
Report prepared for: O'Donnell & Associates

Industry: 54133 - Engineering Services

Periods: 12 months against the same 12 months from the previous year

LIQUIDITY



PROFITS & PROFIT MARGIN



SALES



BORROWING



ASSETS



EMPLOYEES



LIQUIDITY



Generally, what is the company's ability to meet obligations as they come due?

Operating Cash Flow Results

The company has generated negative cash flow from operations for the period, which is unfavorable. It is also a little unusual that the company is profitable yet cash flow from operations is poor, something that should at least be examined by evaluating current asset and current liability accounts more carefully. Since overall conditions on the Balance Sheet are still good (as will be discussed below), it is possible that negative cash flow is not cause for too much concern. Yet, since cash flow is the largest driver of long-run liquidity, perhaps there are things that can be tweaked in Balance Sheet management to improve cash flow.

General Liquidity Conditions

In this section, the company's general and overall liquidity position is analyzed. Typically, two of the most important barometers to this measurement are the current ratio and the quick ratio. The current ratio is equal to total current assets divided by total current liabilities. The quick ratio is equal to cash plus accounts receivable divided by current liabilities. Of course, it is optimal for the company to have relative strength in both of these key ratios, as this company has accomplished.

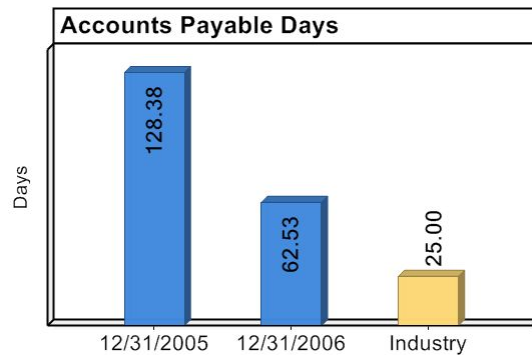
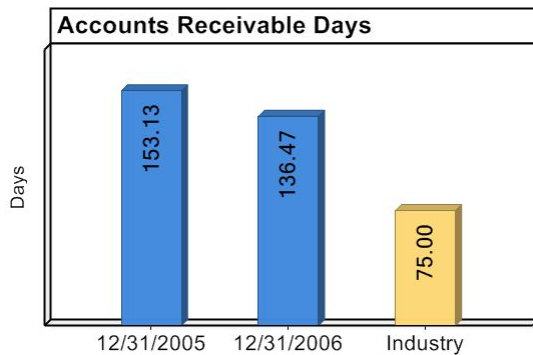
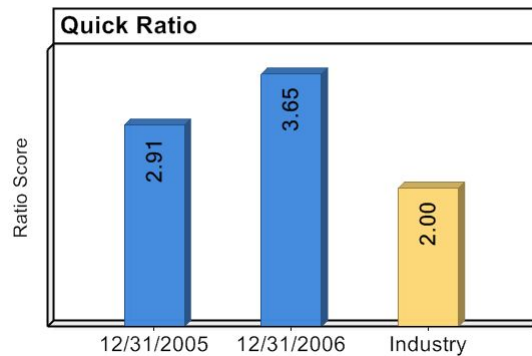
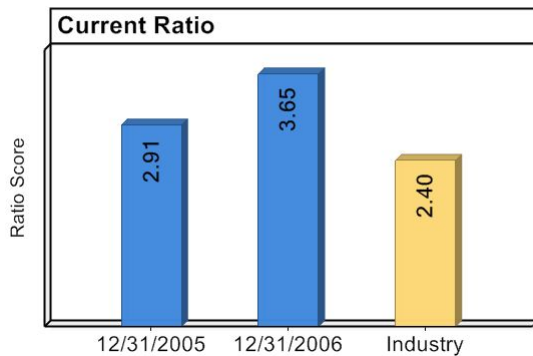
Fortunately, the company has both more profitability and better liquidity concurrently. This means that the company has performed better on both the Income Statement and the Balance Sheet this period. This situation is very positive; however, it **does not** mean that the company will never have some occasional difficulties meeting its current obligations. It **does** mean that the firm's **general** liquidity position is very good as of this specific Balance Sheet date. In fact, the company's position is even good when compared to that of other similar firms in the industry. One potential weak point is that the net income margin has declined, which will be discussed in more detail in the next section. For now, simply note that net margins affect both profitability and cash flow.

