BWMacfarlane LLP
CHARTERED ACCOUNTANTS

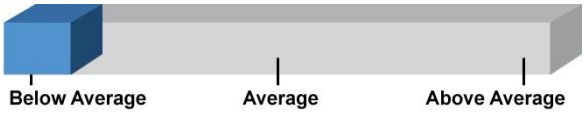
Sample report – Construction

FINANCIAL REPORT

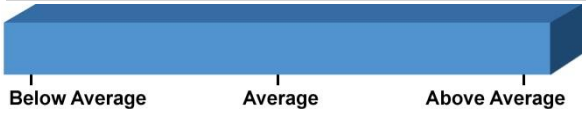
This report is designed to assist you in your business' development. Below you will find your overall ranking, business snapshot and narrative write-up.

Snapshot of: **High Street Construction**
Industry: 41.20/1 - Construction of commercial buildings
Revenue: £1M - £10M
Periods: 12 months against the same 12 months from the previous year
Prepared by: http://www.bwm.co.uk
Phone: 0151 236 1494

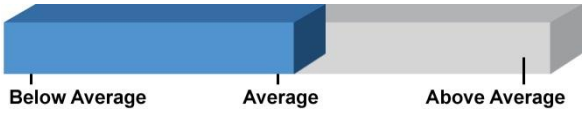
Financial Score for High Street Construction



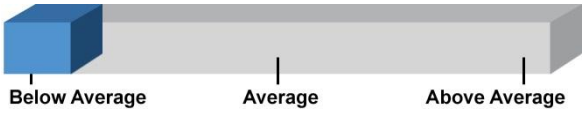
LIQUIDITY -
A measure of the company's ability to meet obligations as they come due.



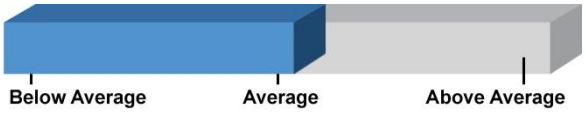
PROFITS & PROFIT MARGIN -
A measure of whether the trends in profit are favourable for the company.



TURNOVER -
A measure of how turnover is growing and whether this is satisfactory for the company.



BORROWING -
A measure of how responsibly the company is borrowing and how effectively it is managing debt.



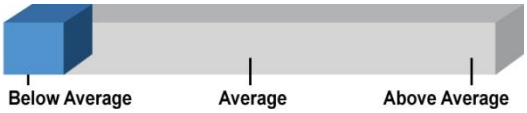
ASSETS -
A measure of how effectively the company is utilising its tangible assets.

EMPLOYEES -
A measure of how effectively the company is hiring and managing its employees.

Financial Analysis for High Street Construction

LIQUIDITY

A measure of the company's ability to meet obligations as they come due.



Operating Cash Flow Results
Cash flow from operations and operating profits are both positive for the period, which is good, especially considering that overall liquidity results are less than ideal (as will be discussed in more detail below). It would be positive if the company could continue to generate positive cash flows to boost its short-term liquidity position, which seems to require some improvement.

General Liquidity Conditions
Both Balance Sheet and Profit and Loss Statement results are quite similar to last period. The most noteworthy aspect of these results is that the company has not seemed to improve its position from last period. As was the case previously, there still does not seem to be enough cash and other highly liquid assets relative to short-term obligations. Essentially, the company needs to find some ways to keep more cash in the business. The graph area of the report shows that the weak "quick ratio", a **key** benchmark, is below that of other similar companies.

The firm might also work on shifting the composition of its liquidity base. There is a marginal but sufficient amount of total current assets; however, these are not the kind of assets that can be used to pay the bills. The specific challenge is still in the cash accounts. If the company's position does not improve, it is possible

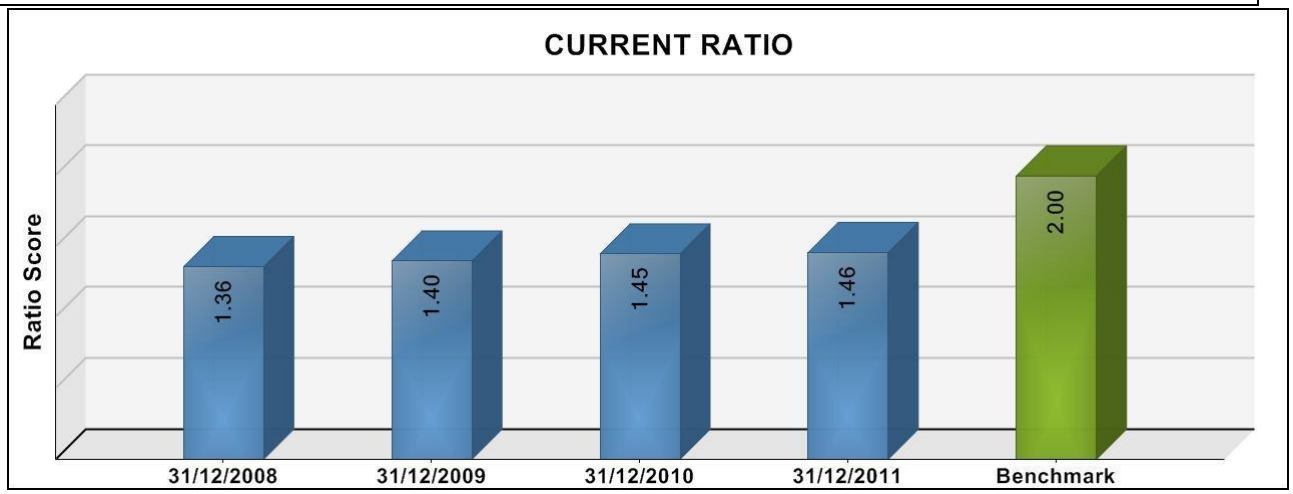
that it will be difficult to pay the bills readily over time.

With regard to liquidity turnover results, the company seems to be collecting its trade debtors efficiently but **may** be having some problems selling stock as quickly as its competition. This is indicated by the company's relatively low trade debtor days and its high stock days. It may be important to monitor these metrics over time, since they can have a significant impact on the cash account.

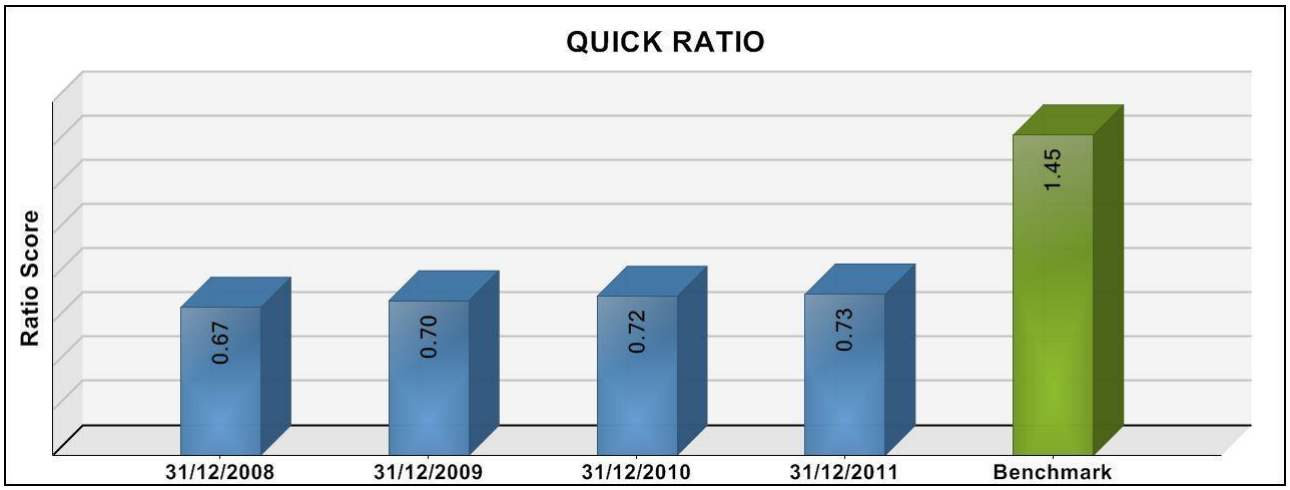
Tips For Improvement
In order to more effectively manage liquidity conditions, here are some actions/"tips" that managers might consider:

- Speed up the billing of customers (even three days earlier each month) in order to accelerate the collection process.
- Watch for contracts that have a retention factor that could delay funds for a lengthy period of time. Delaying payment to vendors, when agreed upon, could help off-set the cash restraint.
- Make sure giving credit will increase revenues/income and be cost effective. Consider providing different credit terms to different customers based upon credit-worthiness (risk) and the overall relationship involved.
- Monitor the impact that tax payments may have on cash. Keep enough money aside to be able to meet future tax obligations based on earnings.

