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Question: Was the Rock of Ages Company better off in 2003 than in 2002? Why?

Rock of Ages Financial Ratio Analysis

While the Balance Sheet and the Statement of Income are good starting points for successful financial management, ratio analysis helps management to spot trends in a business and to compare its performance and condition with the average performance of similar businesses in the same industry or during different time periods, watching especially for any unfavorable trends that may be starting.

Important Balance Sheet Ratios measure profitability (the amount of money garnered from sales which accrues to the owners), liquidity and solvency (a business's ability to pay its bills as they come due), activity (how well inventory is managed and how rapidly money from sales is collected), and leverage (the extent to which the business is dependent on creditors' funding).

The financial ratios garnered from the Statements of Operations and Balance Sheets for Rock of Ages help determine if the company was better off financially in 2003 than during the previous year. The results of the analysis yielded the following observations:

PROFITABILITY

The Profitability Ratios contained in Figure 1 are calculated with and without a $28.7MM cumulative write-down of goodwill to its fair value during 2002.

Figure 1

ROCK OF AGES

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KEY RATIOS SUMMARY

YEAR	2003	2002 (Adjusted)	2002 (Not Adjusted)
FROM INCOME STATEMENT			
Sales Revenues	$84,417,030	$87,715,000	$87,715,000
Total Cost of sales	$50,374,878	$47,747,696	$47,747,696
Gross Profit	$37,340,122	$39,967,304	$39,967,304
Total Operating Expenses	$35,892,917	$64,882,515	$36,172,217
Net Income (loss)	$1,447,205	($24,915,211)	$3,795,087
FROM BALANCE SHEET			
Cash	$3,226,870	$6,185,263	$6,185,263
Marketable securities	$11,078,870	$5,427,020	$5,427,020
Accounts receivable, net	$15,586,829	$17,670,481	$17,670,481
Total current assets	$51,044,265	$50,708,346	$50,708,346
Total long-term assets	$27,162,347	$25,011,732	$25,011,732
TOTAL ASSETS	$102,461,187	$125,834,030	$125,834,030
Total current liabilities	$7,448,445	$7,794,108	$7,794,108
Total long-term liabilities	$21,291,511	$43,988,366	$43,988,366
TOTAL LIABILITIES	$39,491,440	$63,188,398	$63,188,398
Total shareholders' equity	$62,969,747	$62,645,632	$62,645,632
Average Number of Shares Outstanding	7199100	7675700	7675700
Inventory	$21,151,696	$21,425,582	$21,425,582
Accounts Receivable	$15,586,829	$17,670,481	$17,670,481

KEY RATIOS

	2003	2002 (Adjusted)	2002 (Not Adjusted)
PROFITABILITY RATIOS			
Return on sales	0.02	(0.28)	0.04
Return on Investment	0.02	(0.40)	0.06
Earning per Share	0.20	(3.25)	0.49
LIQUIDITY RATIOS			
Current ratio	6.85	6.51	
Quick or acid test ratio	4.01	3.76	
ACTIVITY RATIOS			
Inventory Turnover	2.38	2.23	
Accounts Receivable Turnover	5.42	4.78	
LEVERAGE RATIOS			
Debt to equity ratio	0.63	1.01	
Debt to Total Assets	0.39	0.50	

