

Prepared for:

## RENTAL & SALES INC.

For the Year Ended December 31, 2006,  
As Compared to the Year Ended December 31, 2005

Industry Used for Benchmarking: 45321 – Office Supplies and Stationery Stores

<b>LIQUIDITY</b>	90 out of 100	<b>BORROWING</b>	71 out of 100
<b>PROFITS &amp; PROFIT MARGIN</b>	57 out of 100	<b>ASSETS</b>	87 out of 100
<b>SALES</b>	54 out of 100	<b>EMPLOYEES</b>	86 out of 100

### LIQUIDITY

90 out of 100

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

#### Operating Cash Flow Results

The company is generating strong, positive cash flow from operations this period. This is especially good when combined with overall strong liquidity conditions, which will be discussed below. Ultimately, cash flow drives long-run liquidity for almost any company.

#### General Liquidity Conditions

Of all possible scenarios, the company has had the most superior results. What does this mean? Net income and net margins are up, and all areas of liquidity look strong at this specific time. Better, all liquidity indicators have risen from last period, as depicted in the graph area of the report. For example, notice in the graph area that the company's "current" and "quick" ratios are very good **and** have risen. This indicates that both the scope and the composition of the liquidity base are sound (as of this **particular** time). Basically, the company is doing well, even when compared to the competition. It's interesting to note that stable sales volume with higher net income can often improve liquidity, as has been the case here.

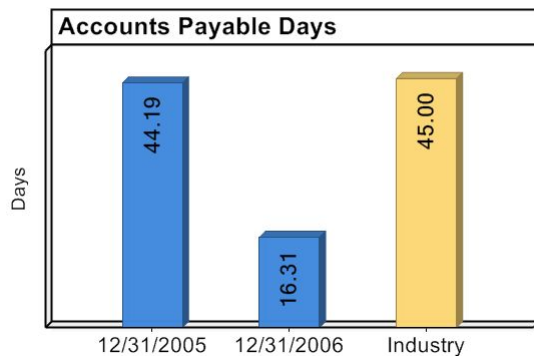
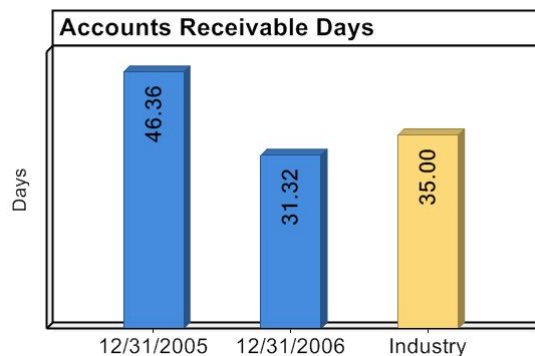
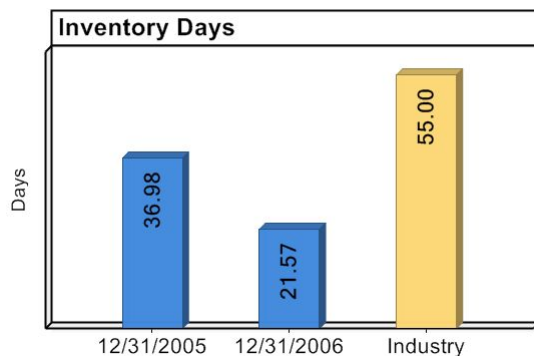
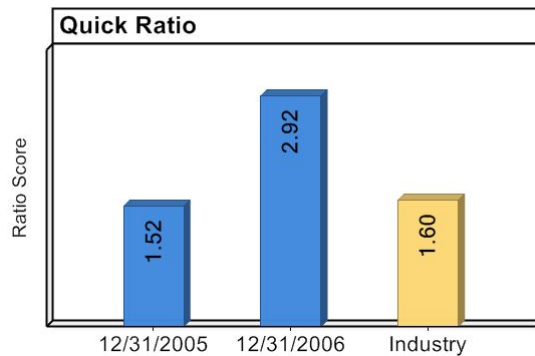
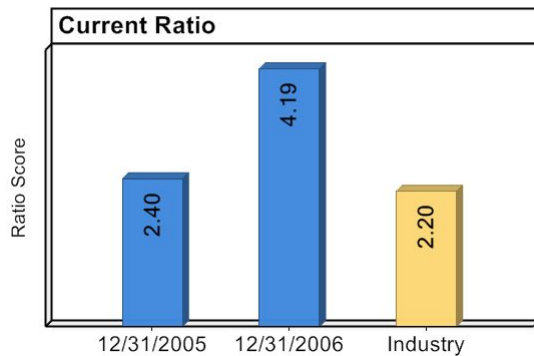
When we examine profitability in a subsequent section, we'll realize even more fully the benefits that a strong liquidity position can yield. If the company can maintain this strong position over time, management may be able to "invest" in the expense items that can help propel future profits. **Present** liquidity should help propel **future** net profitability.

