ANALYSIS OF FINANCIAL STATEMENTS

Table of contents

Introduction

Financial performance analysis is the most important but time consuming activity that the management of any company needs to perform to understand the sustainability of the business in the short and long run. Financial analysis indicates the market position of a company from different perspectives like, profitability, liquidity, efficiency, capital structure and investment attracting capacity. In this study, the financial performance analysis will be conducted considering the financial results of Carillion Plc for last three years that are from 2014 to 2016. The financial analysis will be conducted or perform following the technique of ratio analysis. At the same time, the study will provide some recommendations for further improvements of the financial performance of the company. Before concluding the overall study, a suggestion regarding the investment in Carillion Plc will be provided to one competitor of Carillion Plc.

1. Discussion and analysis of the financial performance and position of Carillion Plc

The financial performance of a company can be easily analyzed using the financial ratios. The financial ratios use the past data of the company to understand its financial performance trend. Here, for analyzing the financial performance of Carillion Plc, mainly five different types of financial ratios have been used. These financial ratios are – profitability ratios, liquidity ratios, and efficiency ratios, gearing ratio and investment ratios. These ratios of Carillion Plc are shown below:

Profitability ratios:	**2014**	**2015**	**2016**
Gross profit ratio	9.37347949	8.62885058	7.97970375
Operating profit ratio	5.0087295	4.6422153	3.3129309
Net profit ratio	3.64921721	3.52848862	2.94659719
Liquidity ratios:	**2014**	**2015**	**2016**
Current ratio	1.02461011	1.02354469	1.02363128
Quick ratio	0.996903	0.98723957	0.98809416

Efficiency ratios:	2014	2015	2016
Inventory turnover ratio	63.2015968	56.1399689	51.322335
Assets turnover ratio	0.89669952	1.02082634	0.99138301
Gearing ratio:	**2014**	**2015**	**2016**
Debt to equity ratio	1.33448854	1.06330483	2.03562132
Investment ratios:	**2014**	**2015**	**2016**
EPS	28	30.9	28.9
P/E ratio	2.05357143	2.4184466	4.41418685

(Source: Ft.com 2018)

Considering the ***profitability ratios*** of Carillion Plc in the above table, it can be stated that during the period of 2014 to 2016, the profitability position of the company has declined. The gross profit ratio, operating profit ratio and net profit ratio are showing continuous decrease in the profitability level of the business. For example, in the financial year 2014, the gross profit ratio of Carillion Plc was 9.37, which decreased to 8.62 in 2015 and 7.97 in the financial year 2016. The situation was almost same in the case of operating ratios and net profit ratios of the business.

The decreasing trend of the profitability of Carillion Plc is indicating that the cost level of the business has increased during these years because the revenue of the company increased gradually at this time. However, if the analysis is made in more critical manner, it can be identified that the percentage increased in the revenue of the company was very low and the difference between the revenue and cost of sales of the business was also very less. This has reduced the profitability of the business. This situation is indicating that the management of the company is unable to control the cost level and the marketing activities were not effective enough for increasing the level of sales of the business (Lins *et al.* 2017). This is not a satisfactory situation for the stakeholders like, shareholders, investors, management and employees because the income levels of these stakeholders are directly linked with the profitability of the company. Hence, the management of Carillion Plc needs to be more careful regarding the control of cost.

Considering the ***liquidity ratios*** of Carillion Plc it can be stated that the company had strong liquidity position during 2014 to 2016. At the same time, it can also be stated that the liquidity of the company was almost in the static level during these period. For example, in the year 2014, the current ratio was 1.0246; in 2015, the current ratio was 1.0235 and in 2016, the current ratio was 1.0236. These financial figures are indicating that the liquidity of the business was almost same in every year from 2014 to 2016. The situation was kind of similar in the context of quick ratios. However, it is also true that from 2014 to 2016, the quick ratio of the business decreased by a little percentage.