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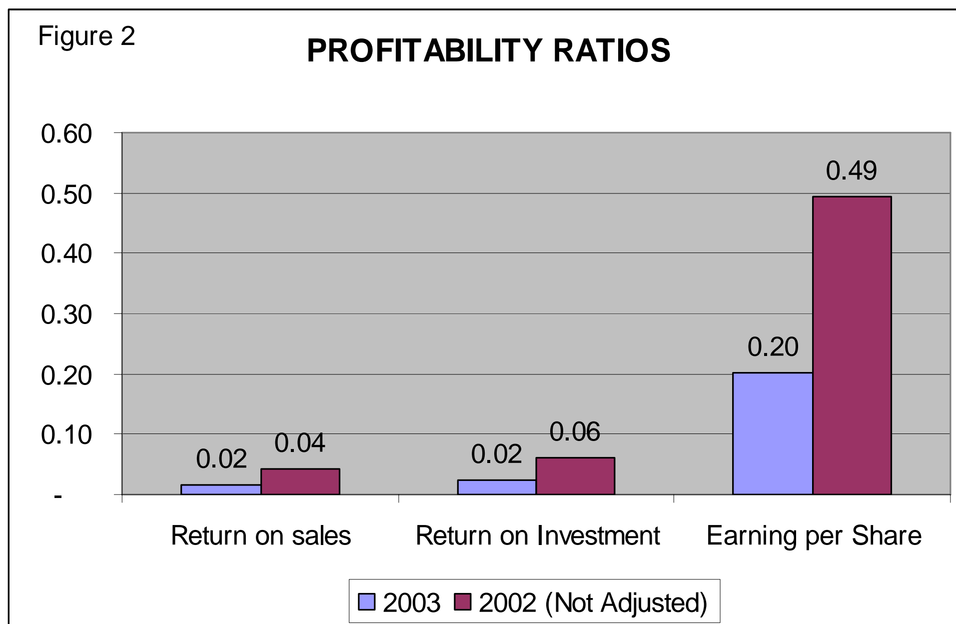
The relative strength of the company's operations when compared with 2003 is most appropriately calculated prior to the adjustment, so the histogram depicted in Figure 2 demonstrates that the return on sales and on the capital invested in the business were actually significantly higher during 2002, and that earnings for the shareholders in 2002 would have greatly exceed those for 2003, except for the write-down. In other words, Rock of Ages enjoyed much higher revenues and pre-adjustment profits for 2002 than for 2003. The reasons for the profit decreases in the latter year were a decrease in saleable stone from the Pennsylvania Black quarry due to poor geological formations and a sharp increase in selling, general and administrative expenses primarily caused by the increase in legal fees and expenses in connection with the Eurimex arbitration.



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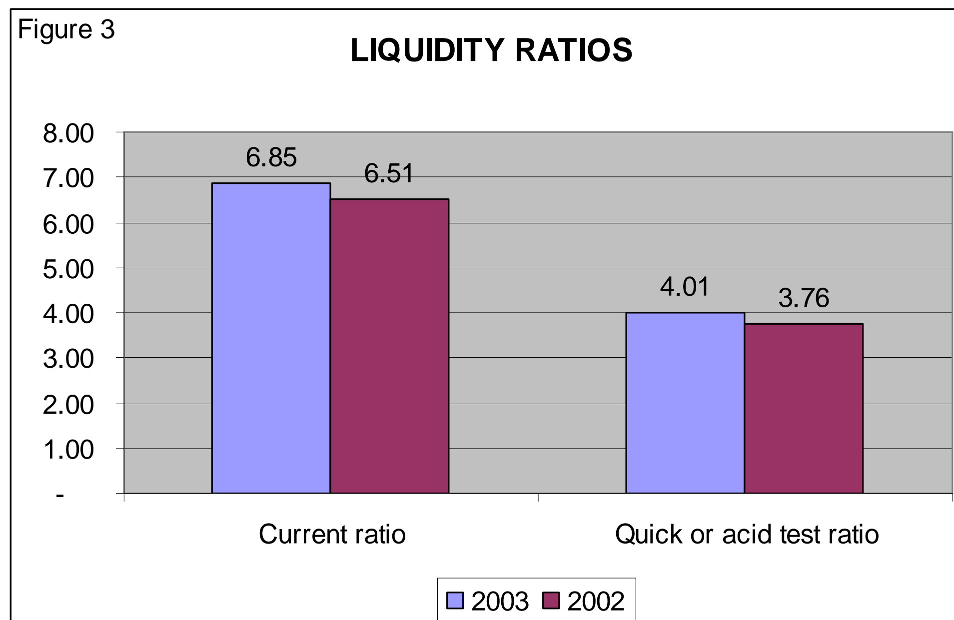
LIQUIDITY

The ratios that indicate the ease with which Rock of Ages is able to turn assets into cash include the Current Ratio and the Quick Ratio. The Current Ratio is one of the best indicators of financial strength, gauging a business' ability to meet its current obligations by measuring if it has enough assets to cover its liabilities. The standard ratio for a healthy business is 2, meaning it has twice as many assets as liabilities. As shown in Figure 3, the respective ratios for Rock of Ages for the years 2002 and 2003 were 6.51 & 6.85, indicating an extremely strong liquidity position during both years.

