Report analysing the performance, liquidity and profitability of Ashburton Plc

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Executive Summary

This report analyses the performance of Ashburton Plc, using profitability, liquidity and other ratios.

Between 2000 and 2001, Ashburton Plc achieved:

- a 21.7% decrease in Return on Capital Employed
- a decrease in Annual Turnover ratio from 3.8 to 2.7
- no/small change in the current and acid test ratio
- the period of time for debtors to make the payments increased, but was still within the thirty day credit period given
- the period of time taken to pay back creditors increased from 17 days to 20 days
- a decrease in both gross and net profit ratios
- an increase in gearing ratio

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1.0 Introduction

1.1 Objectives

The aim of this report is to analyse the performance of Ashburton Plc and to try and pinpoint areas of concern.

1.2 Methodology

The analysis will be done by calculating performance, liquidity and other relevant ratios. This can help pinpoint areas of concern for the organisation.

1.3 Terms of Reference

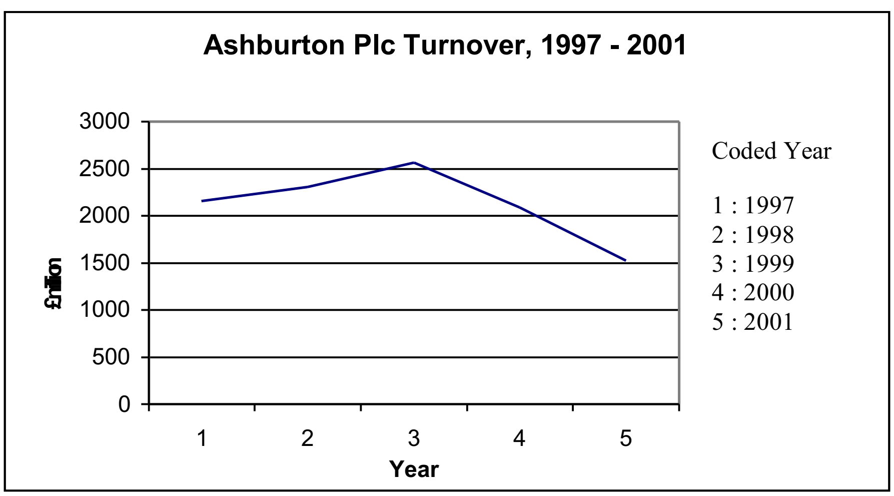
This report is aimed for the directors, shareholders and prospective shareholders of Ashburton Plc. The ratios will illustrate the performance, profitability and liquidity of the organisation.

2.0 Ashburton Plc

2.1 Performance

2.1.1 Turnover

The graph below illustrated Ashburton Plc turnover for the past five years. As you can see, turnover was growing steadily until after 1999 when it began to drop sharply. This could be the start of a declining trend in turnover.



2.1.2 Ashburton's Annual Turnover Ratio

2001: 2.7

2000: 3.8

The annual turnover ratio shows the relationship between the turnover and the capital employed, in general, the higher the ratio the better as it indicates higher turnover. In 2000, the turnover was 3.8 times the capital employed and in 2001 the turnover was 2.7 times the capital employed. This could mean several things, either the turnover has decreased or the turnover has remained the same and the capital employed has increased.

2.2 Profitability Ratios

2.2.1 Ashburton's Gross Profit percentage

2001: 6.6%

2000: 13.0%

Between 2000 and 2001 the gross profit margin almost halved. This can be due to number of things:

- Increase in costs
- Increase in competition

As you can see in profit and loss account, the cost of sales figure decreased from £1,814m to £1,421.4m. However when you look at the cost of sales in relation to the sales you can see that it has in fact increased from 87.0% to 93.4%, this indicates an increase in costs.

This combined with an increase in competition could explain the decrease in the gross profit margin.