Analyzing the liquidity ratios of the business critically, it can be stated that the company had enough short-term assets to mitigate the short-term or current liabilities. This is indicating that the company was financially stable, which is good for the current position of the business (Loosemore and Lim 2017). Moreover, if the liquidity position of the business remains strong, the company can easily satisfy the short-term creditors. Due to this, the company can easily gather the short-term debt from the external market (Akgul *et al.* 2017). Therefore, the management of the company needs to maintain the liquidity position properly in the future to make the business easier.

The ***efficiency ratios*** of the business are indicating that the level of efficiency of Carillion Plc has declined during 2014 to 2016. As per the above table, in the year 2014, the inventory turnover ratio of the business was 63.201, which declined to 56.139 in the financial year 2015 and 21.3223 in the financial year 2016. This continuous decrease in the inventory turnover ratio is indicating that the company or its management failed to handle the inventory efficiently. At the same time, it is also indicating that due to the inefficiency of the management as well as employees, the company could not enhance the sales level by high amount. Moreover, the table is indicating that the inventory turnover ratio was in continuous decreasing trend, which indicates weak financial performance of the company.

This type of situation indicates danger for the business. However, in this context, it must be noted that the assets turnover ratio of the company was in bit fluctuating trend. In 2014, the assets turnover ratio was 0.89, which increased to 1.02 in the financial year 2015 and again in 2016 the ratio decreased to 0.99. This fluctuation indicates instability in the organizational performance. However, in the current competitive scenario, it is very important for the companies to maintain stability in their financial performances. Higher level of efficiency helps to maintain stability in the financial performance (Zhao *et al.* 2017). If the financial position of the company remains stable it becomes easier for the company to attract new investors and satisfy the existing shareholders.

The ***gearing ratio*** of Carillion Plc for the years 2014 to 2016 is indicating that the company is highly dependent on the debt capital. High dependency on the debt capital indicates that the risk level of the business is high. In this context, it is important to be mentioned that the debt to equity ratio of the business of Carillion Plc has gradually enhanced from 2014 to 2016, which means the management continuously increased the proportion of debt capital in the capital structure of the company. This affects the long-term stability of the business. At the same time, it can also be stated that the current capital structure of the business is not able to attract the investors those are not willing to take high risk in investment (Loosemore and Lim 2017).

Therefore, in this situation, it is important to reduce the proportion of debt capital in the capital structure of the business. If the company reduces the debt capital and enhance the proportion of equity capital, the overall risk of the business will be reduced. At the same time, the management will be able to enhance the amount of new investment.

The ***investment ratios*** of the business of Carillion Plc are indicating that the company is failure to satisfy its existing investors or shareholders. In the last three years that are from 2014 to 2016, the EPS to the shareholders was very low that is between the range of 28p to 30.9p, which was much low. On the other hand, the P/E ratios of the business are also indicating that the share value of the company in the market is low. However, it is also important to be mentioned that the value of share has increased by little proportion, which is indicating increasing trend of financial performance.

Therefore, from the overall analysis of the financial performance of the business, it can be stated that the management of the business is not efficient enough for improving the financial position of the business. The low profitability of the business is indicating that the company is losing its competency level in the national as well as international market (Lins *et al.* 2017). Decrease in the profitability level signifies that the management needs to take much care of the sustainability position of the business. As the liquidity position of the business is already strong, the management needs to take special care, so that the liquidity can be maintained in a better way in the long-run. Therefore, the higher authority of Carillion Plc needs to take immediate activities or develop the needful strategies for better survival of the organization. At the same time, the management also needs to reframe the capital structure to reduce the level of risk in the capital structure.

