COVER PAGE AND DECLARATION

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Introduction

The financial statements are important source of information for the investors to determine the performance of a business and accordingly take decisions relating to their investments. To get a proper understanding of the performance of a business and its trends, key financial ratios are considered often by investors. Financial ratios cover the different categories of ratios which are important indicators of the financial performance of a business and thereby help in determining the overall financial health of the company.

The focus of this assessment is to review the financial health of Gulf Services and Industrial Supplies Co which is engaged in providing industrial tools to the customers and support gulf companies with their operations (Gulf Services & Industrial Supplies Company LLC, 2023). To assess the financial health of the company, key financial ratios are computed for the last four years considering the annual reports of the business. The analysis would be recommendations management based on the ratios computed so that the operations of the business can be improved. Further the analysis would be considering a project which the company wants to implement for improving its operations. For such a project, investment appraisal techniques would be applied for ensuring that the project is viable or not for the future. In addition to this, financing decisions for the project would be considered in terms of whether the business should use retained earnings or any other source of finance.

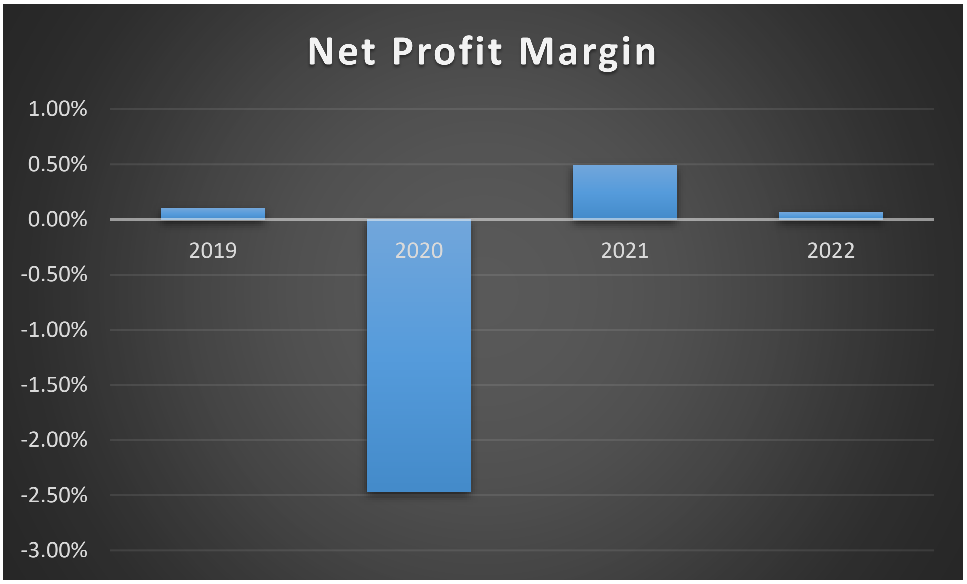
Performance Assessment

The performance of Gulf Services and Industrial Supplies Co would be assessed based on the information covered in the financial reports and it would be the basis on which key financial ratios are computed. To make comparisons between ratios and establish a trend, ratios are computed for the past four years (2019- 2022). The different category of ratios which are considered for analysis are listed and explained below:

Profitability Ratios

The profitability ratios for a business are important as they determine whether the business is generating appropriate profits. The profitability ratios cover some of the key ratios which are considered by investors to take decisions whether the financial health of the company is sound or not. The profitability ratios cover gross profit margin, net profit margin, and return on equity and assets s portrayed in the table below:

Profitability ratios		**2019**	**2020**	**2021**	**2022**
Gross margin	(Gross Profit/ Revenue) *100%	24.78 %	24.32 %	24.84 %	28.22 %
Net Profit margin	(Net Profit/ Revenue) *100%	0.10 %	-2.47 %	0.50 %	0.07 %
Return on equity	(Net profit/ Total Equity)	0.15 %	-2.79 %	0.55 %	0.07 %
Return on Capital Employed	Operating Profit/ (equity +Non-Current Liabilities)	31.79 %	25.15 %	25.63 %	26.60 %
Return on Total Assets	(Net profit/ Total Assets)	0.07 %	-1.44 %	0.32 %	0.04 %