LIMITS TO LIQUIDITY ANALYSIS: Keep in mind that liquidity conditions are volatile, and this is a general analysis looking at a snapshot in time. Review this section, but do not overly rely on it.

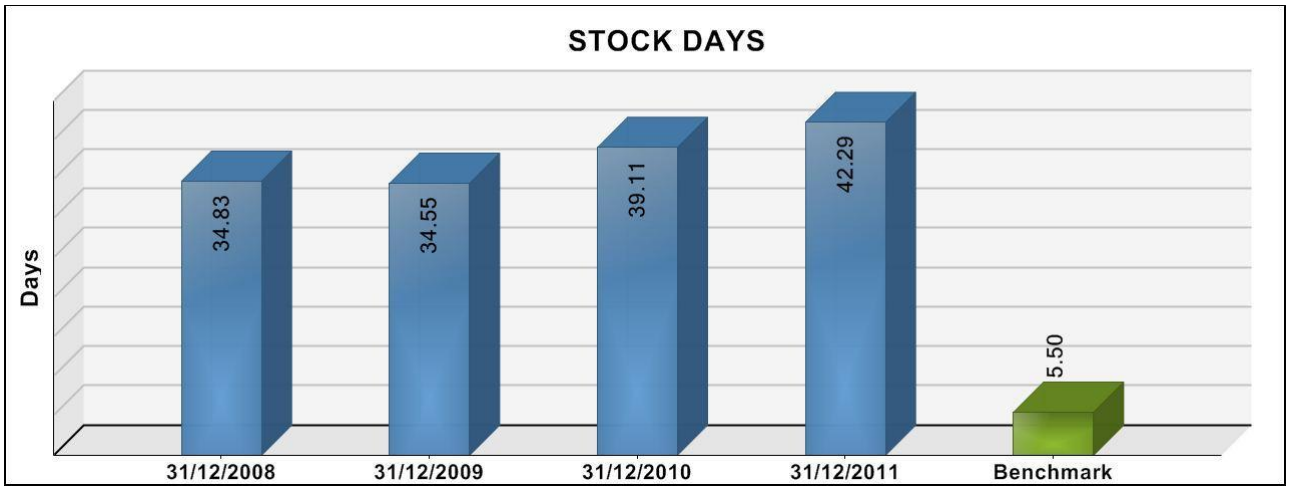


Generally, this metric measures the overall liquidity position of a business. It is certainly not a perfect barometer, but it is a good one. Watch for big decreases in this number over time. Make sure the accounts listed in "current assets" are collectible. The higher the ratio, the more liquid the company is.

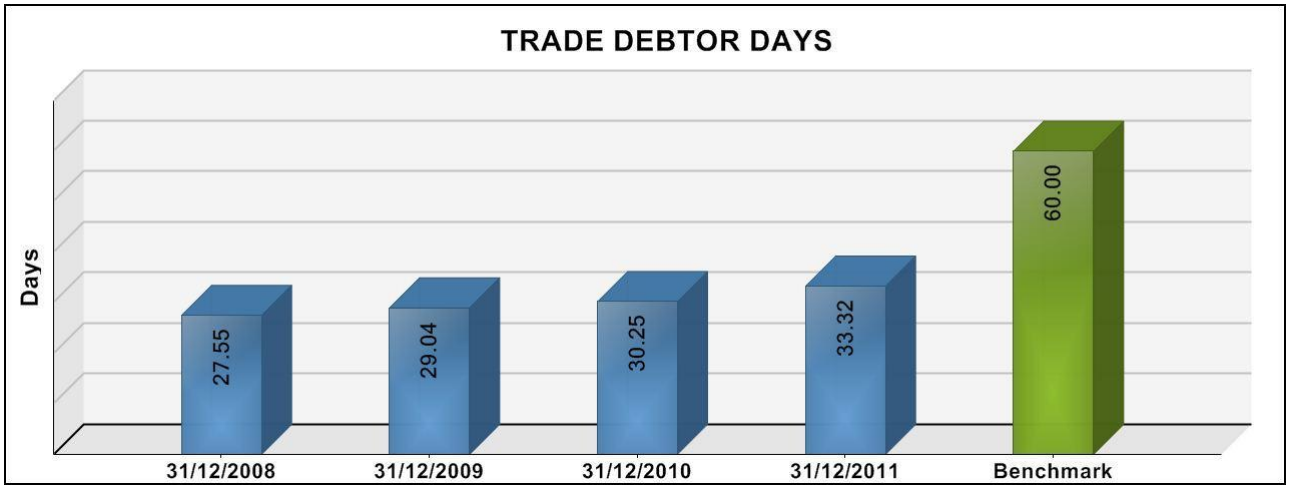


This is another good indicator of liquidity, although by itself, it is not a perfect one. If there are debtor accounts included in the numerator, they should be collectible. Look at the length of time the company

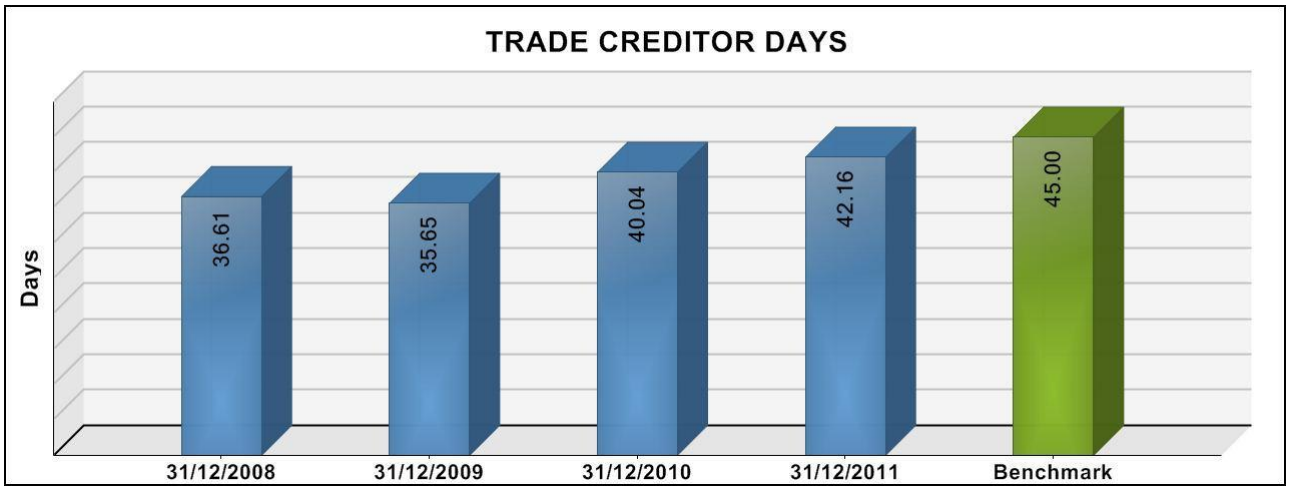
has to pay the amount listed in the denominator (current liabilities). The higher the number, the stronger the company.



This metric shows how much stock (in days) is on hand. It indicates how quickly a company can respond to market and/or product changes. Not all companies have stock for this metric. The lower the better.



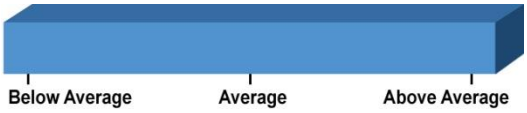
This number reflects the average length of time between credit sales and payment receipts. It is crucial to maintaining positive liquidity. The lower the better.



This ratio shows the average number of days that lapse between the purchase of material and labour, and payment for them. It is a rough measure of how timely a business is in meeting payment obligations.

PROFITS & PROFIT MARGIN

A measure of whether the trends in profit are favourable for the company.



The company has maintained relatively the same profit position as last period. The net profit margin is about the same as it was last period, and so are turnover and net profits. This basically means that conditions have remained about the same, which is actually favourable, because the company was quite strong last period. Specifically, the net profit margins are still strong, and net margins are the most important statistic to focus on. The company's net profit margin is strong both generally, and relative to the net margins that are being earned by competing firms; this is highlighted in the graph area of the report. The company is doing effective work in this area, as it was last period as well.