The company is doing a good job with its liquidity turnover ratios. Both inventory days and accounts payable days are relatively low compared to other companies in this industry. Creditors like to see a low accounts payable days number (over time, it reflects payment strength); and the low inventory days ratio indicates that the company is doing a good job in "turning" its inventory.

The challenge of maintaining liquidity never goes away. Managers **might** employ the following to either maintain or improve liquidity conditions over time:

- Try to establish a sufficient line of credit from the bank. There are methods to determine the amount of short-term credit needed to run the business. Talking with the bank can be helpful in this area. The business should obtain, but not necessarily use, as much financing as possible from the bank.
- Avoid pre-paying expenses or Accounts Payable. The reason is to keep funds inside the business (potentially earning interest) for as long as possible. It is generally not a good idea to pay bills earlier than the terms agreed upon -- utilize trade credit fully. Discounts may be an exception.
- Finance over the long term rather than the short term when financing is possible and necessary. This can help reduce per period cash outflows.

- Carefully manage order points for inventory. Utilize a system that allows the business to order when needed so cash is not tied up in merchandise.



## PROFITS & PROFIT MARGIN

57 out of 100

### *Are profitability trends favorable in the company?*

The company performed well in the Profitability area this period, despite having sales that have not changed much since the previous period. The company has improved its net profit margin and significantly increased its net profits (in dollars). It looks as though the company controlled its expenses in order to achieve this result -- on relatively flat sales, the company has increased its net profit dollars by 489.29%, which is clearly a positive achievement. The company is now earning more with relatively the same sales volume as last period, which is excellent. As long as the company does not cut costs to the point of hurting the quality of its services or products, expense management is a great way to improve efficiency.

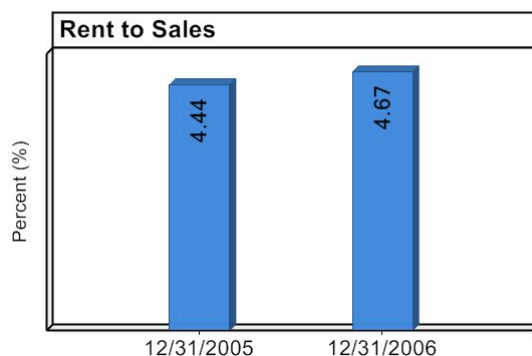
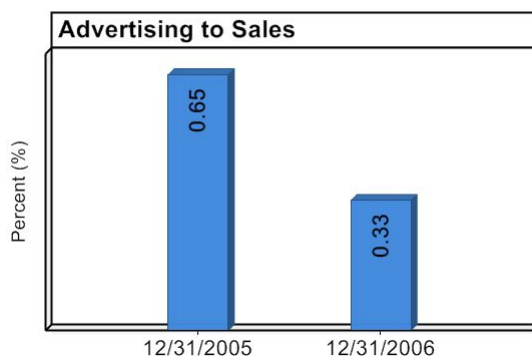
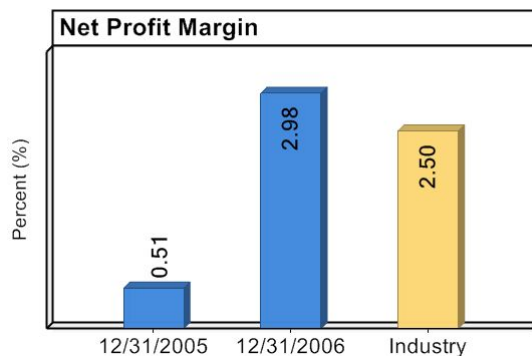
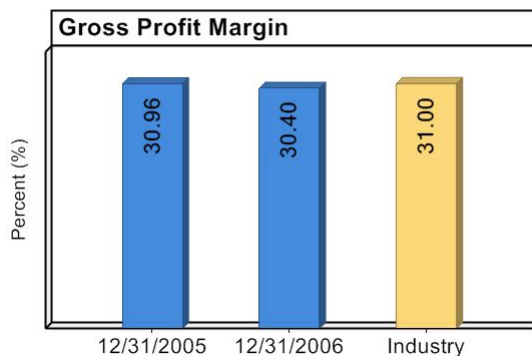
As a result, the net margin improved considerably this period, which should be noted. The company is generating about average net profits for the industry in which it competes. This is positive because the net margin, which measures the cents of net profit that a company earns on every dollar it generates in