It might be good for the company to lower both its accounts receivable days and accounts payable days ratios. Both these statistics are higher than the industry average this period. The high accounts receivable days number indicates that the company may not be collecting its receivables as efficiently as other companies in the industry. The high accounts payable days ratio is generally not viewed well by creditors. These facts need to be balanced against the overall strong current ratio of the company.

It is imperative to keep working on liquidity, because the game to stay liquid never ends. Here are some actions managers **might** consider:

- Prepare yearly forecasts that show cash flow levels at various points in time. Consider updating these forecasts on a monthly or even bi-weekly basis. This can help predict/prepare for potential cash shortfalls that may occur in the future.
- Eliminate or reduce some overhead or fixed costs to reduce monthly expenses. Small decreases in overhead will typically yield large cash savings over time, especially if fixed costs can be reduced (those costs which tend to stay the same over time).
- Monitor the amount of money that is being used for activities unrelated to the business. An example could be money taken out of the business on draws to principals.
- Monitor the impact tax payments may have on cash. Keep enough money aside to be able to

meet future tax obligations based on earnings.



PROFITS & PROFIT MARGIN



Are profitability trends favorable in the company?

Despite falls in net and gross profit margins from the prior period, this company has managed to raise its net and gross profit dollars, largely due to a significant increase in sales. To begin with the big picture on the company's performance, the net profit margin is still strong, and it was strong last period as well. Furthermore, net profits in dollars are up by 79.81% from last period. Generally, the company has simply done good work in this area. The company is very profitable and is even more profitable than many of its competitors, which is an important point and is depicted in the graph area of the report.

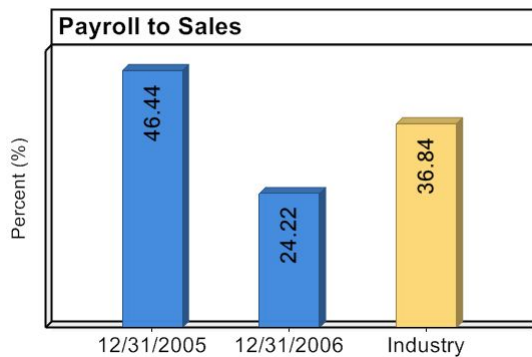
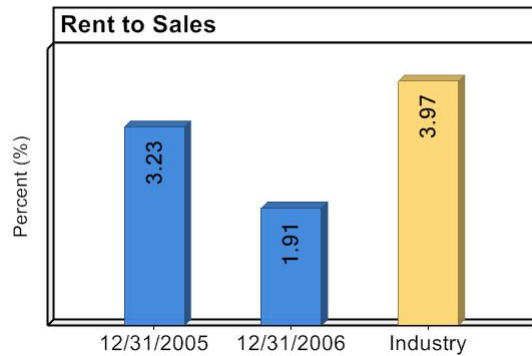
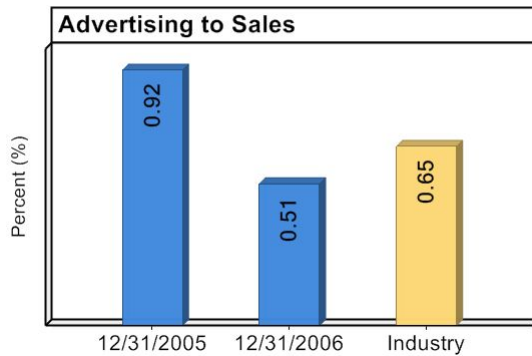
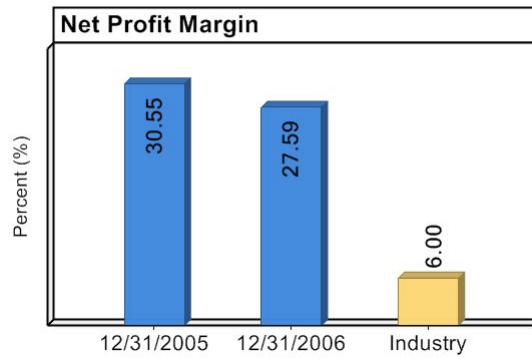
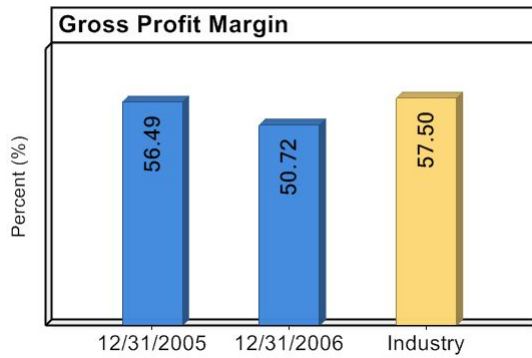
The one component to watch, however, is that both the net profit margin and gross profit margin have fallen from last period. The excellent sales and net profit increases hid this fact. Lower margins indicate that the company may be controlling the expense side of the business less efficiently than last period. This simply means that the company is spending more money per sales dollar. Having lower gross margins and lower net profit margins concurrently is a condition that may need to be reversed in the future as the company continues to grow sales. Success often hides potential problems; lower margins are a sign that expenses could be getting a little out of line.