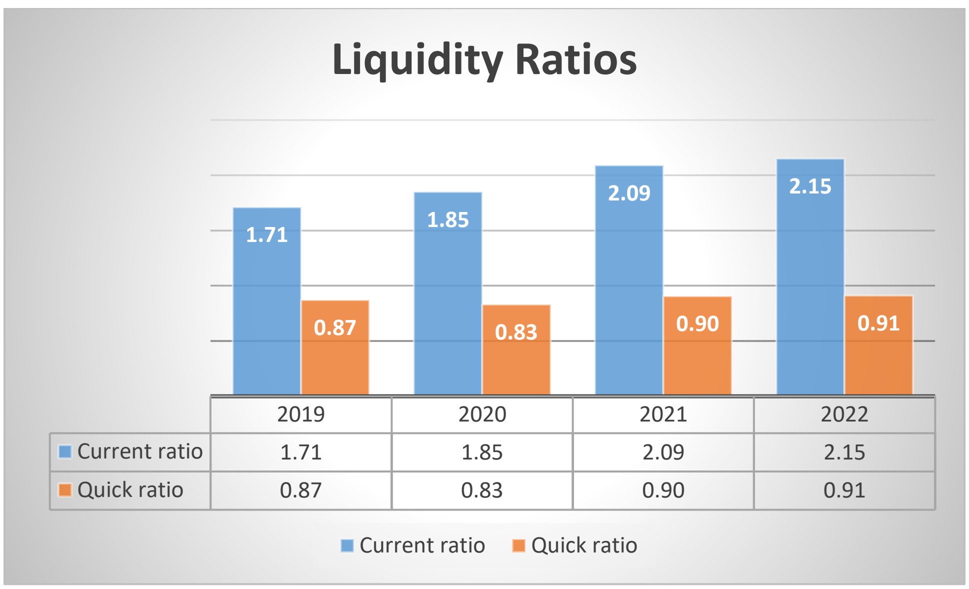


The gross profit margin for Gulf Services and Industrial Supplies Co for 2022 is shown to have increased in comparison to 2021 and the same is represented to be 28.22%. This shows that the business is managing its direct costs of operations in a better manner. However, the net profit margin for the company in 2022 is shown to be 0.07% which is significantly low in comparison to last year which was 0.50%. The graph which is presented above also gives a clear idea that the profitability trend of the business is not appropriate and thereby investors cannot rely on it for taking investment decisions (Fridson & Alvarez, 2022). The decline in net profit margin suggests that the company is not managing its overhead expenses or indirect expenses in an appropriate manner and therefore the business is barely making profits. The return on equity and return on assets is shown to be 0.07% and 0.04% which is significantly low which provides further evidence that the business is not doing so well in terms of profitability. The management of Gulf Services and Industrial Supplies Co should seriously consider on making plans on improving profitability as it directly affects the behaviours of the investors.

Liquidity Ratios

The liquidity ratios for the business are assessed by the current assets and liabilities which the business manages. The liquidity ratios provide insights regarding the liquidity position of the business and how much the business has capacity to finance its operations. The main ratios which are computed under this category include current ratio and quick ratio as portrayed in the table below:

Liquidity ratio		**2019**	**2020**	**2021**	**2022**
Current ratio	Current Assets/ Current Liabilities	1.71	1.85	2.09	2.15
Quick ratio	(Current Assets-Inventory)/ Current Liabilities	0.87	0.83	0.90	0.91
Cash Ratio	Cash/ Current Liabilities	0.02	0.02	0.06	0.02