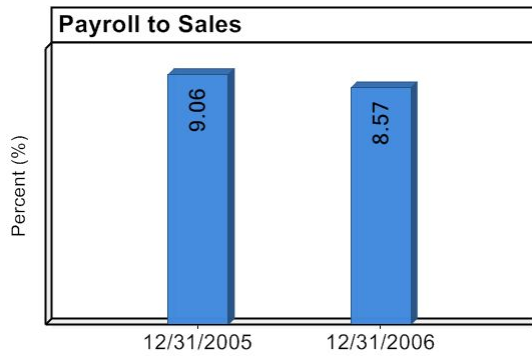
sales revenue, is the most important Income Statement ratio for a company to manage - it directly contributes to the company's bottom line. If the company can find some ways to turn sales volume higher and still contain costs, it will see even stronger results. A good goal for this company might be to improve its net margin and net profits to above-average levels for its industry.

Here is something more specific to think about: if the net profit margin is better and net profits are higher, can managers now invest some of these extra profits in building long-term profitability? The advantage of having more profits **now** is to be able to use them to build even more profits **later**. This can provide a firm with an advantage over its competitors.

It is a challenge to generate strong profitability in any business over the long run. Here are some ideas managers **might** find useful to leverage even greater results in the future (these are "tips" or ideas to think about):

- Obtain an annual business check-up. Meet with an accountant or banker to review financial statements and get advice on how to improve performance.
- Advertise effectively by monitoring which media outlets are most effective. For example, a business that does three different forms of advertising, but has no way of tracking which forms are working, may be overspending in some areas.
- Search out multiple qualified vendors to get the best prices through competition, while maintaining quality. If the business is not continually reviewing/updating its existing and potential vendor lists, it may overspend on supplies/inventory.
- 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

54 out of 100

### *Are sales growing and satisfactory?*

When there is little change in a company's sales management area, it is difficult to draw conclusive results. In this case, sales have been maintained on approximately the same fixed asset base. It is more important to focus on profitability results than on sales results, but as a general rule it is usually important to keep increasing sales over time. This is because expenses tend to increase over time, so for most companies, sales should always be growing at least moderately.

## BORROWING

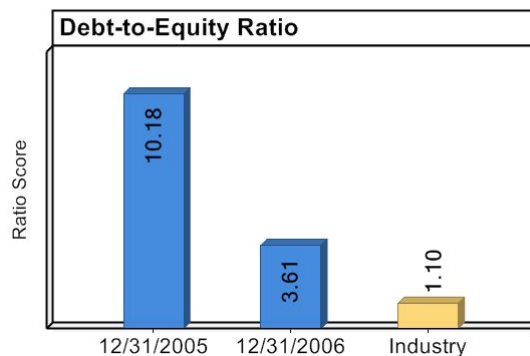
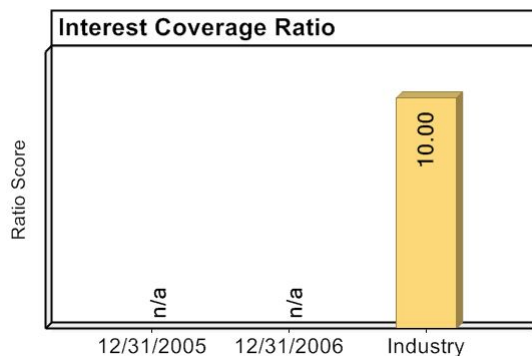
71 out of 100

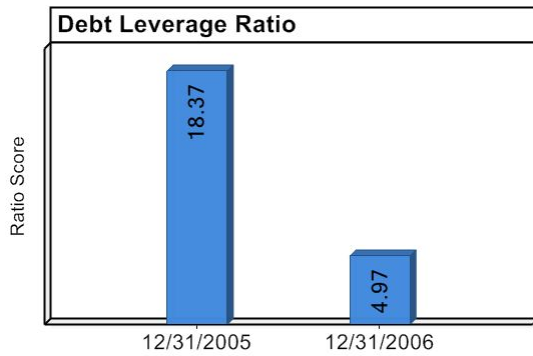
### *Is the company borrowing profitably?*

Net profitability improved by 489.29% while debt was lowered. In other words, a reduction in total debt coincided with improved profitability, at least for this period. Not only this, but the net profit margins and overall liquidity actually improved. This is a very good situation -- profitability was able to expand without additional debt. This dynamic should help long-term profitability, especially if it can be continued over multiple periods.

Interestingly, the company seems to have a relatively high amount of debt on hand, yet it is not reporting net interest charges. This would be somewhat unusual for most companies. It would be important to know the type of debt that is on the books, which either does not carry high interest charges or which may have been recently added, in which case interest expense charges can be expected to rise significantly in the near future.

