.50.

The market-to-book value ratio shows the relationship between the company's stock market value to its book value. It indicates if management has been successful in creating value for its stockholders. The book value per share divides common equity by the number of common stock shares outstanding, which helps investors determine if a stock price is undervalued. In 2014, Cranston's book value per share increased from \$10.69 to \$11.64. Its market-to-book ratio significantly decreased from 3.55 in 2013 to 2.83 in 2014, which is 1.43 below the industry average of 4.26. This indicates that the stock could be undervalued and investors aren't optimistic about Cranston's future.

The market value ratios indicate that investors are not optimistic with Cranston's future. The price-to-earnings ratio significantly decreased below the industry average in 2014, and a 0.50 PEG ratio in 2014 indicates little growth for the company. With a decrease in the market-to-book value ratio from 2013 to 2014 by 0.72, along with the below industry average price-to-earnings and PEG ratios, Cranston's stock may be attractively priced but without confidence from investors it will be hard for Cranston to excel and grow.

## **DuPont Analysis:**

The DuPont analysis breaks down return on equity into three components: operating efficiency, asset management efficiency, and financial leverage. Cranston's return on equity has always been below the industry average of 20.59, which is due to their lower profit margins, total asset turnover (we have already established that they inefficiently manage and use their current assets), and equity multiplier. Their debt ratio continues to grow which is why they have been able to get by in the short-term, but in the long-term a high debt ratio cannot sustain a company.

## **Question 5:**

Despite an increase in sales and total assets year to year over the period of 2012 to 2014, total liabilities and owners' equity also continues to grow. We've analyzed several ratios that indicate that Cranston does not efficiently manage their current assets, and it's evident by looking at the market value ratios that investors don't have much confidence in Cranston and the company's future. Though Cranston appears to be growing, they need to make sure they don't get overwhelmed by the growth. They need to step back and pay attention to the small details. They need to look at their efficiency processes regarding their current assets and they need to evaluate their credit policies. Both their day's sale in inventory and day's sale in

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receivables are significantly higher than the industry average. They need to find a way to turnover the inventory more times in a given year, as well as collect payments from their customers in a shorter period of time. Cranston cannot pay their own bills if customers aren't paying them for nearly 3 months. If Cranston does not more efficiently manage their current assets and improve their credit policies, it is likely that investors will continue to be pessimistic about their future and they could face bankruptcy in the future if their current ratio, debt ratio, profit margin, and returns on assets and equity continue to be significantly below the industry averages.