2. Recommendations for the improvement of financial ratios of the company

The above analysis of the financial results of Carillion Plc is indicating that the management needs to improve the financial performance as soon as possible. In order to improve the financial performance of the company, the management of Carillion Plc may adopt the following strategies:

- ***Performing detail analysis of employees' performance standards* –** The financial analysis has indicated that the performance standards of the employees at Carillion Plc are not up to the market. Therefore, in order to improve the financial performance standards, the higher authority of the company needs to take special care of the performance analysis of employees. This will help the management identifying in which area the employees are lacking behind (Vuong *et al.* 2017).
- ***Arranging employees' training session* –** After analyzing the employees' performance standards and identifying the areas of improvements, the management of Carillion Plc needs to arrange for training sessions, which will be arranged especially for improving the lacking areas of the employees. This will also help the employees in developing their performance level in the coming financial year (Wang and Sarkis 2017).
- ***Improved inventory management system* –** The management of Carillion Plc also needs to take care of the inventory management of the business. In the financial ratios analysis, it has been determined that the inventory turnover is low, which indicates poor inventory management of the business. In this context, the management of Carillion Plc may consider the FIFO or LIFO or AVCO method for better inventory management. These

systems or methods are quite effective in maintaining smooth flow of goods and services from the company to the end users (Wolfson *et al.* 2018). At the same time, improved level of inventory will enhance the current assets of the business, which will help to maintain the liquidity position of the business.

- ***Better promotional strategies* –** The financial ratio analysis has shown that the profitability of the business during the last three years was very poor and at the same time, it has also been mentioned that the company failed to enhance its revenue by higher proportion. Therefore, in order to improve the situation, the management needs to concentrate on the promotional strategies of the business. The management may focus on the online promotion through social media. This will help to reach to a large number of customers within very less time (Vuong *et al.* 2017). Therefore, the revenue will be enhanced very easily and quickly.
- ***Employment relation* –** The management of Carillion Plc also needs to focus on the employment relationship within the business. Considering the current and the past situation of the business, it must be noted that the employee retention rate in Carillion Plc is very low, which means the employment relationship within the organization is not much strong. However, in order to improve the financial performance, maintaining better employment relation is very important (Wolfson *et al.* 2018). In this context, it can be stated that the management can maintain better employment relationship through the satisfaction of the employees and co-ordination among the people within the country.

3. Suggestion to the competitor

One of the competitors of Carillion Plc is planning to buy 15% shares of the company. However, before investing in any company, it is important to analyze the viability and suitability of the investment (Alwan *et al.* 2017). In the context of the competitor of Carillion Plc, it can be stated that the management of that competitor organization needs to verify the vitality and suitability of the investment in Carillion Plc by focusing on two different methods. The first method is the calculation of P/E ratio and the second method is dividend yield method.

The valuation of the 15% share of the business is determined below:

Determining the P/E ratio of the Carillion Plc in 2016:

P/E Ratio = Price per share / Earnings per share

= 127.57p / 28.9p

= 4.4142

Determining the dividend yield of Carillion Plc in 2016:

Dividend yield = Dividend per share / Price per share

= 18.45p / 127.57

= 0.14

Therefore, if the two calculations of the share value of the company are considered, it can be stated that the value of Carillion Plc's share is low, which means if the management of the competitor firm decides to invest in the share of Carillion Plc, it will not be that much beneficial for the competitor. The P/E ratio of a business indicates the measurement of the price of the share in the current scenario on the basis of the earnings per share. On the other hand, the dividend yield indicates that the percentage of earnings that the shareholders may generate from the business in terms of dividend. As the results of the two measurements are indicating that the competitor of Carillion Plc will not be able to generate much income by investing in this particular firm. At the same time, it can also be stated that the financial performance standard of the company as per the financial ratios are also not up to the mark. Therefore, it can be stated that the competitor firm should not invest in the share of Carillion Plc.

4. Suggestion to the elderly relative

In the current scenario, Carillion Plc is operating its business internationally. It means the business of Carillion Plc has been expanded over a large portion of market. However, as per the results of the financial analysis of Carillion Plc for 2014 to 2016, it can be stated that the company is suffering from financial problems since last few years. There is lack of profitability in the business. The gross profit, operating profit and net profit margins of the business during the last three years were much low and these were below the industry standards. At the same time, the efficiency level of the business was also low. There was very low growth rate of the revenue, which means the income generating capacity of the business was limited. Moreover, the capital structure of the business was very risky, which is another matter of consideration in this context. However, one of the positive points in the financial ratios of the business is the strong liquidity of the organization.