2.2.2 Ashburton's Net Profit percentage

2001: 3.1%

2000: 8.0%

Again, there was a decrease in the net profit percentage between 2000 and 2001, which more then halved. As the gross profit percentage had shown a decrease of about 50%, it is expected that the net profit percentage would also decrease by about that amount. The net profit percentage in this case had decreased by just over 50%, which indicates that there was an increase in expenses. Note 3b of accompanying the accounts show more in dept information about the different expenses. It becomes easy to pinpoint where the extra expenses came from. The depreciation, property rentals and royalties receivable have all increased when it should have decreased in relation to the decrease in turnover.

2.3 Use of Assets

2.3.1 Sales to fixed Assets ratio

2001: 1.96 : 1

2000: 3.41 : 1

The Sales to fixed assets shows how well an organisation is utilising their fixed assets. It would seem that Ashburton is not utilising their fixed assets efficiently, however, in 2001 Ashburton invested more in their fixed assets, this extra investment contrasted with the lower sales figures give this low ratio.

2.3.2 Debtor's turnover period

2001: 9.1 days

2000: 5.1 days

The debtor's turnover period shows the average period of time taken for debtors to pay you back. Ashburton have a very good debtors turnover ratio this is assuming they allow organisations thirty days credit as most organisations do.

2.3.3 Creditors turnover period

2001: 20.4 days

2000: 17.2 days

The creditors turnover period is the period of time taken to pay your creditor. As most organisations allow thirty days credit, Ashburton are paying their creditors within that period. However, they would need to maintain this period of time in order to ensure their creditors faith in them.

2.4 Liquidity Ratios

2.4.1 Ashburton's current ratio

2001: 0.97 : 1

2000: 0.97 : 1

This shows the ratio of current assets to current liabilities has not changed. The low current ratio can be explained by the lack of sales and high stock levels, which accounted for 52.9% of total current assets in 2000 and 51.5% in 2001.

The Acid test ratio will give a better view of the organisations liquidity as in some cases it is hard for the organisation to convert their stocks to cash quickly.

2.4.2 Ashburton's Acid Test Ratio

2001: 0.47 : 1

2000: 0.46 : 1

These ratios again have not changed much over the year, it does however show how much of the organisation's current assets are tied up in its stocks. The organisation's low acid test ratio could pose a threat should the organisation need to raise cash quickly.

2.5 Return to Investors

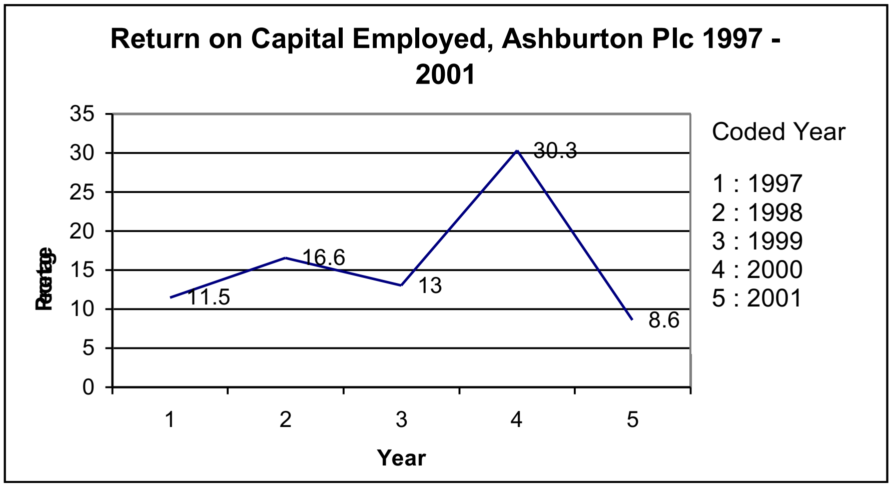
2.5.1 Ashburton's Return on Capital Employed (ROCE)

2001: 8.6%

2000: 30.3%

The return on capital employed ratio shows how efficiently an organisation is using the resources invested in it. This ratio can be used by shareholders to assess whether they would be better off by putting the money they invested in the bank.