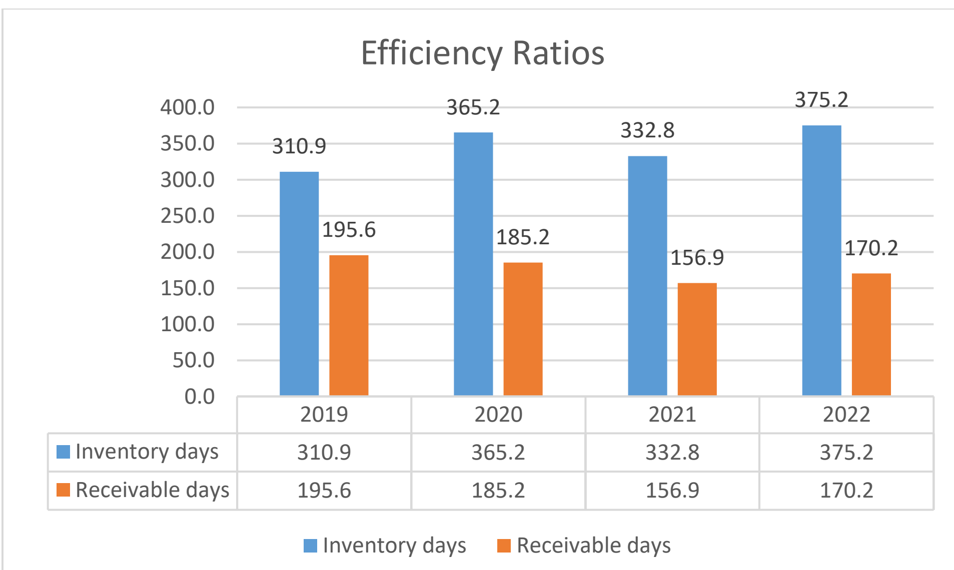


The current ratio which is computed above shows an increasing trend considering the last four years. The estimate was 1.71 in 2019 and this estimate has improved to 2.15 in 2022 which clearly shows that the management has worked to enhance its liquidity so that future opportunities can be accessed easily. The management has made a conscious effort to ensure that the liquidity is maintained so that any current obligation which may arise is managed (Palepu et al., 2020). The quick ratio for the business also shows an increasing trend clearly suggesting that the liquidity of the business has improved over the years, and it is even better than the ideal scenario. A good liquidity ratio suggests that the business is in a good position to start off new operations or invest in new opportunities for the growth of the entire firm.

Efficiency Ratio

The efficiency ratio is the category of ratios which are directly influenced by the internal policies of the business and have an Impact on the efficiency of the business. The key ratios which are computed under this category are receivable days, inventory days and payable days. These ratios are directly influenced by the internal policies of the business and the management should be vigilant to ensure that such policies are set appropriately. The table presented below shows the efficiency ratio which are computed for Gulf Services and Industrial Supplies Co:

Efficiency ratios		**2019**	**2020**	**2021**	**2022**
Trade payable days	(Total Payables/COGS) *365 Days	63.7	82.3	84.4	75.3
Inventory days	(Inventory/ COGS) *365 Days	310.9	365.2	332.8	375.2
Receivable days	(Account Receivables/ Sales) *365 days	195.6	185.2	156.9	170.2