Also shown in Figure 3 is the Quick Ratio, sometimes called the "acid-test" ratio, and is one of the best measures of liquidity. Many financial planners consider it a tougher measure than the current ratio because it excludes inventories when counting assets. It calculates a business' liquid assets in relation to its liabilities. The higher the ratio is, the higher the business' level of liquidity, which usually corresponds to its financial health. The optimal quick ratio is 1 or higher; since Rock of Ages produced quick ratios of 3.76 and 4.021 during 2002 and 2003, respectively, the company was well capable of meeting its short-term financial obligations during both years.



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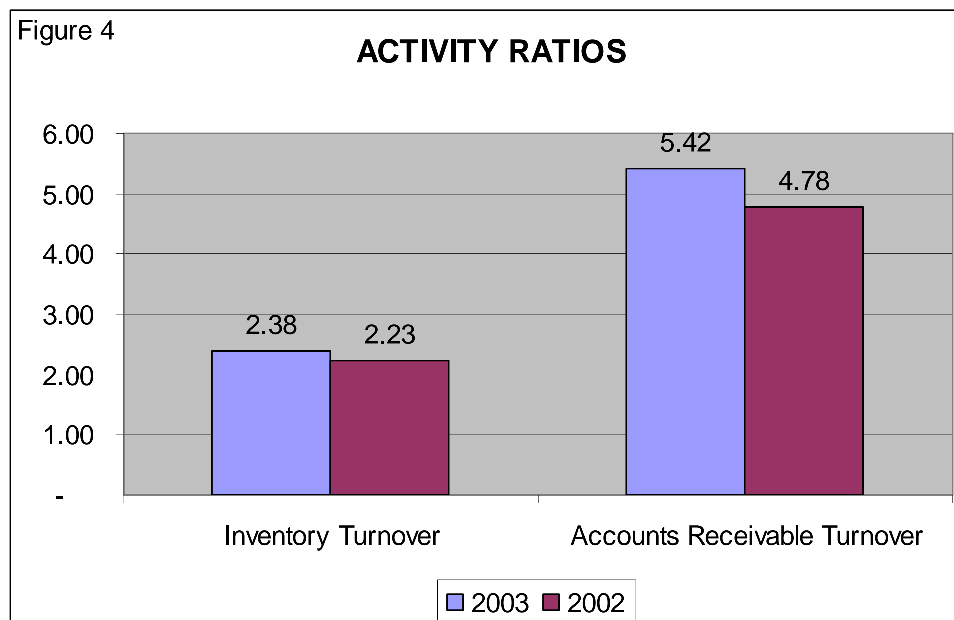
ACTIVITY

Another group of important ratios, shown in Figure 4, are Activity Ratios, often referred to as Management Ratios, that are also derived from Balance Sheet and Statement of Income information. The Inventory Turnover Ratio reveals how well inventory is being managed. It is important because the more times inventory can be turned in a given operating cycle, the greater the profit. An extremely low inventory turnover value is undesirable because this implies that capital is being tied up in inventory. Alternatively, an abnormally high inventory turnover could mean inadequate inventory, which could lead to slow delivery to customers, thereby adversely affecting sales. The 2002 and 2003 ratios for Rock of Ages, at 2.23 and 2.38, respectively, are neither too high nor too low, and are essentially on a par with each other.

The Accounts Receivable Turnover Ratio, also shown in Figure 4, indicates how well accounts receivable are being collected. If receivables are excessively slow in being converted to cash, liquidity could be severely impaired. The Rock of Ages ratios were 4.78 for 2002 and 5.42 for 2003, indicating that accounts were received at a slightly improved rate during the latter period.