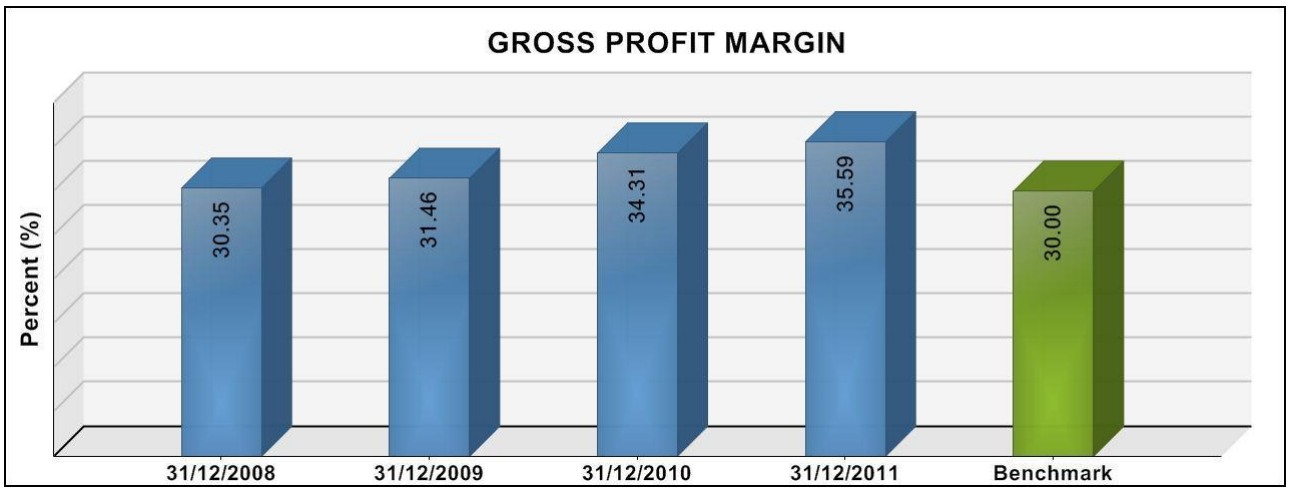
There is one point to think about, however: if the company is not moving turnover and profits higher over time, then this may lead to some difficulty eventually, because expenses tend to grow over time. Even fixed expenses tend to drift upward. The basic rule of business is that if a company is not moving forwards, it is falling behind. Of course, this comment is simply a point to consider, and stability for one period is certainly not unfavourable. The bottom line is that net profits are very good as they were last period, and the company is doing quite well overall.

There are always some general management actions that can help the company move forwards: 1) Getting good budget reports by using an accounting system that produces reports showing actual expenses against budgeted expenses. 2) Identifying KPIs --- what are the key performance indicators that drive profits in this business? 3) Doing a cost audit --- going through all expenses and seeing which ones can be cut or reduced.

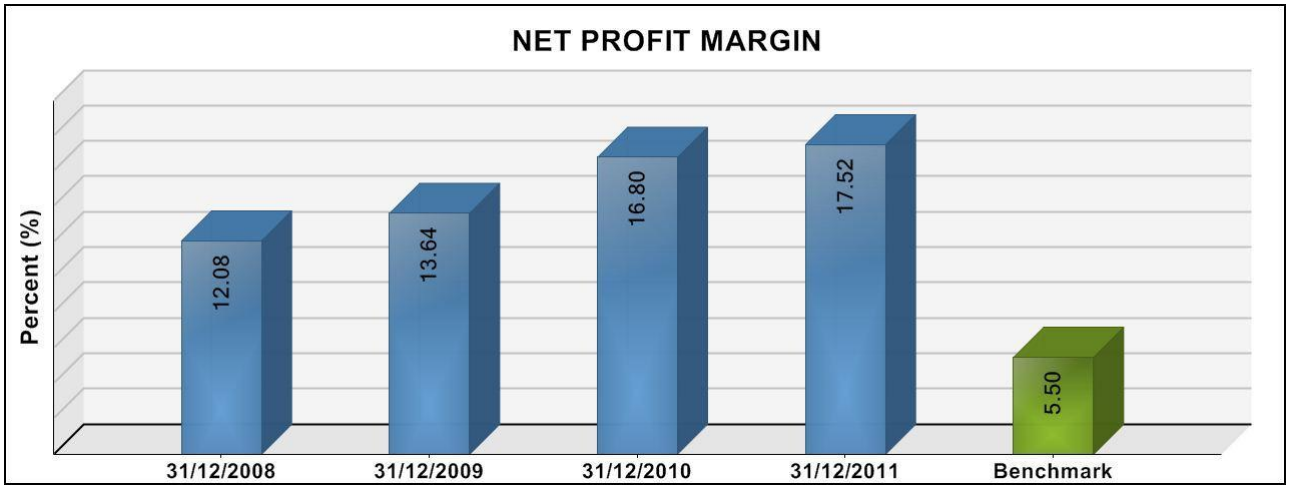
Tips For Improvement

Managers may want to consider actions that could drive even greater profits over time. Here are some potential ideas that might be helpful:

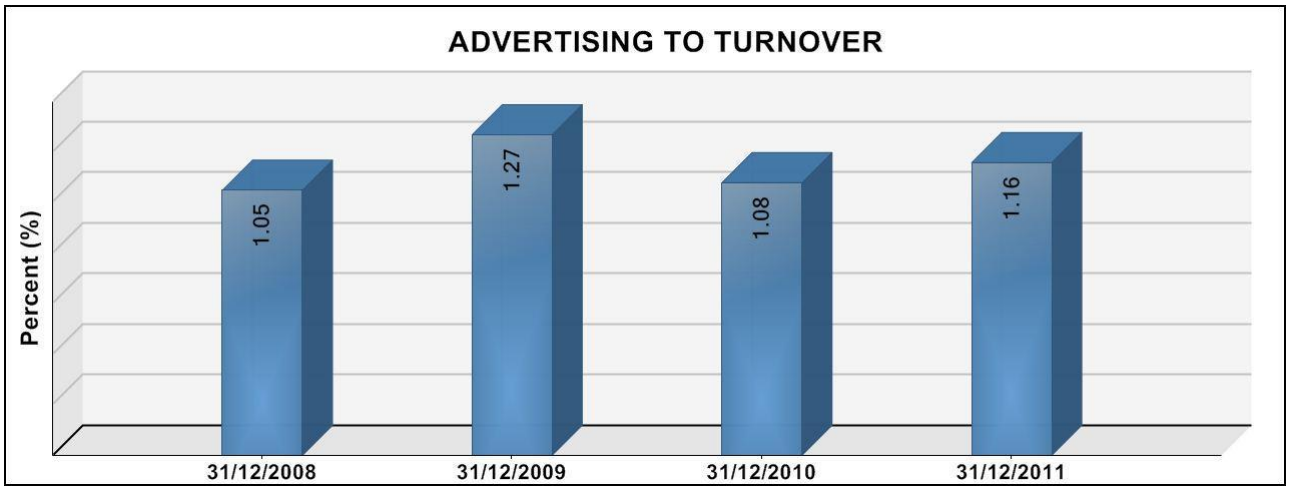
- Forecast equipment requirements and keep equipment functional at all times. If there is too much equipment, it will be sitting idle whilst still being paid for. If there is not enough equipment, jobs will be harder to complete in time.
- Become an expert in certain specialty arenas of building construction, such as schools or churches. This can create a competitive advantage for the business and be a means to attract these types of customers in the future.
- Examine the purchasing of materials and determine whether buying larger quantities will be cost effective. This may be especially helpful if material costs are expected to rise or if quantity discounts are available.
- Have systems in place to gather feedback from customers regarding the quality of work performed. Consider contacting customers three to six months after projects are completed, since small failures don't always show up immediately.