Capacity planning is a challenge here. This involves simply thinking out into the future: how long can profitability improve without increasing borrowing? Analyzing the relationship between investments in resources (such as assets) and profitability improvement, as well as effectively forecasting sales and cash flow, can help answer this question and lead to the best borrowing policies for the near future.





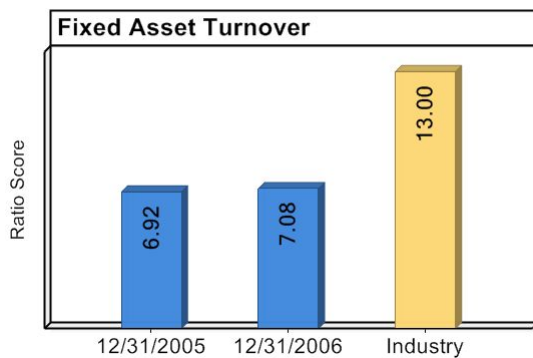
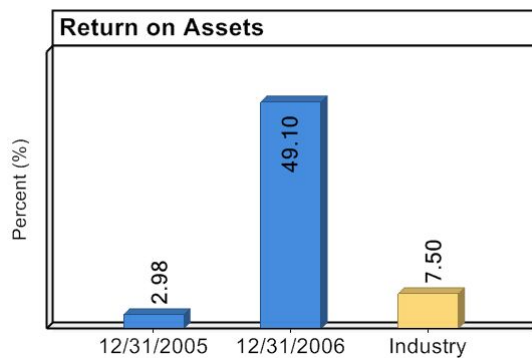
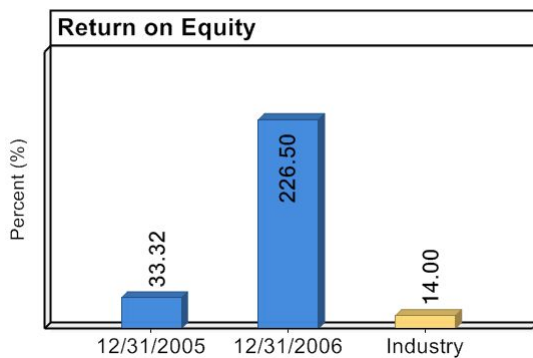
## ASSETS

87 out of 100

### *Is the company using gross fixed assets effectively?*

This period, profitability improved significantly but fixed asset levels stayed relatively flat. This means: 1) profitability was able to improve without adding assets, and 2) the company **may** not need additional assets to continue to improve profitability at this specific time. In other words, the company may be able to grow profitability a bit more with the level of assets currently in place. This should also continue to help improve net margins, which also improved this period. An improvement in net margins is an indication of improved efficiency as the company has a relatively stable asset base.

Before leaving this area, we would want to point out one component that was discovered to be below average. The company seems to be generating a **poor score for fixed asset turnover**, which means that it is generating insufficient revenue relative to fixed assets. Over time, this can possibly affect overall return on assets, which is actually very good right now. Of course, the lower score for this one metric could just be a one-time occurrence.