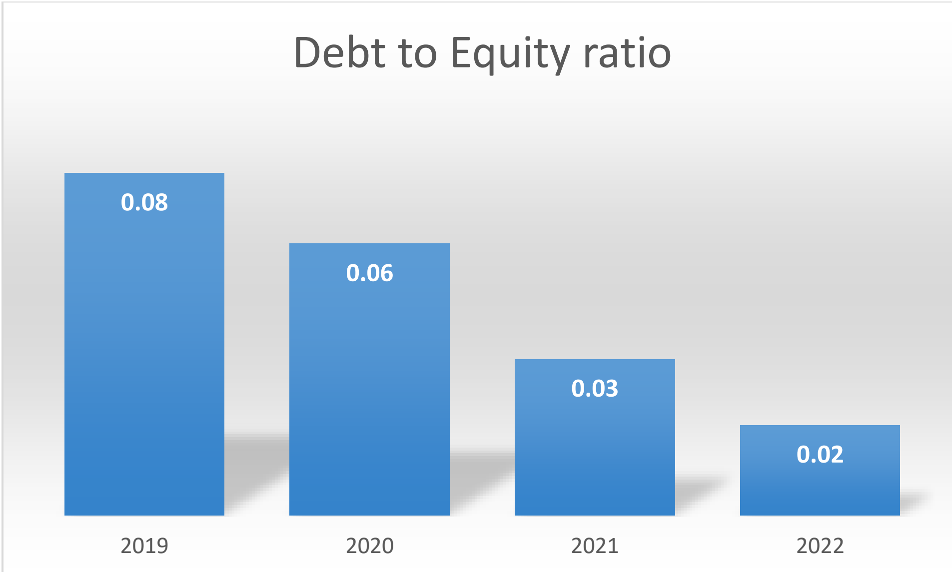


The receivables days which are computed for Gulf Services and Industrial Supplies Co. shows that the receivables day has increased to 170 in 2022 which was 157 days in 2021. This clearly suggests that the management has made some changes to its internal policies of debtors and thereby the credit period has increased. Further the inventory days has also increased to 375 days from 332 days in 2022. This clearly suggests that there have been some lapses in efficiency of the business which can be a major concern for the business as it can enhance the costs of the business (Wahlen, Baginski, & Bradshaw, 2022). The management of Gulf Services and Industrial Supplies Co needs to ensure that the internal policies are set appropriately so that it does not have any adverse effect on other areas of performance.

Gearing Ratios

The next category of ratios which are computed for the business are gearing ratios which are closely associated with the capital structure of the business. The gearing ratios are used by investors and even the management to determine the percentage of leverage which is used by the management in the capital structure of the company (Husna & Satria, 2019). Some of the important ratios which are computed under such a category is debt equity ratio and interest cover ratio. A table which is presented below shows the key gearing ratios which are computed for the business:

Gearing ratio		**2019**	**2020**	**2021**	**2022**
Debt to Equity ratio	Total Debt/ Total Equity	0.08	0.06	0.03	0.02
Debt ratio	Total Liabilities/ Total Assets	0.54	0.48	0.41	0.39
Interest cover	EBITDA/ Interest expenses	6.23	5.05	7.63	10.59

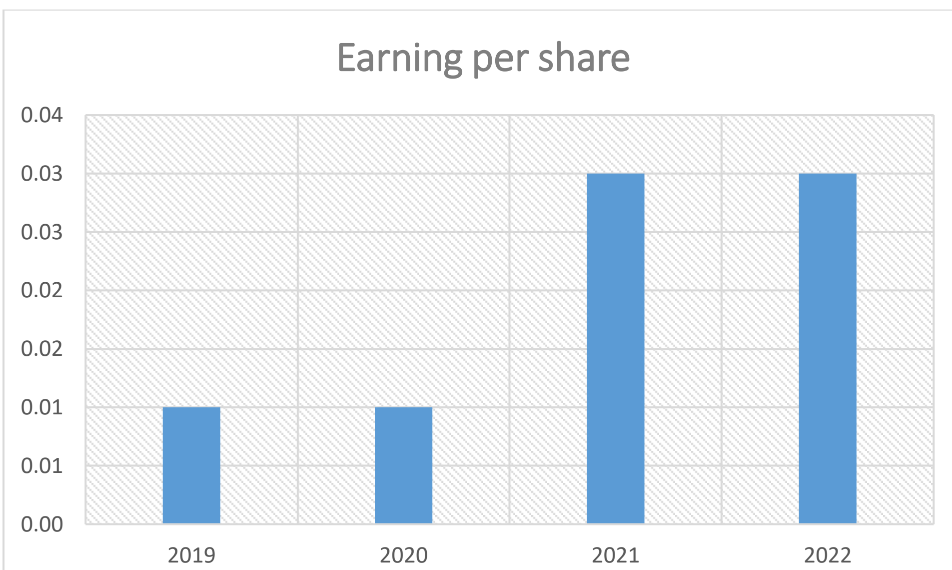


The debt equity ratio for the business shows a consistent decline in estimate which suggests that the management is trying to reduce the proportion of debt capital which is being used in the capital structure of the business and thereby maintain an optimum capital structure. The debt ratio which is computed, or the business also depicts a similar result which is a clear indicator that the management is looking for more proportion of equity capital in the capital structure. The interest coverage ratio has improved in 2022 which is a sign that the business is trying service the remaining debt capital in an appropriate manner so that efficiency is achieved (Weygandt et al., 2019). The approach of the management suggests that the business is looking to dilute its debt proportion so that the risk return relationship is appropriately managed.

