

**WINKY FOODS CORPORATION**  
**Financial Performance Analysis Report**  
**August 1998**

*Profitability*

Sales went down by 9% in 1997. This may have been brought about by a weak market resulting from the effects of the crisis. If so, then it is expected that WFC's ability to generate sales will continue to suffer in 1998. The company is likewise hampered by its high-cost position. Even if some improvements were realized in 1997, operating margins are still too low. This makes them vulnerable to competitors, particularly if pricing is a major factor in the market. This becomes more important now since consumers are becoming price-sensitive given the decline in their purchasing power. Unless it can implement cost-cutting measures, WFC, with its low margins, may not be in a position to compete price-wise with other players in the market.

Profitability has likewise suffered because of the company's high debt-burden. Interest expense for both 1996 and 1997 were higher than the company's operating profits. Without high miscellaneous expenses, WFC would have incurred losses during the period.

Interest coverage ratio for both years shows that WFC barely covered its interest expense. Debt service ratio, on the other hand, shows minimal coverage of maturing obligations. The company's high leverage position contributed significantly to this.

*Liquidity and Cash Flow*

WFC's liquidity ratios (i.e. current ratio, quick ratio) also point out to weaknesses in the company's balance sheet. Current assets cannot cover all of the company's current liabilities in 1996 and 1997 showing its illiquid position. This again was brought about by WFC's high debt burden as current maturities of long-term debt account for a substantial portion of the company's total current liabilities.

Cash flow coverage are likewise very weak. Funds from operations cannot account for more than 9% of WFC's total interest bearing debts in 1996 and 1997. Continuous increase in working capital, particularly accounts receivable, as well as advances to related parties further compounds the problem as these tie up needed cash. Increase in receivables may mean collection problems or it may suggest the relaxing of credit policies as a result of competitive pressures. Either way, this does not help the company in so far as generating the needed cash inflows are concerned, specially at this time when the company is in the midst of an expansion as what its capital expenditure figures suggests. Thus we see free operating cash flow to total debt registering negative figures during the period.

*Capital Adequacy*

WFC's aggressive stance in sourcing debt has pushed its debt to equity ratio to very high levels. Although it would seem that the company's DE ratio improved in 1997, such improvement did not come from additional capital infusion, significantly higher retained earnings, or lowering of debt levels. This materialized because of the revaluation increment in property. Without this, WFC's DE ratio would have deteriorated further in 1997.

Total debt to capitalization is high at 87% in 1996 and 68% in 1997. As mentioned earlier, the improvement in 1997 was due to a revaluation in property. Excluding this, total debt to capitalization in 1997 would have been 88%, with LT debt accounting for 58% of capital.

The higher the debt the company has in its balance sheet, the greater is the financial risk that it is facing. This means the company has to earn more profits to cover higher interest payments. In WFC's case, it is faced with this task amidst adverse business conditions resulting from the effects of the Asian financial crisis.