Profit and loss management is all about continually finding ways to change things in the business to improve profits. Managers **might** think about the following ideas/hints/tips:

- Establish expense accounts using excess funds not dedicated to taxes. Use these accounts to grow revenues and increase earnings -- marketing expenses, equipment purchases, and employee training can be considered. Remember, this has the dual benefit of lowering present tax burdens (these expenses will lower taxable earnings) and driving long-term profits.
- Create good monthly budgets with cost reduction goals, broken down by account, that are put right into an accounting system (chart of accounts). This should allow management the ability to

pull "variance reports". These reports compare budgeted revenues and expenses with actual revenues and expenses and can help managers keep costs down.

- Reward the employees who perform best. To do this effectively, the business needs to monitor labor performance.
- Obtain internal reports that identify the business's key performance indicators (KPIs). KPIs help managers make good decisions by identifying the figures that are critical to performance. Net profit is not a KPI -- profits are a result of managing KPIs well.



SALES



Are sales growing and satisfactory?

Significant increases in sales were realized this period. It looks like the firm has also added a substantial amount of fixed assets. If these assets have helped to drive sales higher, then the company should be generally pleased that the asset base is generating more sales dollars. Ideally, this dynamic will help the company earn greater profitability in the future.

BORROWING

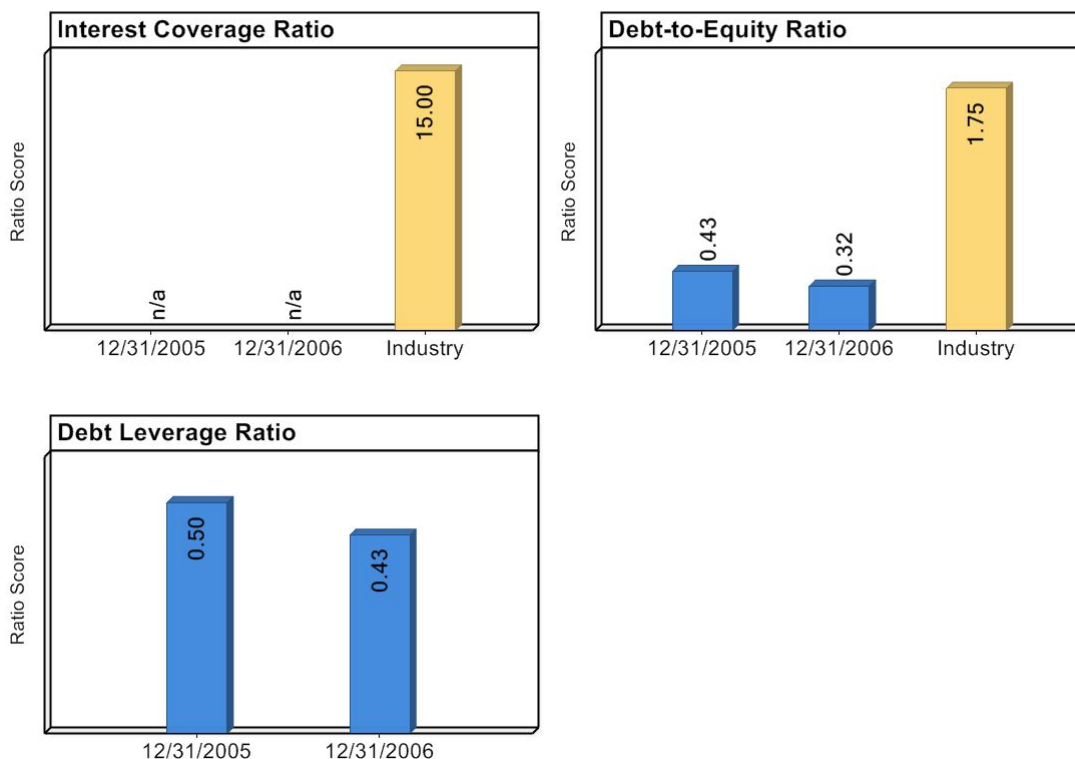


Is the company borrowing profitably?