Market Ratios

The market ratios are computed by businesses so that the perception of the market can be understood regarding the stocks of the business. Some of the key ratios which are covered by market ratio includes price earnings ratio and earnings per share (Gitman, Juchau & Flanagan, 2015). These ratios are important for the investors as it helps them to determine whether the company in which they are investing actually takes care of the investors or not. For the business of Gulf Services and Industrial Supplies Co, market ratios would be different as the company itself is 99% owned by Arabi Group and therefore it is the parent company (Yahoo.com. 2023). For such a reason the market price of Arabi group is considered for computing the market ratios of lf Services and Industrial Supplies Co. The table which is portrayed below shows some of the key market ratios which can be considered by investors.

Market Ratios		**2019**	**2020**	**2021**	**2022**
Earnings per Share		0.01	0.01	0.03	0.03
Price Earnings Ratio	Market price/ Earning per share	6500	21100	6600	14800
Book value to Market Value	Market price/ Book value per share	6.5	21.1	19.8	44.4



The market ratios which are computed above shows the price earnings ratio and earning per share which are more prominent. The trend shows that due to the deteriorating financial performance, the business has not been able to pay attention to the needs of the investors. The management of Gulf Services and Industrial Supplies Co have made a consistent effort to reduce the losses so that some profit margin can be generated. As per the estimates which are computed, the market ratios have hardly improved in 2022 from previous period which shows that the management should solely focus on improving its profitability first.

Based on the key financial ratios which are computed, it can be said that the financial health of the business has deteriorated over the last few years. For instance, the profitability ratios shows that the business is barely making profits and therefore this is putting significant effort on the reserves and retained earnings maintained. Further the efficiency ratio shows that the efficiency level in the organization has reduced in 2022 and therefore serious improvements are required.

Recommendations for Improvements

The financial ratios which are computed for the business provides a great deal of information regarding the current performance of the business in 2022 and the trend over the last four years. The performance assessment above shows different category of ratios which reveals performance aspects regarding different area of operation. The recommendation which can be given to the management of Gulf Services and Industrial Supplies Co are listed below:

1. The profitability ratios are the major concern area for the business as it has not shown significant improvement from 2021 or the past years which clearly suggests that the business is struggling to maintain its costs which in turn is affecting the profits of the business. The management needs a better monitoring function wherein budgets are implemented so that regular updates are present on cost over runs and such budgets would also ensure that the business is able to utilise its resources in an optimum manner. There is a requirement for the business to ensure that sales revenue is also increased so that the profit margins can be boasted

automatically.

2. The liquidity of the business is one of the positives for the management as it is more than ideal standards and this has continuously improved over the years. The management of Gulf Services and Industrial Supplies Co can take advantage of its liquidity situation and make investments in projects which can help the business develop competitive advantage in the market and thereby enhance the revenue generation capacity of the business.
3. The efficiency ratio shows that the estimates are not favourable, and this suggests that the internal policies are not efficient. It is recommended to the management of Gulf Services and Industrial Supplies Co that credit period should be reduce for debtors and should be allowed to some of the regular customers for the business to reduce the receivable days. Further a better system needs to be devised for managing its inventory of tools and supplies so that they are in perfect condition for sales. A warehouse management system can work for the business as it will keep track of the inventory and the sales made by the business.
4. The management further needs to reduce its reliance on debt capital as it enhances the risks level of the company. The senior management can use its liquid funds to settle a proportion of debts so that proper relationship is maintained between the risks and returns of the business. The management should rely on more of internal source of capital as it would demonstrate internal strength of the company and enhance the confidence of the potential investors in the business.

Investment Appraisal for a New Project

The business of Gulf Services and Industrial Supplies Co is engaged in providing industrial tools and support services to some of the large-scale industries in the region. The industrial development in the country is at its peak and therefore Gulf Services and Industrial Supplies Co also needs to pick up its pace so that it can cater the needs of the industry and ensure that more revenue is generated from operations (Alkaraan, 2017). The project which is considered would be improving the productive capacity of the business and therefore it would be able to enhance its output, but it is to be noted that project would be requiring significant initial investments. As per the anticipation of thee business, the initial investment which would be required is around $ 800,000 and the project period is considered to be for 5 years. The management intends to use 40% of its partners capital accumulated which would be the equity capital in the mixture and another 60% of the capital would be raised from banks in the form of debt capital. However, it is to be noted that before the project can be accepted, the management of Gulf Services and Industrial Supplies Co should appraise the project so that the overall viability of the project can be established (Konstantin et al., 2018). This is done by using NPV as a metrics to estimate whether the project would generating appropriate cash flows for the future.