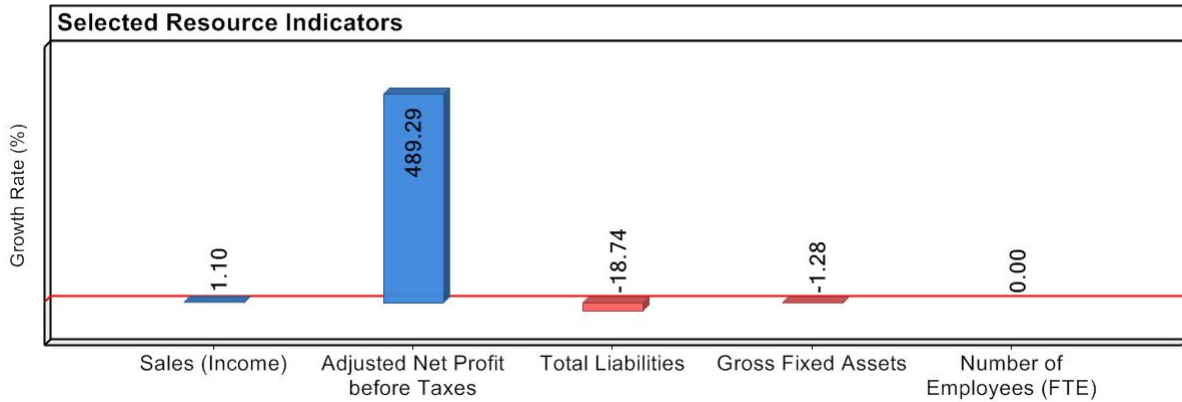
## EMPLOYEES

86 out of 100

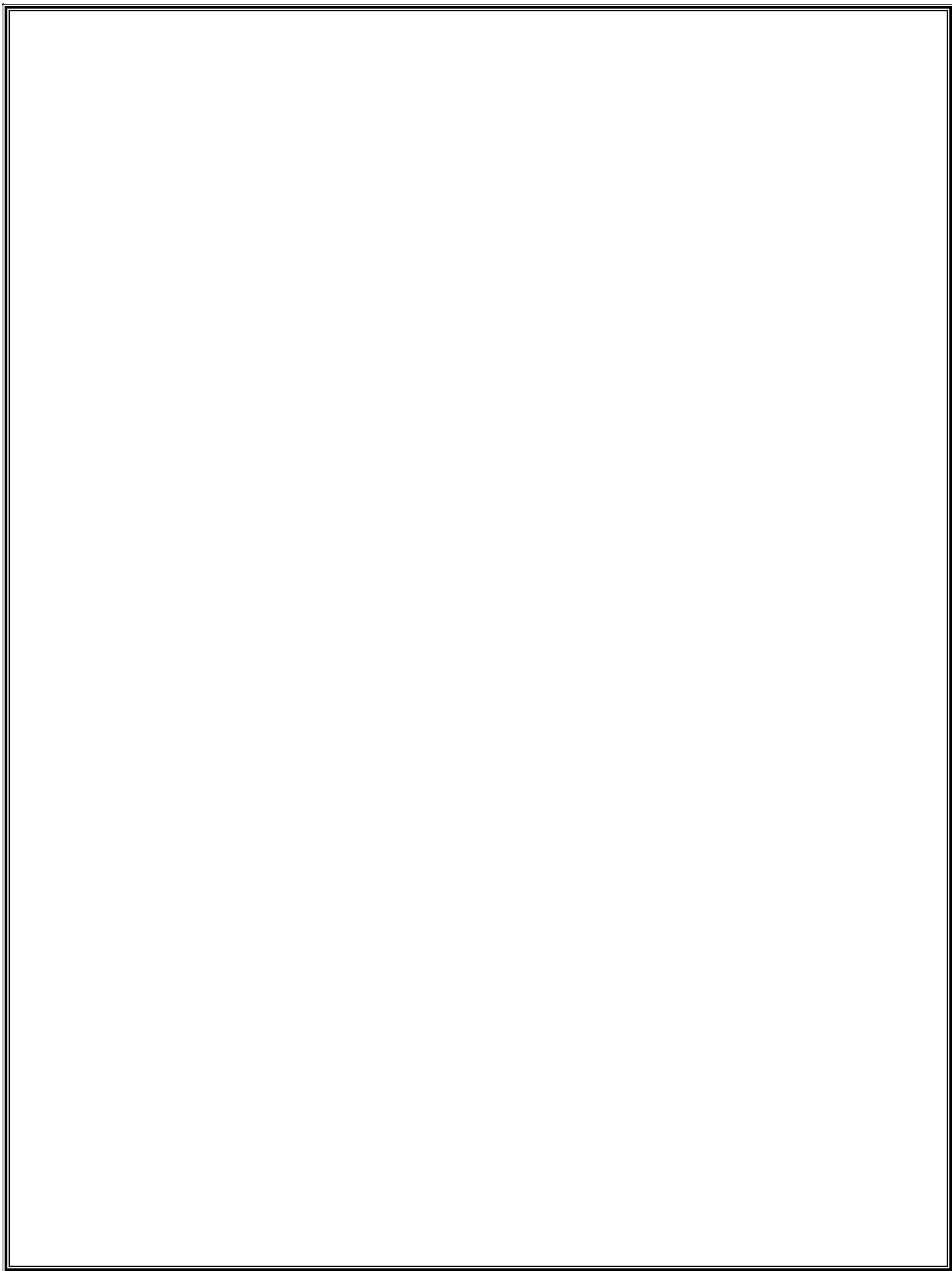
### Is the company hiring effectively?

This company has done strong work with respect to its employees. Net profitability has improved significantly, and the company has done this with relatively the same employee and asset bases. Essentially, this means that the company's resources are being managed more effectively. It also means that the key to success (at least in the short run) may be "off the books" -- that profitability may be driven by factors other than assets or employees. Both the company's assets and employee base stayed relatively flat -- the company did not require much more of either to improve net profitability. To put it simply, the company is now driving more profitability through its existing resources, which is excellent.