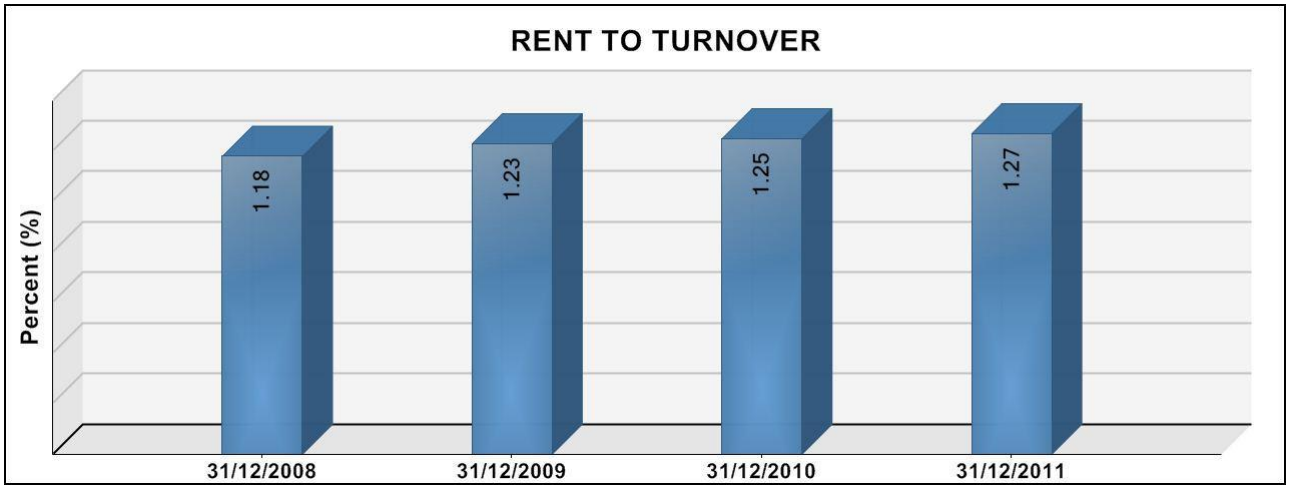
This number indicates the percentage of turnover that is not paid out in direct costs (costs of sales). It is an important statistic that can be used in business planning because it indicates what percentage of gross profit can be generated by future turnover. Higher is normally better (the company is more efficient).



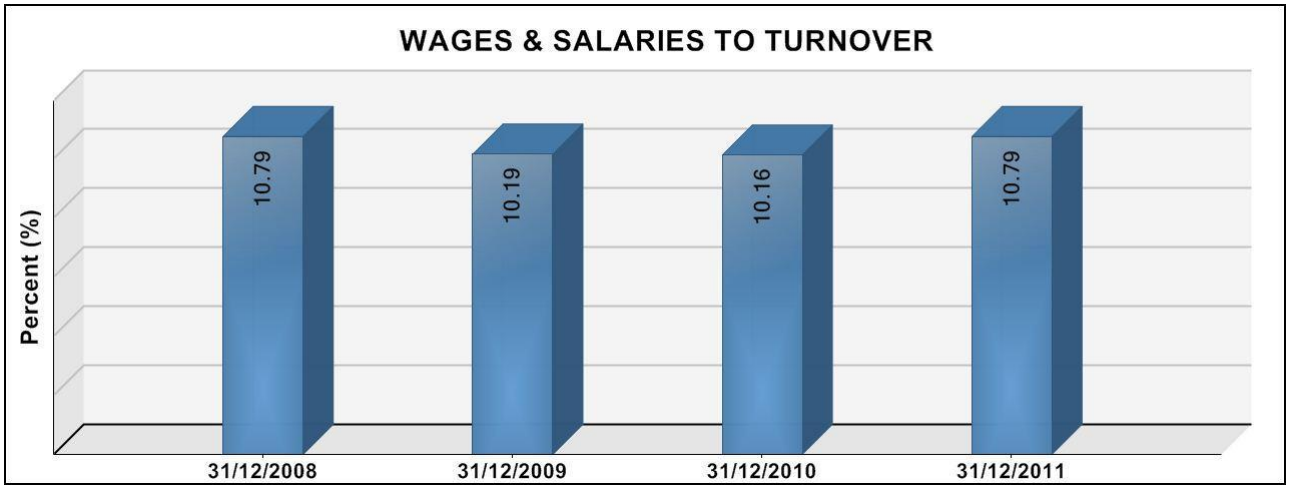
This is an important metric. In fact, over time, it is one of the more important barometers that we look at. It measures what percentage of profit the company is generating for every pound of turnover it earns. Track it carefully against industry competitors. This is a very important number in preparing forecasts. The higher the better.



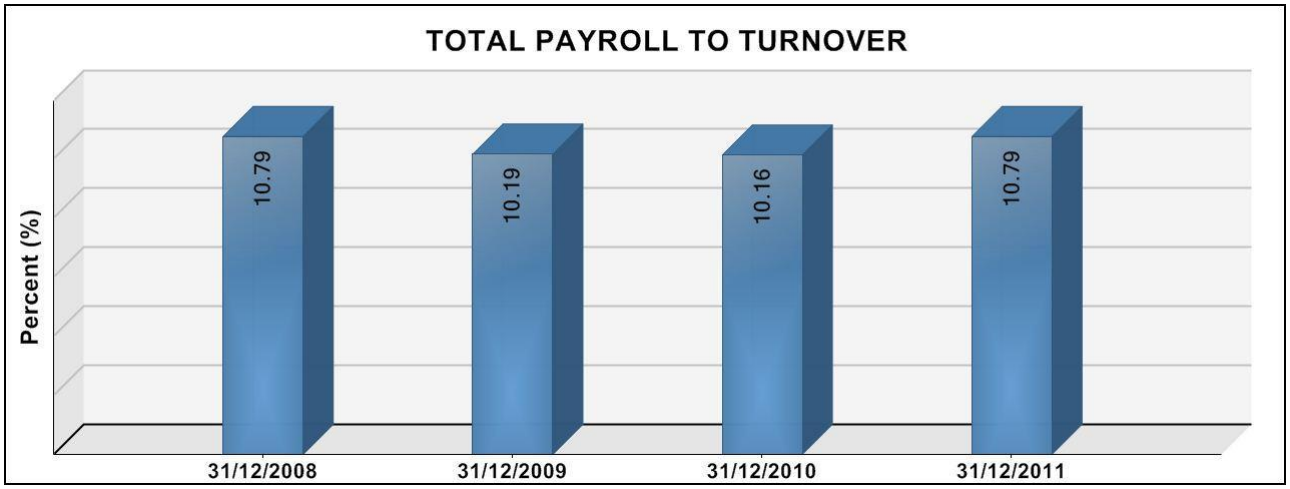
This metric shows advertising expense for the company as a percentage of turnover.



This metric shows rent for the company as a percentage of turnover.



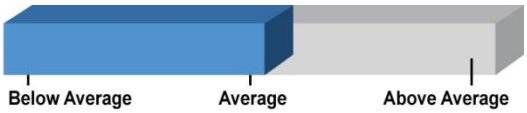
This metric shows G & A, wages and salaries for the company as a percentage of turnover.



This metric shows total payroll expense for the company as a percentage of turnover.

TURNOVER

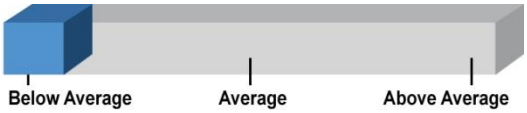
A measure of how turnover is growing and whether this is satisfactory for the company.



Turnover data is fairly simple to interpret -- turnover is either increasing or decreasing. This company's turnover is about the same now as it was in the previous period. However, the company's employee base has decreased slightly from last period, so the firm is **now moving more revenue through each employee**. Each employee is generating more turnover than last period, which is a favourable result. Generally, however, managers will want to look for longer-run trends in this area of the report.

BORROWING

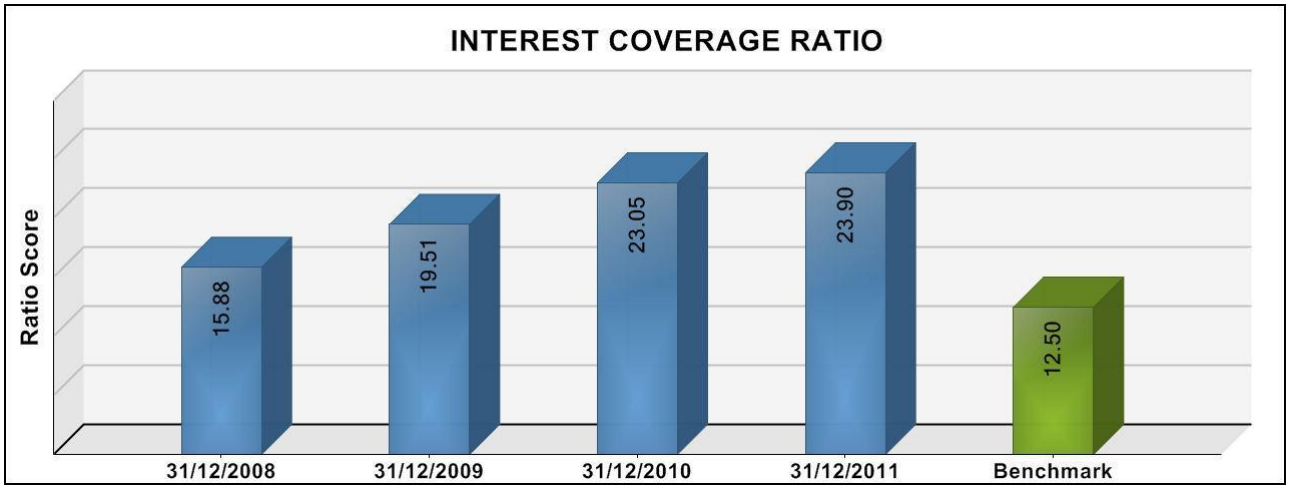
A measure of how responsibly the company is borrowing and how effectively it is managing debt.