Usefulness of NPV and WACC

To use the investment appraisal technique, the first step is to compute the WACC of the business or cost of capitals which are being used by the company. The management would be considering 40% of the capital to be used as equity capital while the rest 60% capital would be used in the form of debt capital. A table is portrayed below showing the capital structure which the management of Gulf Services and Industrial Supplies Co intends to utilise.

Statement showing capital structure	
Particulars	**Amt**
Initial investment required	800000
Capital Contribution	
Equity capital	320000
Debt contribution @ 6%	480000

The debt capital which is required by the business is around $ 480,000 and the equity capital which is required by the management is around $ 320,000. The management meeds to incur an interest expense for the use of debt capital at 6%. On the basis of the capital structure which the management is considering the WACC would be computed, and this will act as a discounting factor for computing the NPV of the project (Arjunan, 2019). The discounting factor is important as it allows the management to estimate the present value of the cash flows and hereby helps in the decision-making process (Hering, Olbrich & Rapp, 2021). The tables which are portrayed below shows the computation of WACC and NPV of the project which is being considered.

Statement showing WACC	
Particulars	**Amt**
Cost of equity (assumed)	10%
Cost of debt	4.20%
WACC	6.52%

	Years					
Particulars	**0**	**1**	**2**	**3**	**4**	**5**
Initial Investment	-800000					
Cash flows		200000	200000	200000	200000	200000
Discounting Factor (Considering WACC)	1.000	0.939	0.881	0.827	0.777	0.729
Discounted Cash flow	-800000	187758.17	176265.65	165476.57	155347.89	145839.18
NPV	**30687.46**					

The above table shows that the WACC is computed to be 6.52% which is computed considering the cost of equity (assumed) to be 10% while the cost of debt is computed considering the rate of interest of 6% and a corporate tax rate of 30%. Once the WACC is computed, the NPV is computed in the table below considering the discounting factor to be WACC. It is estimated that the project would be generating cash flows of $ 200,000 on a regular basis for the five years period which is considered (Magni, 2015). The NPV of the project comes to $ 30687.46 which is positive, and this clearly suggests that the project would generate positive cash flows in future as well and therefore it would be worthwhile for the business to make investments in such a project.

Use of Cash or Retained Earnings

The above table shows that the business will be requiring $ 800,000 as the capital for ensuring that the operations of the project can be commenced in an effective manner. The decision which the management needs to undertake is regarding what source of capital which it will use to finance the project. Retained earnings are a suitable option for the business as it will allow the management to use up the reserves of profits which are kept aside from past periods. The use of cash would not be a suitable option for the management mainly since cash are used mostly to finance short term opportunities and obligations. The project which is being considered is a long-term prospect and therefore it should be finance with the help of retained earnings so that no stress is formed over the liquidity of the business.

Decision on Retained Earnings

The retained earnings are basically parts of profits which are kept aside by the management so that the same can be used for any opportunity or urgent obligation which arises. The dividends which are paid by a business are basically share of profits which are paid to the investors. The management can use retained earnings to pay dividends why retained earnings are formed from profits itself. However, it is preferable that the management utilises other alternative source of capital as retained earnings are useful for reinvestments and therefore the business can take advantage of any opportunity which may arise in the market.

In the case of Gulf Services and Industrial Supplies Co, the business is having problems in terms of maintaining the current level of profitability and therefore not much retained earnings are accumulated. The management therefore needs to either rely on the contributions which will be made by the partners or on debt capital for financing the project which is being considered. The business has not made decent profits in the last four years of its operations and therefore no dividend has been declared over such a period. The management needs to work on improving the controls of the business so that more profits are generated, and a level of efficiency is achieved in the operations. For the operations of Gulf Services and Industrial Supplies Co, the focus should be on improving the profitability and solvency and thereby the project should be financed either by the contributions made by the partners or by taking a long-term loan from the bank.