Managers should think about how net profitability improved without increasing assets or employees. This may be the way the company will want to expand in the short run because it will generally **not** involve the larger expenses incurred when hiring employees or purchasing fixed assets.

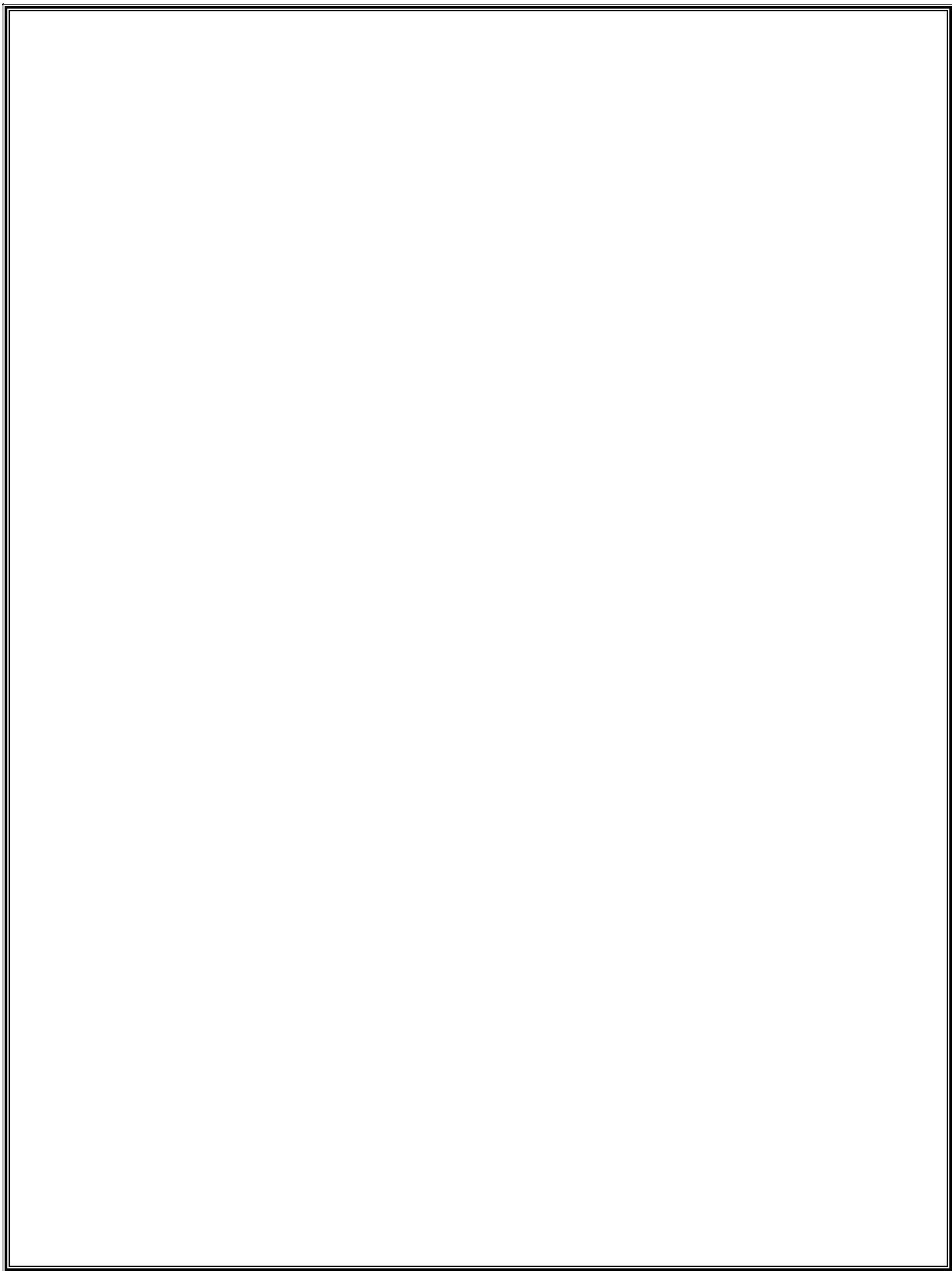


**A NOTE ON SCORING:** Each section of this report (Liquidity, Profits & Profit Margin, etc.) contains a numerical score/grade, which is a rough measure of overall performance in the area. Each grade represents a score from 1 to 100, with 1 being the lowest score and 100 being the highest. Generally, a score above 50 would be a "good" score and a score below 50 would be a "poor" score. The scores are derived by evaluating the company's trends, either positive or negative, over time and by comparing the company to industry averages for different metrics.



