MEMORANDUM

TO: Board of Directors & Management

FROM: Eric Watson

SUBJECT: Analysis of Common Size Income Statement

After a review and analysis of a common size income statement for your company over the past three years I have found some trends that need to be addressed immediately.

As your company grows expenses will increase because of growth but the percentages at which they are increasing are alarming because of how it is affecting your net income. Your COGS has increased by 6% dropping your gross margin by equally. We must address this and find a more effective way to develop your products to increase the gross margin.

Marketing is another expense that has dramatically increased. Which makes sense with the increase in sales but we need to meet with the marketing department and look for new ways to market in order to increase sales even higher. This may mean increasing the price of products. This is imperative! Your earnings before interest and tax have declined 14% in 3 years and your net income has declined 9.6%.

If we do not address these problems soon, you will be in the RED next year! At the moment we cannot afford to increase spending in any department. We need to find ways to use the money they have more effectively.

MEMORANDUM

TO: Board of Directors & Management

FROM: Eric Watson

SUBJECT: Analysis of Statement of Cash Flows for 20X2 and 20X3

To start on a positive note we have a positive cash flow in 20X2 and 20X3. Unfortunately this is not always a good thing.

In 20X2 we have a good cash flow from net income. Other than that our major cash flow came from an increase in long term debt and depreciation.

In 20X3 we have some cash flow coming from net income but it was almost half as much as in 20X2. Again our two biggest cash flows were depreciation and an increase in long term debt.

Your company is seeing less cash coming in from net income each year. With a pretty significant increase in accounts receivable and inventory which is not a good sign. There needs to be a tremendous push to collect on accounts receivable. Possibly introduce a cut back on production because of the increase in inventory.

In the very near future your cash flow may remain positive but it will become negative soon and the company will be in deep financial trouble if something is not done.

MEMORANDUM

TO: Board of Directors & Management

FROM: Eric Watson

SUBJECT: Analysis of Liquidity, Asset Management, Debt Management and Profitability Ratios

Liquidity: We are staying above the industry average in both the current and quick ratio. This is due to the company's continuously growing inventory and accounts receivable. Which is not good for the company's financial standing. This will be shown in more depth from the asset management ratios.

Asset Management: In 20X1 we were right around or even better than the industry average but in the past two years the company has been on a steep decline, specifically in ACP and inventory turnover. In 20X1 our ACP was 40.7 days a little over a day better than the industry average. In 20X2 we are 18.5 days behind the industry average and in 20X3 we are 24.3 days behind the industry average. That means we are collecting what we are owed in 20X2 and 20X3 over a month after we were owed payment. Our inventory turnover has also declined by one 1x each year since 20X1. That means we are selling our inventory at a slower rate. This are both very bad signs.

Debt Management: As publically traded company, you never your company being financed through debt more than 50%. Protek's current debt ratio is 69.6%. This is something that needs to be addressed IMMEDIATELY! The debt: equity is also increasing, while times earned interest in steadily decreasing. This company must make a significant push to collect on accounts receivable and gain more financing through equity to pay off debt. This company will be on the verge of bankruptcy very soon.

Profitability: In 20X1 Protek's ROS, ROA and ROE were all well above the industry average. Which is phenomenal, in the last two years though all of these have dropped catastrophically. In 20X3 the ROS was only 2.4%, ROA was 3.0% and ROE was 10%. The industry average for ROS is 9%, ROA is 10.8% and ROE is 22.8%. With the dramatic drop in profitability it is going to become increasingly difficult to gain financing through equity.