Conclusion

The analysis which is presented above appropriately shows the operations of Gulf Services and Industrial Supplies Co which is engaged in providing supplies to industrial sectors. The analysis shows the financial performance of the company with the help of ratio analysis for a period of four years. The analysis of key financial ratios reveals that the business has significant weakness in terms of profitability, efficiency, and solvency situation. Further appropriate recommendations are also provided so that the situation can be reversed, and the overall financial performance of the company can be improved. The discussion further shows an investment opportunity for the business in a project and how the same will be assessed for long term benefits. The analysis utilises NPV metrics to estimate whether the project would generate appropriate cash flows. Further there is a discussion on whether retained earnings should be used as a source of capital or cash should be used for financing the project.

Appendix

Key Financial Ratios Analysis		Gulf Services and Industrial Supplies Co			
	Formula Used	**2019**	**2020**	**2021**	**2022**
		RO	**RO**	**RO**	**RO**
Gross profit		2177654	1653730	1652188	1698244
Current assets		11458127	9358089	8040077	7706532
Current liabilities		6697487	5061846	3847678	3583154
Inventories		5631404	5148545	4557935	4441070
Cash		164612	102129	224622	61673
Sales revenue		8787960	6799097	6651486	6018867
Total Debts		473016	365250	211027	121908
Total assets		13547226	11638269	10294392	9968704
Total liabilities		7373436	5630034	4253746	3919353
Total shareholder's equity		6173790	6008235	6040646	6049351
NonCurrent Liabilities		675949	568188	406068	336199
Interest expense		349278	327714	216564	160416
Net income		9003	-167697	32932	4079
Operating profit		2177654	1653730	1652188	1698244
Cost of sales		6610306	5145367	4999298	4320623
Trade payables		1152823	1159504	1156247	891655
Trade receivables		4710332	3449347	2859579	2806907
Earnings per share		0.01	0.01	0.03	0.03
Market price per share		65	211	198	444

Liquidity ratio		**2019**	**2020**	**2021**	**2022**
Current ratio	Current Assets/ Current Liabilities	1.71	1.85	2.09	2.15
Quick ratio	(Current Assets-Inventory)/ Current Liabilities	0.87	0.83	0.90	0.91
Cash Ratio	Cash/ Current Liabilites	0.02	0.02	0.06	0.02
Gearing ratio		**2019**	**2020**	**2021**	**2022**
Debt to Equity ratio	Total Debt/ Total Equity	0.08	0.06	0.03	0.02
Debt ratio	Total Liabilities/ Total Assets	0.54	0.48	0.41	0.39
Interest cover	EBITDA/ Interest expenses	6.23	5.05	7.63	10.59
Efficiency ratios		**2019**	**2020**	**2021**	**2022**
Trade payable days	(Total Payables COGS)*365 Days	63.7	82.3	84.4	75.3
Inventory days	(Inventory/ COGS)*365 Days	310.9	365.2	332.8	375.2
Receivable days	(Account Receivables/ Sales)*365 days	195.6	185.2	156.9	170.2
Profitability ratios		**2019**	**2020**	**2021**	**2022**
Gross margin	(Gross Profit/ Revenue)*100%	24.78 %	24.32 %	24.84 %	28.22 %
Net Profit margin	(Net Profit/ Revenue)*100%	0.10%	-2.47%	0.50%	0.07 %
Return on equity	(Net profit/ Total Equity)	0.15%	-2.79%	0.55%	0.07 %
Return on Capital Employed	Operating Profit/ (equity +Non-Current Liabilities)	31.79 %	25.15 %	25.63 %	26.60 %
Return on Total Assets	(Net profit/ Total Assets)	0.07%	-1.44%	0.32%	0.04 %
Market Ratios		**2019**	**2020**	**2021**	**2022**
Earnings per Share		0.01	0.01	0.03	0.03
Price Earnings Ratio	Market price/ Earnin per share	6500	21100	6600	14800
Book value to Market Value	Market price/ Book value per share	6.5	21.1	19.8	44.4

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