Apart from the financial ratios of the company, the study has also determined the value of the shares of Carillion Plc based on the performance of the business in 2016 and it has been identified that the value of the share was not much high, which is again indicating that the company needs improvements in the financial performance standards. Therefore, considering the overall market scenario and the financial performance of the Carillion Plc, it can be suggested to the elderly relative that he or she can invest in the shares of Carillion Plc. However, this investment must be for the long period. It is because if the elderly relative invests for the long period, the risk level of the investment will be lower and there will be higher chances of achieving profit from the investment (Vuong *et al.* 2017). As the company is reputed in the national and international market, it can be considered that in the future, the value of the share of Carillion Plc will be increased by the increase in the share price of the company. At the same time, it can also be considered that the management of Carillion Plc will be conscious enough for improving their financial performance, which will help the company enhancing the level of profitability.

Therefore, it can be stated that in the long run, there are more chances of enhancing the share value or financial performance of the business, which will increase the return percentage to the investors. Therefore, long-term investment in the shares of Carillion Plc will be suitable or will minimize the risk level and maximize the return percentage to the elderly relation.

Conclusion

The discussion and analysis in this study have indicated that the financial position of Carillion Plc can be considered as weak performance. The study has performed the financial ratio analysis by considering the financial results of Carillion Plc for the years 2014, 2015 and 2016. After the analysis, it has been pointed out that the management of Carillion Plc needs to improve company’s profitability, efficiency and investment ratios. At the same time, it has also been indicated that the capital structure of the business is risky due to the higher proportion of debt capital. The study has suggested that in order to improve the financial position the management of Carillion Plc needs to improve the inventory management system, reduce the cost level and arrange the training sessions for the employees. While identifying the value of stock based on the P/E ratio and dividend yield, the study has suggested that the competitor of Carillion Plc must avoid investing in the 15% share of Carillion Plc. However, the study has also suggested that an individual can invest in Carillion Plc for the long run only.

Reference list

Akgul, B.K., Ozorhon, B., Dikmen, I. and Birgonul, M.T., 2017. Social network analysis of construction companies operating in international markets: case of Turkish contractors. *Journal of Civil Engineering and Management*, *23*(3), pp.327-337.

Alwan, Z., Jones, P. and Holgate, P., 2017. Strategic sustainable development in the UK construction industry, through the framework for strategic sustainable development, using Building Information Modelling. *Journal of cleaner production*, *140*, pp.349-358.

Ft.com. 2018. *Carillion PLC*. [online] Available at: https://www.ft.com/topics/organisations/Carillion_PLC [Accessed 7 Mar. 2018].

Lins, K.V., Servaes, H. and Tamayo, A., 2017. Social capital, trust, and firm performance: The value of corporate social responsibility during the financial crisis. *The Journal of Finance*, *72*(4), pp.1785-1824.

Loosemore, M. and Lim, B.T.H., 2017. Linking corporate social responsibility and organizational performance in the construction industry. *Construction management and economics*, *35*(3), pp.90-105.

Vuong, N.B., Vu, T.T.Q. and Mitra, P., 2017. Impact of Capital Structure on Firm's Financial Performance: Evidence from United Kingdom. *Journal of Finance and Economics Research*, *2*(1), pp.16-29.

Wang, Z. and Sarkis, J., 2017. Corporate social responsibility governance, outcomes, and financial performance. *Journal of Cleaner Production*, *162*, pp.1607-1616.

Wolfson, M.A., Tannenbaum, S.I., Mathieu, J.E. and Maynard, M.T., 2018. A cross-level investigation of informal field-based learning and performance improvements. *Journal of Applied Psychology*, *103*(1), p.14.

Zhao, Z.Y., Tang, C., Zhang, X. and Skitmore, M., 2017. Agglomeration and competitive position of contractors in the international construction sector. *Journal of Construction Engineering and Management*, *143*(6), p.04017004.