Borrowing (using leverage) can be a valuable tool for a business -- it can improve profitability considerably. The only problem is that the effectiveness of leverage depends upon how well the company uses it. This company did well in this area -- debt increased and profitability improved significantly by 79.81% from last period. In fact, profitability actually improved at a quicker rate than debt grew, which is a very good result. If continued, this situation should bring better returns on owners' equity over time.

Even though the company received a good score in this area, it is still quite important to evaluate real returns. For example, the trend here is good, but the company will still want to determine the rates of return on assets and borrowed money. This report only indicates trends, not acceptable rates of return on borrowed funds.

Note: Although the overall score is high in this area, the company does not have much debt relative to equity. Consequently, we should not put too much emphasis on this section of the report. Debt does not seem to be a significant part of the Balance Sheet at this time.



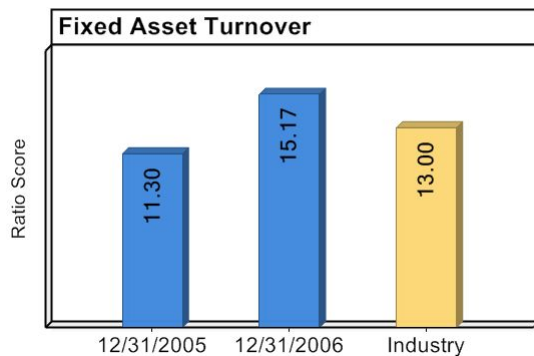
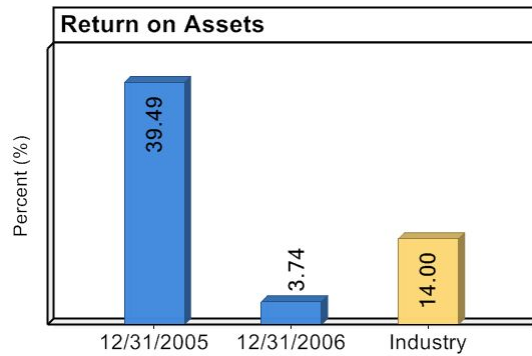
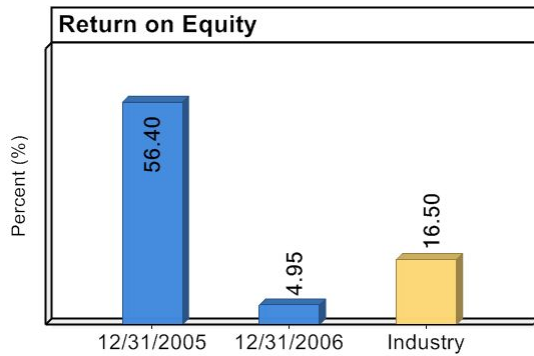
ASSETS



Is the company using gross fixed assets effectively?

The company is performing quite well in this area -- fixed assets were increased, and net profitability was also improved considerably. Even overall liquidity improved, which can be difficult when increasing the asset base. However, the net profit margin fell by 9.68%. Lower profit margins **or** lower liquidity could act as constraints to the company's future asset growth.

The reader needs to temper the overall good score in the area with some important considerations. Although the company's trend data looks positive, it is **troublesome** that both return on assets and return on equity are quite low. Over time, the goal for managers of this company is to keep the positive trend and push for adequate ROA and ROE numbers.