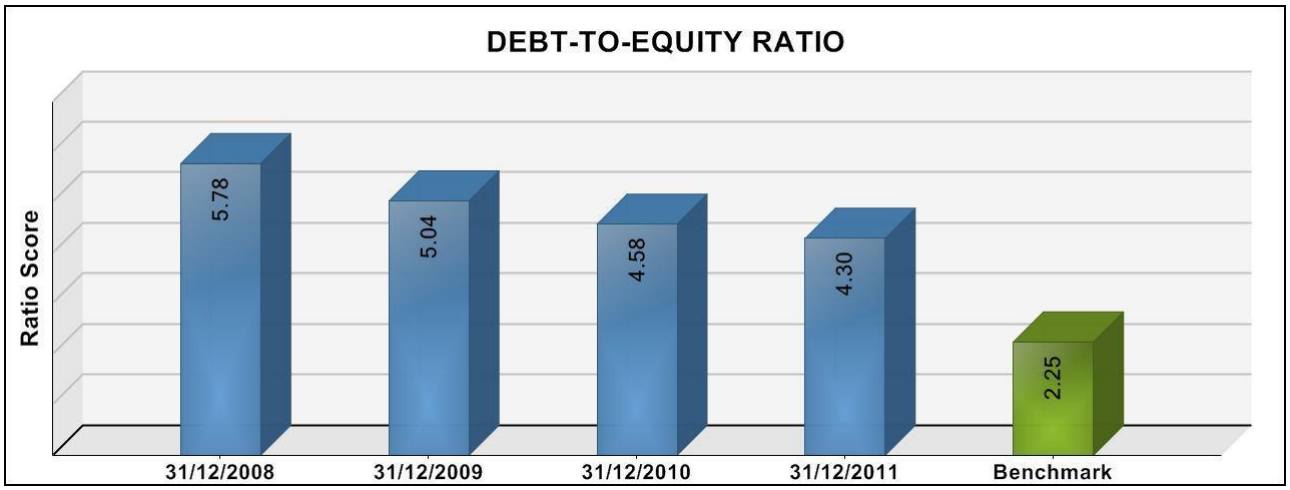
Even though total debt was increased in the company, net profitability stayed relatively the same as last period. This is only somewhat unfavourable in the short run, but it could be rather risky if continued in the long run. Basically, there is little advantage to increasing debt if this action does not improve profitability over time. This even holds true for short-term debt, which sometimes creeps up naturally in companies that are growing. Ultimately, all forms of debt carry risk and therefore require reward (profitability).

Although the company's trend of debt and profitability does not seem positive, it should be noted that the company has derived enough earnings (before interest and non-cash expenses) to meet interest expenses.

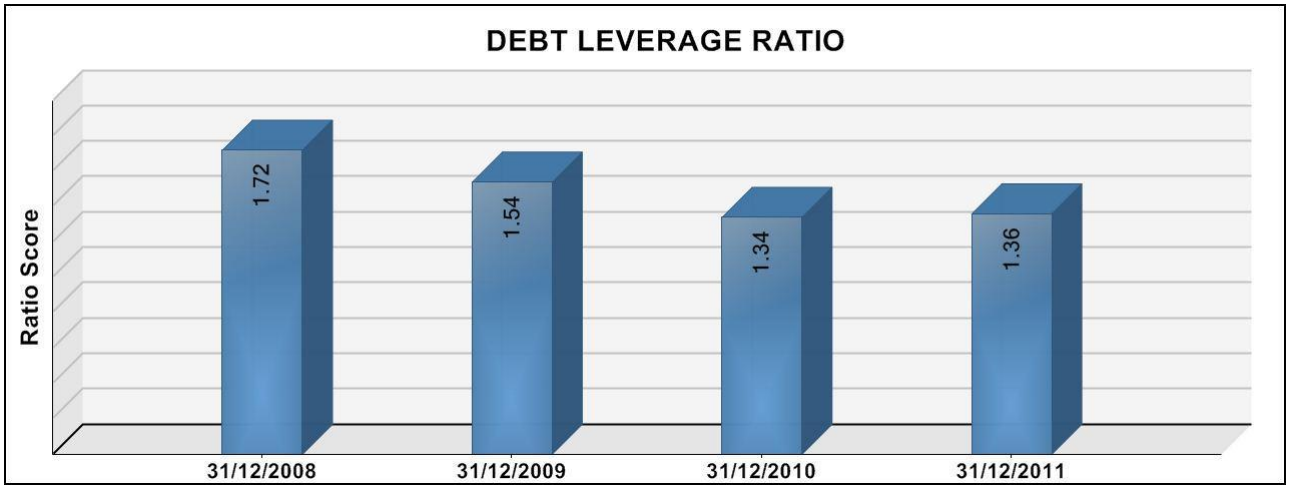
Also, this has been accomplished while maintaining a large amount of debt relative to total equity. Often, companies that are highly leveraged with a relatively unfavourable trend of debt and profitability would also have poor coverage ratios. Therefore, in this specific case, we would need to balance these considerations against the company's overall score.



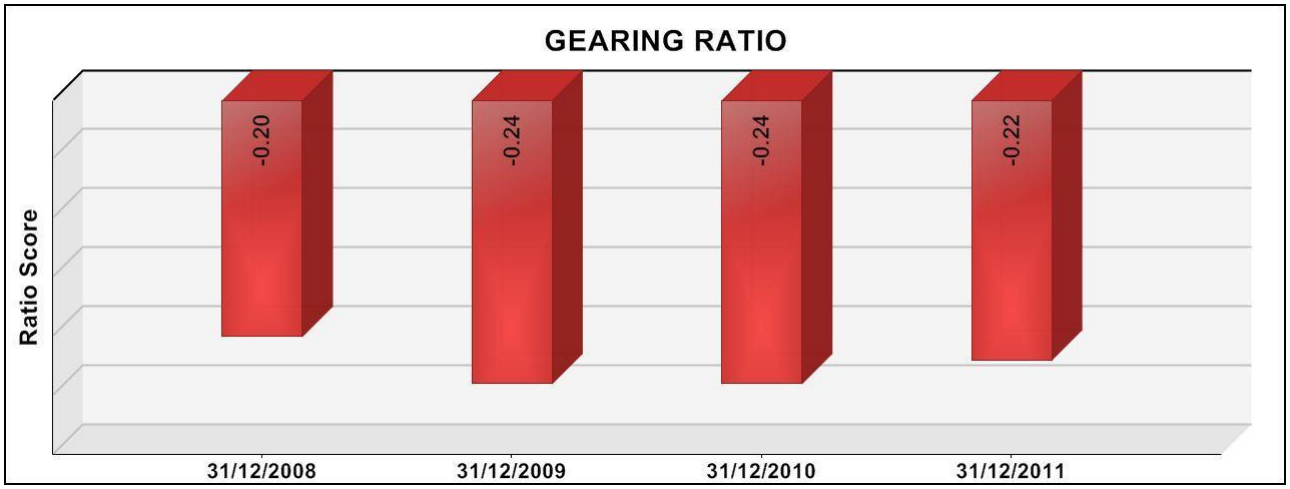
This ratio measures a company's ability to service debt payments from operating cash flow (EBITDA). An increasing ratio is a good indicator of improving credit quality. The higher the better.