## RAW DATA

	12/31/2005	12/31/2006
<b><u>Income Statement Data</u></b>		
Sales (Income)	\$3,103,640	\$3,137,728
Cost of Sales (COGS)	\$2,142,716	\$2,183,877
Gross Profit	\$960,924	\$953,851
Gross Profit Margin	30.96%	30.40%
Payroll / Wages / Salary	\$281,123	\$269,014
Rent	\$137,776	\$146,517
Advertising	\$20,081	\$10,313
Depreciation and Amortization	\$20,895	\$17,032
Interest Expense	\$0	\$0
Net Profit before Taxes	\$15,847	\$93,384
Adjusted Net Profit before Taxes	\$15,847	\$93,384
Net Profit Margin	0.51%	2.98%
EBITDA	\$36,742	\$110,416
Net Income	\$22,090	\$343,860
<b><u>Balance Sheet Data</u></b>		
Cash (Bank Funds)	\$28,342	\$192,775
Accounts Receivable	\$394,188	\$269,258
Inventory	\$217,101	\$129,064
Total Current Assets	\$667,375	\$663,777
Gross Fixed Assets	\$448,800	\$443,046
Total Assets	\$741,228	\$700,267
Accounts Payable	\$259,426	\$97,614
Total Current Liabilities	\$277,526	\$158,294
Total Liabilities	\$674,941	\$548,454
Total Equity	\$66,287	\$151,813
Number of Employees (FTE)	30.0	30.0