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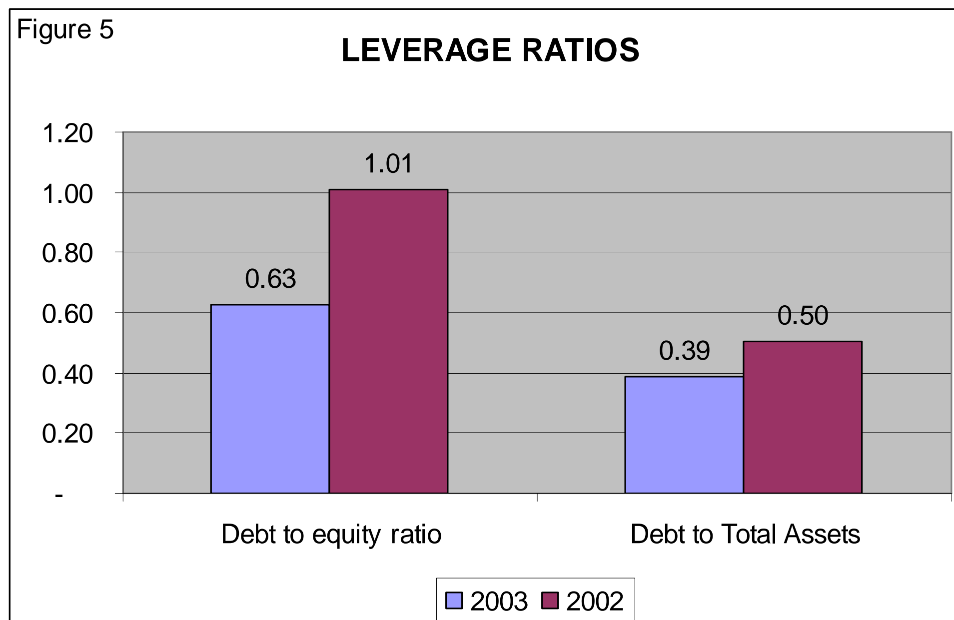
LEVERAGE

Equity and debt are two key figures on a financial statement, and lenders or investors often use the relationship of these two figures to evaluate risk. The ratio of Rock of Ages' equity to its long-term debt provides a window into how strong its finances are. The Debt-to-Equity ratio, as depicted in Figure 5, indicates how much the company is leveraged (in debt) by comparing what is owed to what is owned. A high debt to equity ratio could indicate that the company may be over-leveraged, and should look for ways to reduce its debt. Generally, creditors prefer a lower ratio to decrease financial risk, while investors prefer a higher ratio to realize the return benefits of financial leverage. Rock of Ages' ratios were 1.01 and .63 for the two years shown, both of which would be highly attractive to creditors.

The Debt-to-Worth (Total Assets) Ratio indicates the extent to which the business is reliant on debt financing (creditor money versus owner's equity). Generally, the higher this ratio, the more risky a creditor will perceive its exposure in the business, making it correspondingly harder to obtain credit. Ratios of .5 and .39 for the years 2002 and 2003, respectively, would also be considered quite favorable to prospective creditors.



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Summary:

From a profitability standpoint, Rock of Ages could have produced much better results during 2002 than it did in 2003, except for the $28.7 million goodwill write-off, as demonstrated in Figure 2. In fact, the income from continuing operations before provision for income taxes and the cumulative effect of changes in accounting principle (pg iv of the 2003 Annual Report) was $4.9MM for 2002 and only $1.69MM for 2002, a difference of 290%. However, the net effect of the accounting adjustment caused a $25MM operating loss during 2002. While not adversely affecting operations, the write-down did result in a per share loss of over 3 dollars.

With regard to overall financial stability, the liquidity, activity and leverage ratios for both years demonstrate sound financial management, with slightly improved results during 2003, resulting in shareholder gains of $.20 per share.