This Balance Sheet leverage ratio indicates the composition of a company's total capitalisation -- the balance between money or assets owed versus the money or assets owned. Generally, creditors prefer a lower ratio to decrease financial risk while investors prefer a higher ratio to realise the return benefits of financial leverage.



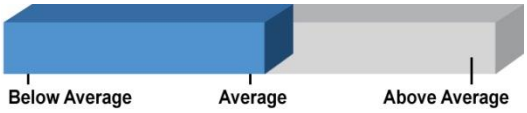
This ratio compares a business's total borrowings to the cash flow generated by the business available to pay back these borrowings. It is a rough measure of the company's capacity to incur additional borrowings.



The Gearing Ratio is Net Borrowings divided by Shareholders funds. It is an expression of the amount of external borrowing versus the amount invested by shareholders. Net borrowings are bank loans and overdrafts minus cash in hand and other deposit balances. A lower ratio is generally better as it shows a the company mainly financed by equity. Higher gearing rates show an overdependence on debt for a large portion of the company's capital needs.

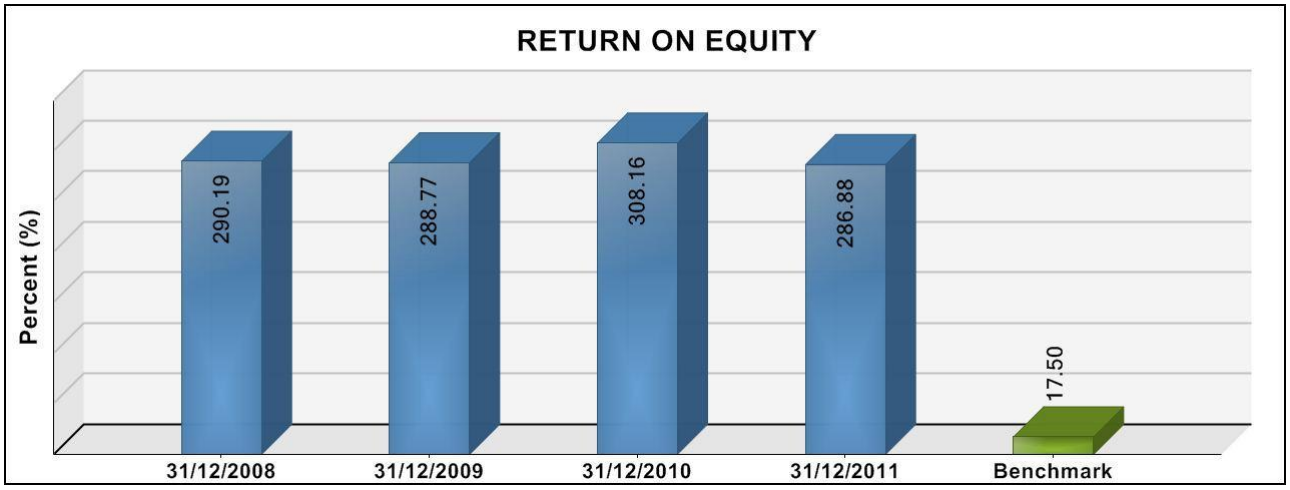
ASSETS

A measure of how effectively the company is utilising its tangible assets.

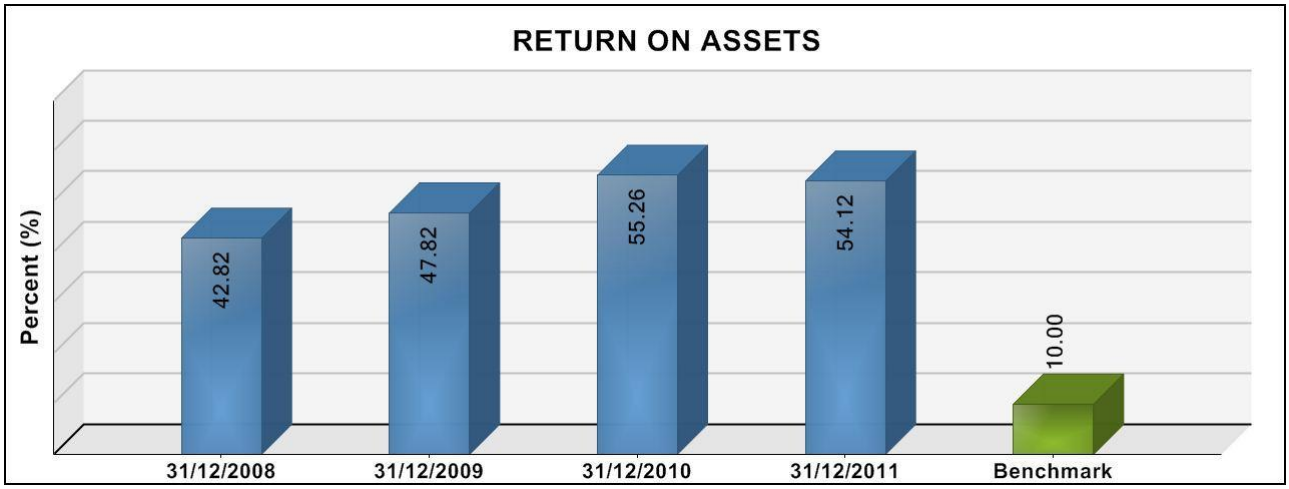


These results are not very conclusive. Basically, both assets and profitability stayed about the same as last period. However, the company is now generating less profitability per pound of assets on the books. It is concerning that the company is not improving efficiency with respect to assets and overall operations. With good asset management and a stable asset base, the company should be able to improve efficiency.

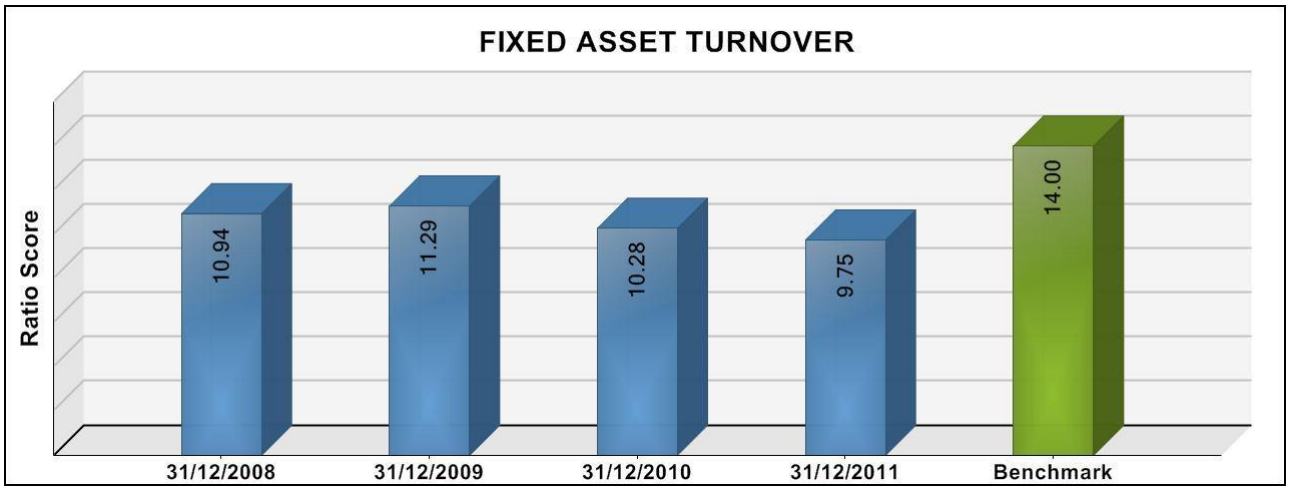
It is also important to highlight critical components that are positive. For example, the company has generated above average returns on equity and assets. While it is true that the changing relationship between operating profits and assets will guide long-term returns, in this case, real economic returns in assets and equity are excellent, a fact that needs to be balanced against the overall unfavourable trend.



This measure shows how much profit is being returned on the shareholders' equity each year. It is a vital statistic from the perspective of equity holders in a company. The higher the better.



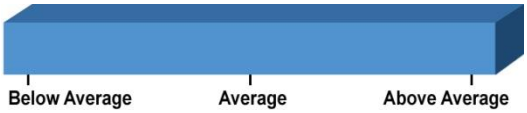
This calculation measures the business's ability to use its assets to create profits. Basically, ROA indicates what percentage of profit each pound of assets is producing per year. It is quite important since managers can only be evaluated by looking at how they use the assets available to them. The higher the better.