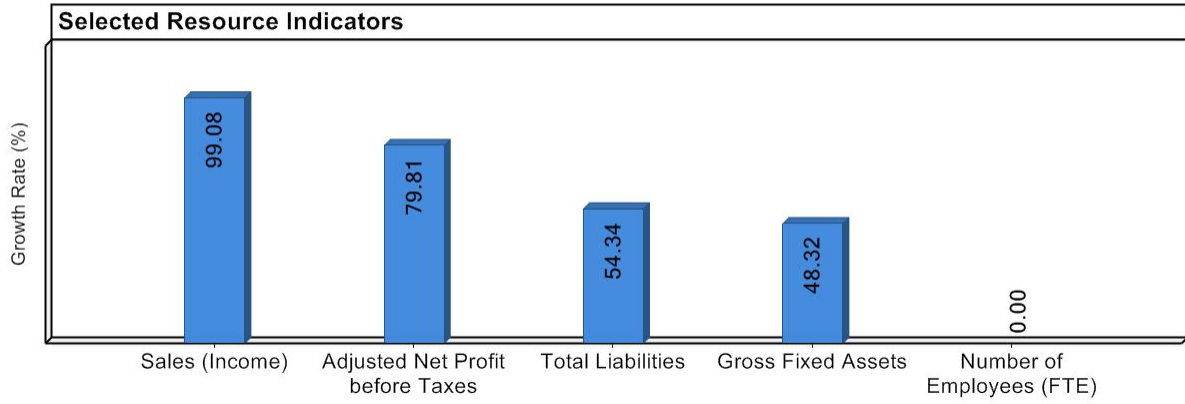
EMPLOYEES



Is the company hiring effectively?

This company achieved very strong results with its employees since the prior period. The employee base has stayed relatively the same, but net profitability has improved significantly, as was discussed earlier in this report. This is a good result because it means that the company is improving its net profitability per employee statistic, which is a key performance indicator in this industry. From a financial perspective alone, this indicates that the company is doing better at managing the people it currently has.

As noted in the Assets section of this report, fixed assets have risen significantly this period as well. Managers should think about how the company was able to improve net profitability - what resource or resources contributed the most to the improvement. If the company can continue to improve net profitability without hiring more people, then it **might** be reluctant to add additional employees at this time. To put it simply, it seems that the company did not need substantially more people to improve net profitability. Of course, this analysis may not hold forever; it is just a reflection of what has already happened. Consequently, planning will be important in this area if managers intend on hiring more people in the future.



A NOTE ON SCORING: Each section of this report (Liquidity, Profits & Profit Margin, etc.) contains a star rating which measures the company's overall performance in the area at the time of the report's generation. One star indicates that the company is below average or may possibly need improvement in the area. Three stars indicate that the company is about average for the area. Five stars indicate that the company is above average or performing quite well in the area.

RAW DATA

	12/31/2005	12/31/2006
<u>Income Statement Data</u>		
Sales (Income)	\$937,991	\$1,867,329
Cost of Sales (COGS)	\$408,131	\$920,148
Gross Profit	\$529,860	\$947,181
Gross Profit Margin	56.49%	50.72%
Payroll / Wages / Salary	\$435,628	\$452,356
Rent	\$30,253	\$35,625
Advertising	\$8,652	\$9,565
Depreciation and Amortization	\$0	\$0
Interest Expense	\$0	\$0
Net Profit before Taxes	\$286,525	\$515,211
Adjusted Net Profit before Taxes	\$286,525	\$515,211
Net Profit Margin	30.55%	27.59%
EBITDA	\$286,525	\$515,211
Net Income	\$189,107	\$34,039
<u>Balance Sheet Data</u>		
Cash (Bank Funds)	\$24,399	\$110,665
Accounts Receivable	\$393,510	\$698,158
Inventory	\$0	\$0
Total Current Assets	\$417,908	\$808,823
Gross Fixed Assets	\$82,994	\$123,100
Total Assets	\$478,822	\$909,843
Accounts Payable	\$143,550	\$157,637
Total Current Liabilities	\$143,550	\$221,555
Total Liabilities	\$143,550	\$221,555
Total Equity	\$335,272	\$688,288
Number of Employees (FTE)	15.0	15.0

COMMON SIZE STATEMENTS

	12/31/2005	12/31/2006
<u>Income Statement Data</u>		
Sales (Income)	100%	100%
Cost of Sales (COGS)	44%	49%
Gross Profit	56%	51%
Payroll / Wages / Salary	46%	24%
Rent	3%	2%
Advertising	1%	1%
Depreciation and Amortization	0%	0%
Interest Expense	0%	0%
Net Profit before Taxes	31%	28%
Adjusted Net Profit before Taxes	31%	28%
EBITDA	31%	28%
Net Income	20%	2%

Balance Sheet Data

Cash (Bank Funds)	5%	12%
Accounts Receivable	82%	77%
Inventory	0%	0%
Total Current Assets	87%	89%
Gross Fixed Assets	17%	14%
Total Assets	100%	100%
Accounts Payable	30%	17%
Total Current Liabilities	30%	24%
Total Liabilities	30%	24%
Total Equity	70%	76%