In 2000, investing in Ashburton Plc would have resulted in a very profitable return on capital employed. This however decreased 21.7% to 8.6% in 2001, which can be seen as marginally better then placing the money in the bank. However, this sharp decrease could be seen as the beginning of a downward trend. However if you look at the graph below, it shows the organisation's ROCE ratio for the past five years, it has fluctuated, but seems to be fluctuating in an upward trend.



2.5.2 Ashburton's Dividend Yield

2001: 20.5%

2000: 22.5%

The dividend yield shows the shareholder's dividend as a percentage of the market value of the share. This ratio can show the shareholder the return they earn from holding stocks with that particular organisation, so from a shareholders point of view, the higher the ratio the better.

Ashburton's dividend yield has decreased 2% over the past year, but is still a relatively good ratio.

2.6 Capital Structure

2.6.1 Ashburton's gearing ratio

2001: 37.2%

2000: 9.8%

The gearing ratio is an indicator to how much funding the organisation gets from debt. The higher the percentage, the more highly geared it is, which could mean that the organisation is more risky. An organisation with a percentage of about 50%+ is considered to be highly geared. Whereas a percentage of about 30% is reasonable if the ROCE ratio is high.

Ashburton Plc has had a significantly high increase in their gearing ratio, from a low gearing ratio to an above average gearing ratio. This, along with the large decrease in ROCE indicates that the Ashburton Plc is highly geared, with much of their finance coming from borrowings. This could pose as a threat to the liquidity of the organisation in coming years.

3.0 Conclusion

The above ratios and analysis illustrate Ashburton Plc slipping position in the market place. Turnover has declined and costs have increased, this leads to the organisation not utilising their resources efficiently. The organisation's liquidity has remained constant in the past year, however the ratio of current assets to current liabilities is less then one, it also emerged that too much of the assets are being ties up in stocks, this combined with the sharp increase in gearing ratio has made the organisation more at risk from debt.

4.0 Appendix

4.1 Ratios Calculated

ROCE = Net Profit before tax / Capital Employed

2001: 47.8 / 556.9 = 8.6%

2000: 165.9 / 548.4 = 30.3%

Annual Turnover Ratio = Sales / Capital Employed

2001: 1522.4 / 556.9 = 2.7

2000: 2086.6 / 548.4 = 3.8

Gearing Ratio = Debt / Debt + Equity

2001: (193.5 + 13.5) / 556.9 = 37.2%

2000: (43.8 + 9.9) / 548.4 = 9.8%

Current Ratio = Current assets : Current liabilities

2001: 389.7 : 402 → 0.97 : 1

2000: 289.3 : 299.2 → 0.97 : 1

Acid Test Ratio = Current Assets – Stock : Current Liabilities

2001: 389.7 – 200.7 : 402 → 0.47 : 1

2000: 289.3 – 153 : 299.2 → 0.46 : 1

Debtors Turnover period = (Debtors / Sales) * 365

2001: (38 / 1522.4) * 365 = 9.1 days

2000: (29.1 / 2086.6) * 365 = 5.1 days

Creditors Turnover period = (Creditors / Cost of Sales) * 365

2001: (79.6 / 1412.4) * 365 = 20.4 days

2000: (85.7 / 1814.8) * 365 = 17.2 days

Gross Profit Percentage = Gross Profit / Sales

2001: 101 / 1522.4 = 6.6%

2000: 271.8 / 2086.6 = 13.0%

Net Profit Percentage = Profit before tax / Sales

2001: 47.8 / 1522.4 = 3.1%

2000: 165.9 / 2086.6 = 8.0%

5.0 Bibliography

- Ashburton Plc Annual Report 2001
- Financial Accounting, Second Edition by Anne Britton and Chris Waterston
- Ratio Analysis by Phillip McCosker