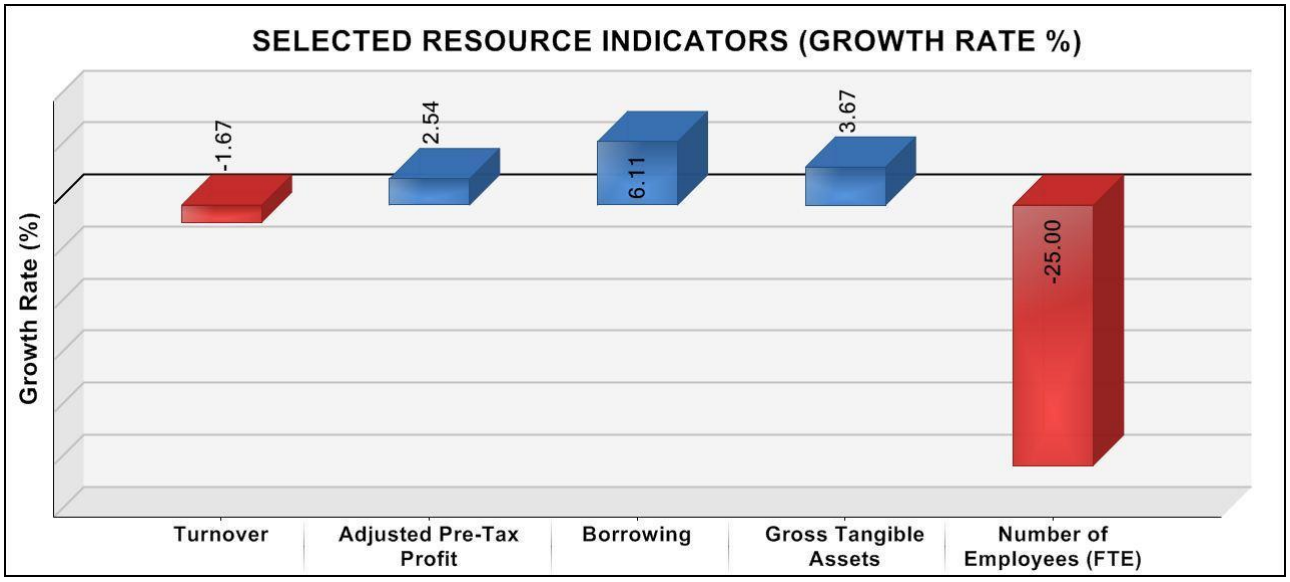
This asset management ratio shows the multiple of annualised turnover that each pound of tangible assets is producing. This indicator measures how well tangible assets are "throwing off" turnover and is very important to businesses that require significant investments in such assets. Readers should not emphasise this metric when looking at businesses that do not possess or require significant tangible assets. The higher the ratio, the more effective the company's investments in Net Property, Plant, and Equipment are.

EMPLOYEES

A measure of how effectively the company is hiring and managing its employees.



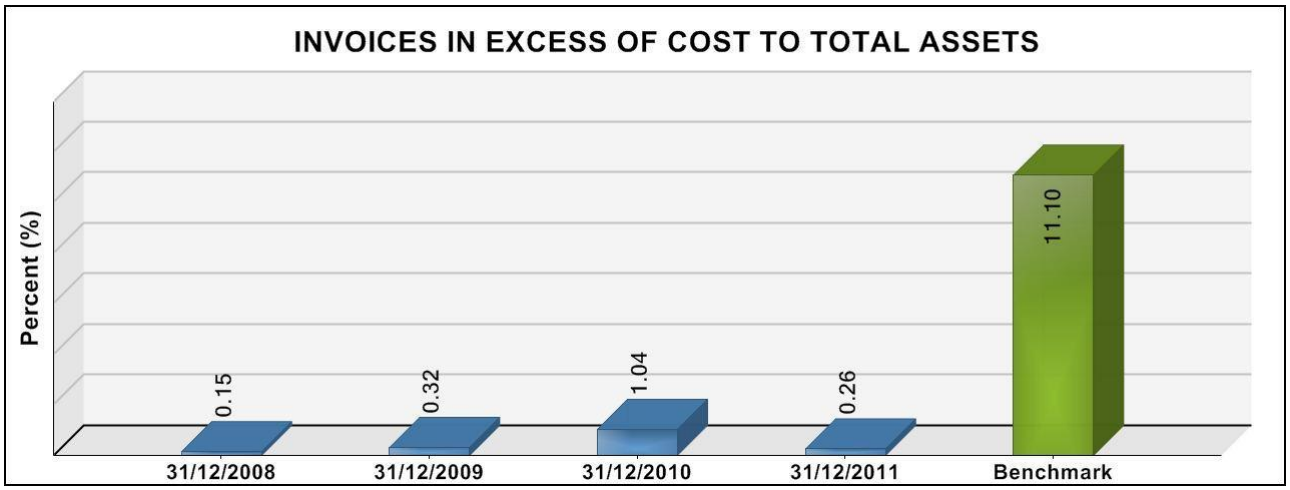
This company performed well in the employee area even though net profitability did not increase from last period. This is because the company has maintained about the same level of net profitability with **fewer** people on staff. The company is increasing level net profitability through a lighter employee load. This improves the net profitability per employee statistic, so it is a positive result when analysing the company's employee use in particular. If the company can maintain or improve net profitability with fewer people, then it will be more efficient in the long run.



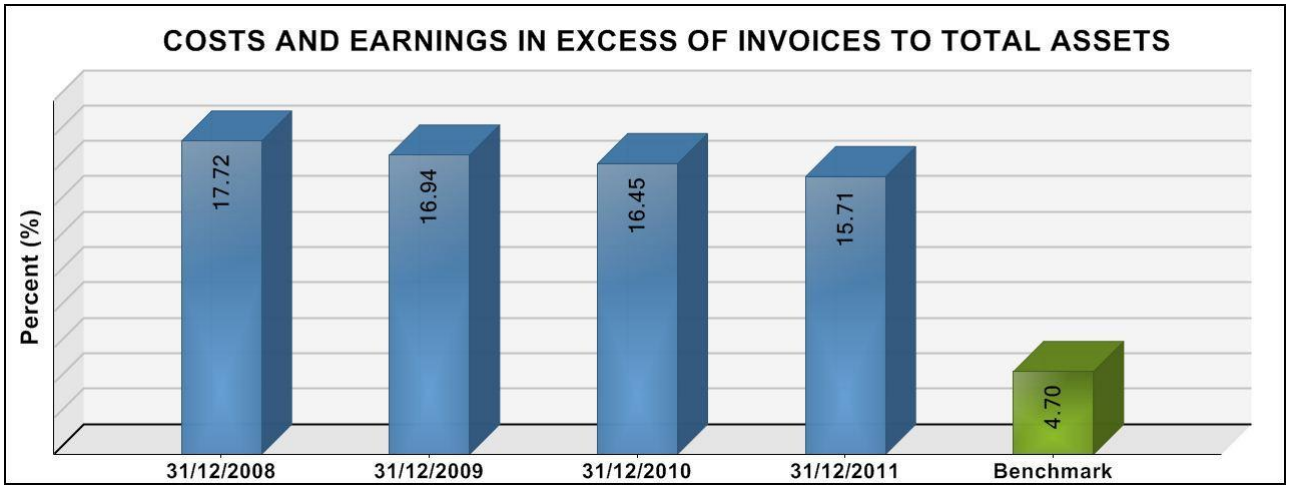
INDUSTRY-SPECIFIC PERFORMANCE RATIOS

What are the Key Performance Indicators for the business?