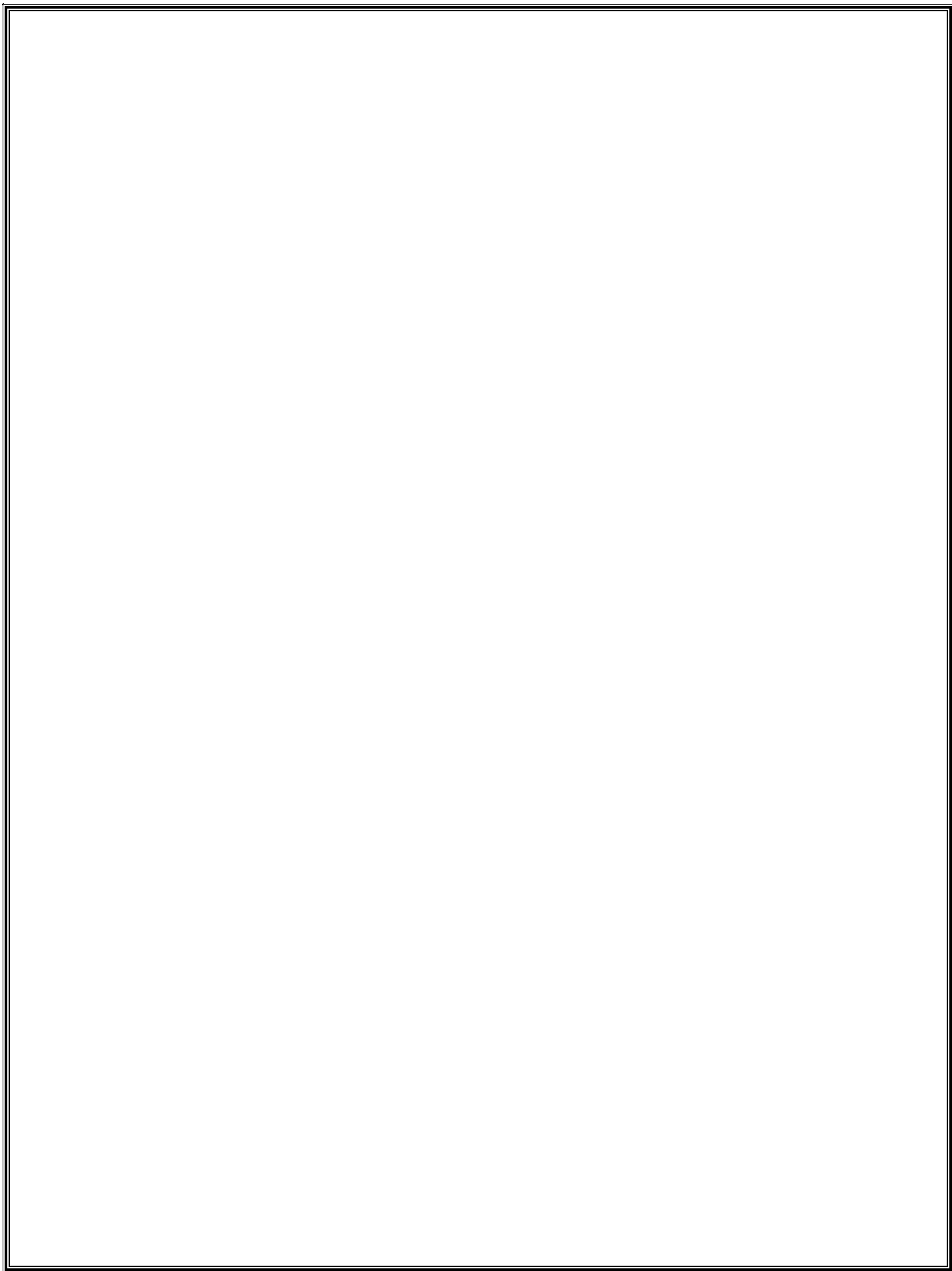
## COMMON SIZE STATEMENTS

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	12/31/2005	12/31/2006
<b><u>Income Statement Data</u></b>		
Sales (Income)	100%	100%
Cost of Sales (COGS)	69%	70%
Gross Profit	31%	30%
Payroll / Wages / Salary	9%	9%
Rent	4%	5%
Advertising	1%	0%
Depreciation and Amortization	1%	1%
Interest Expense	0%	0%
Net Profit before Taxes	1%	3%
Adjusted Net Profit before Taxes	1%	3%
EBITDA	1%	4%
Net Income	1%	11%

### **Balance Sheet Data**

Cash (Bank Funds)	4%	28%
Accounts Receivable	53%	38%
Inventory	29%	18%
Total Current Assets	90%	95%
Gross Fixed Assets	61%	63%
Total Assets	100%	100%
Accounts Payable	35%	14%
Total Current Liabilities	37%	23%
Total Liabilities	91%	78%
Total Equity	9%	22%



## INDUSTRY SCORECARD

Financial Indicator	Current Period	Industry Range	Distance from Industry
<b>Current Ratio</b> = Total Current Assets / Total Current Liabilities	4.19	1.60 to 2.80	+49.64%
<p><b>Explanation:</b> 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>			
<b>Quick Ratio</b> = (Cash + Accounts Receivable) / Total Current Liabilities	2.92	1.00 to 2.20	+32.73%
<p><b>Explanation:</b> 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>			
<b>Inventory Days</b> = (Inventory / COGS) * 365	21.57 Days	40.00 to 70.00 Days	+46.08%
<p><b>Explanation:</b> This metric shows how much inventory (in days) is on hand. It indicates how quickly a company can respond to market and/or product changes. Not all companies have inventory for this metric.</p>			
<b>Accounts Receivable Days</b> = (Accounts Receivable / Sales) * 365	31.32 Days	20.00 to 50.00 Days	0.00%
<p><b>Explanation:</b> This number reflects the average length of time between credit sales and payment receipts. It is crucial to maintaining positive liquidity.</p>			
<b>Accounts Payable Days</b> = (Accounts Payable / COGS) * 365	16.31 Days	30.00 to 60.00 Days	+45.63%
<p><b>Explanation:</b> 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>			
<b>Gross Profit Margin</b> = Gross Profit / Sales	30.40%	25.00% to 37.00%	0.00%
<p><b>Explanation:</b> 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>			
<b>Net Profit Margin</b> = Adjusted Net Profit before Taxes / Sales	2.98%	1.00% to 4.00%	0.00%
<p><b>Explanation:</b> 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>			
<b>Advertising to Sales</b> = Advertising / Sales	0.33%	N/A	N/A
<p><b>Explanation:</b> This metric shows advertising expense for the company as a percentage of sales.</p>			
<b>Rent to Sales</b>	4.67%	N/A	N/A

= Rent / Sales

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

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<b>Payroll to Sales</b>	8.57%	N/A	N/A
= Payroll Expense / Sales			

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

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<b>Interest Coverage Ratio</b>	N/A	5.00 to 15.00	N/A
= EBITDA / Interest Expense			

**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.

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<b>Debt-to-Equity Ratio</b>	3.61	0.70 to 1.50	-140.67%
= Total Liabilities / Total Equity			

**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.

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<b>Debt Leverage Ratio</b>	4.97	N/A	N/A
= Total Liabilities / EBITDA			

**Explanation:** This ratio measures a company's ability to repay debt obligations from annualized operating cash flow (EBITDA).

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<b>Return on Equity</b>	226.50%	8.00% to 20.00%	+1,032.50%
= Net Income / Total Equity			

**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.

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<b>Return on Assets</b>	49.10%	5.00% to 10.00%	+391.00%
= Net Income / Total Assets			

**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.

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<b>Fixed Asset Turnover</b>	7.08	9.00 to 17.00	-21.33%
= Sales / Gross Fixed Assets			

**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.

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**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.).