INDUSTRY SCORECARD

Financial Indicator	Current Period	Industry Range	Distance from Industry
Current Ratio = Total Current Assets / Total Current Liabilities	3.65	1.60 to 3.20	+14.06%
<p>Explanation: Generally, this metric measures the overall liquidity position of a company. 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.</p>			
Quick Ratio = (Cash + Accounts Receivable) / Total Current Liabilities	3.65	1.20 to 2.80	+30.36%
<p>Explanation: This is another good indicator of liquidity, although by itself, it is not a perfect one. If there are receivable 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).</p>			
Accounts Receivable Days = (Accounts Receivable / Sales) * 365	136.47 Days	60.00 to 90.00 Days	-51.63%
<p>Explanation: This number reflects the average length of time between credit sales and payment receipts. It is crucial to maintaining positive liquidity.</p>			
Accounts Payable Days = (Accounts Payable / COGS) * 365	62.53 Days	10.00 to 40.00 Days	-56.33%
<p>Explanation: This ratio shows the average number of days that lapse between the purchase of material and labor, and payment for them. It is a rough measure of how timely a company is in meeting payment obligations.</p>			
Gross Profit Margin = Gross Profit / Sales	50.72%	50.00% to 65.00%	0.00%
<p>Explanation: This number indicates the percentage of sales revenue that is paid out in direct costs (costs of sales). It is an important statistic that can be used in business planning because it indicates how many cents of gross profit can be generated by future sales.</p>			
Net Profit Margin = Adjusted Net Profit before Taxes / Sales	27.59%	2.00% to 10.00%	+175.90%
<p>Explanation: This is an important metric. In fact, over time, it is one of the more important barometers that we look at. It measures how many cents of profit the company is generating for every dollar it sells. Track it carefully against industry competitors. This is a very important number in preparing forecasts.</p>			
Advertising to Sales = Advertising / Sales	0.51%	0.29% to 1.00%	0.00%
<p>Explanation: This metric shows advertising expense for the company as a percentage of sales.</p>			
Rent to Sales = Rent / Sales	1.91%	2.85% to 5.09%	+33.01%
<p>Explanation: This metric shows rent expense for the company as a percentage of sales.</p>			
Payroll to Sales = Payroll Expense / Sales	24.22%	25.12% to 48.56%	+3.58%

Explanation: This metric shows payroll expense for the company as a percentage of sales.

Interest Coverage Ratio = EBITDA / Interest Expense	N/A	5.00 to 25.00	N/A
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Explanation: 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.

Debt-to-Equity Ratio = Total Liabilities / Total Equity	0.32	1.00 to 2.50	+68.00%
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Explanation: This Balance Sheet leverage ratio indicates the composition of a company's total capitalization -- 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 realize the return benefits of financial leverage.

Debt Leverage Ratio = Total Liabilities / EBITDA	0.43	N/A	N/A
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Explanation: This ratio measures a company's ability to repay debt obligations from annualized operating cash flow (EBITDA).

Return on Equity = Net Income / Total Equity	4.95%	8.00% to 25.00%	-38.13%
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Explanation: 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.

Return on Assets = Net Income / Total Assets	3.74%	8.00% to 20.00%	-53.25%
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Explanation: This calculation measures the company's ability to use its assets to create profits. Basically, ROA indicates how many cents of profit each dollar of asset 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.

Fixed Asset Turnover = Sales / Gross Fixed Assets	15.17	6.00 to 20.00	0.00%
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Explanation: This asset management ratio shows the multiple of annualized sales that each dollar of gross fixed assets is producing. This indicator measures how well fixed assets are "throwing off" sales and is very important to businesses that require significant investments in such assets. Readers should not emphasize this metric when looking at companies that do not possess or require significant gross fixed assets.

NOTE: Exceptions are sometimes applied when calculating the Financial Indicators. Generally, this occurs when the inputs used to calculate the ratios are zero and/or negative.

READER: Financial analysis is not a science; it is about interpretation and evaluation of financial events. Therefore, some judgment will always be part of our reports and analyses. Before making any financial decision, always consult an experienced and knowledgeable professional (accountant, banker, financial planner, attorney, etc.).

Performance Review

For the period ending December 31, 2006

Provided By

By The Book Accounting, Inc.

Disclaimer

1/17/2007

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