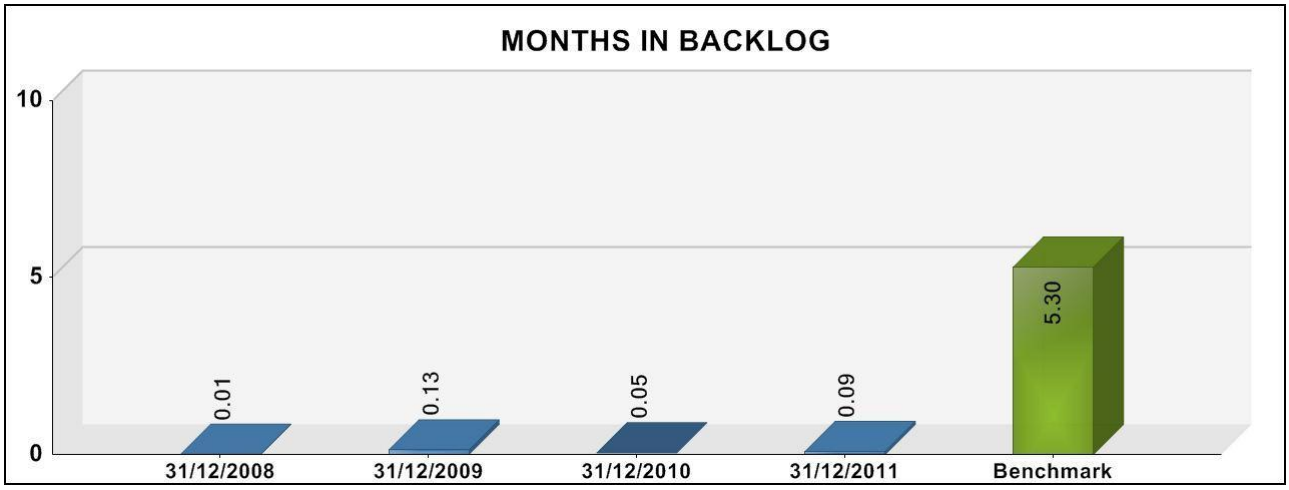
This section of the report provides **Key Performance Indicators** (or KPIs) for the business being analysed, and they are specific to the business's industry and revenue range. Track these KPIs over time and compare them to the industry averages to identify areas where the business might be able to improve operations.



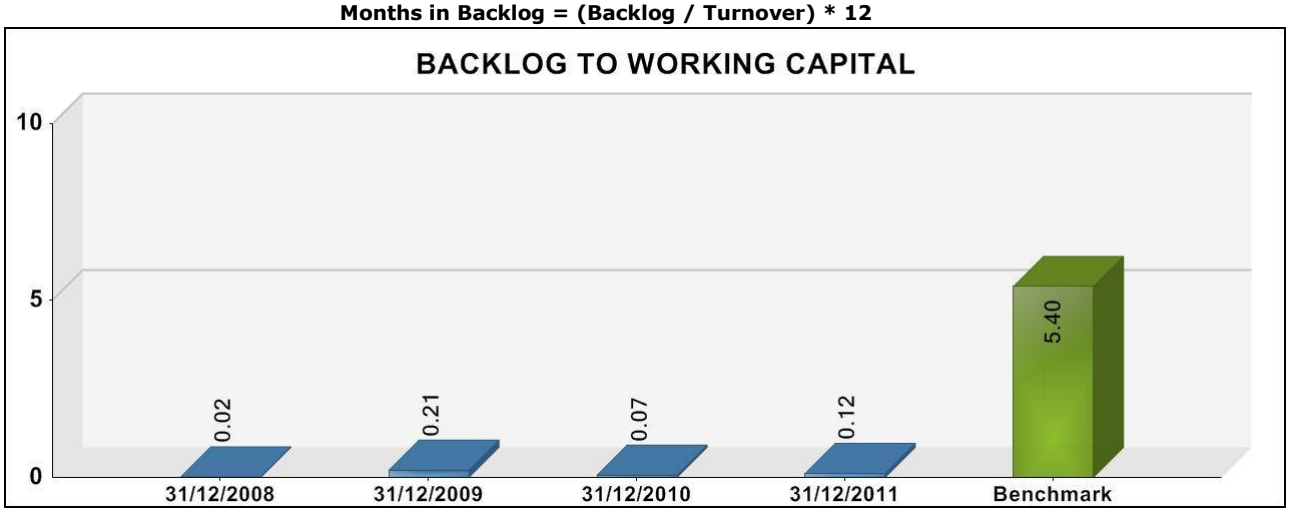
Invoices in Excess of Cost to Total Assets = Invoices in Excess of Costs / Total Assets



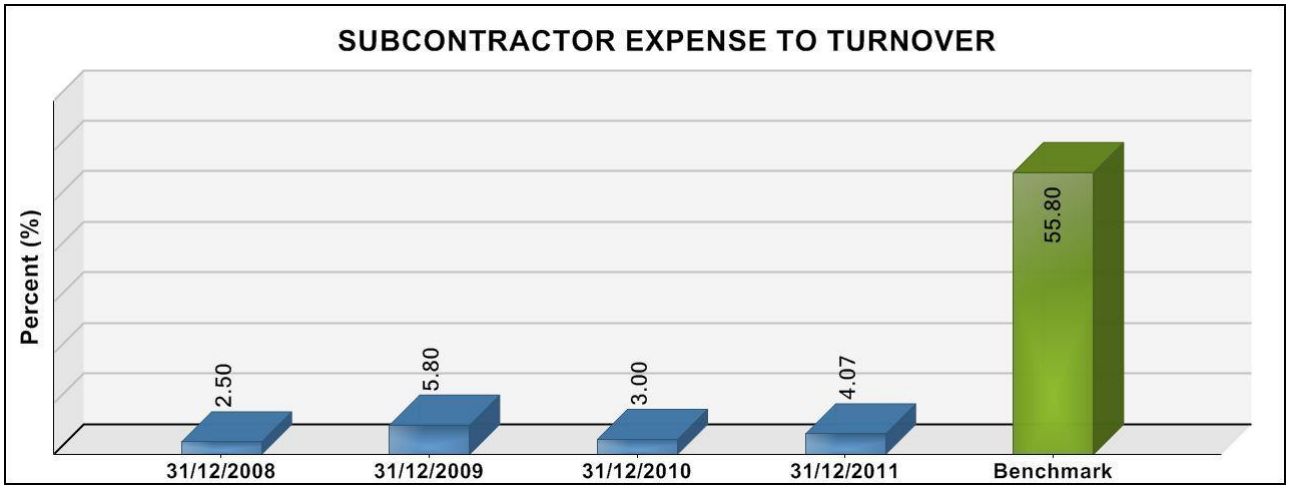
Costs and Earnings in Excess of Invoices to Total Assets = Costs and Earnings in Excess of Invoices / Total Assets



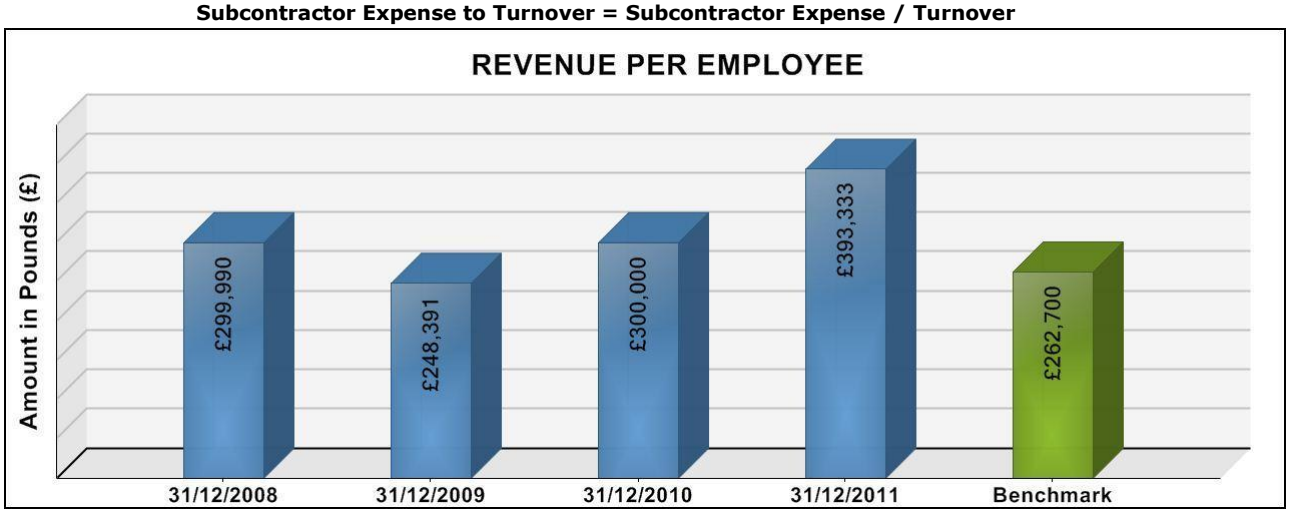
Months in Backlog = (Backlog / Turnover) * 12



Backlog to Working Capital = Backlog / (Current Assets - Current Liabilities)



Subcontractor Expense to Turnover = Subcontractor Expense / Turnover



Revenue Per Employee = Turnover / Employees