2013 Q3 Accunt.
Grafton Group

INTRODUCTION

Revenue and Profit - The consolidated Income Statement shows that GG sales revenue increased by just over 5% in 2012, a relatively small but welcome increase. There was a dramatic increase in after-tax profit: it increased - after exceptional items, finance costs and tax - to more than 16 times the 2011 figure. However the 2011 base was extremely low; it barely broke even that year (with profit of 2.5m revenue of over 2 billion - a margin of just over 1%).

Two factors contributed to the 2012 improvement. Firstly the €117.6m additional sales yielded an extra €18.3m in pre exceptional operating profit. This "marginal return" represents a profit margin of 15.5%, illustrating significant economies of scale benefit and strong control of operating costs. Secondly, a large contribution to the 2012 improvement is due to the €5.9m reduction in exceptional costs and a significantly different tax treatment of these expenses. In 2012 there was a 'tax credit' of almost €24m on the group 26m + exceptional operating costs incurred that year - with the result that the net cost of these expenses was just slightly over €2m compared with more than €31m in 2011. However, as will be seen in section 3, profit margins in 2012 are still low; the €41m profit after tax that year represents less than 2% of sales revenue.

The Statement of Comprehensive Income further shows that about ¼ of the €41m was eroded by negative 'other comprehensive items' of (10.4m) - where the positive currency translation effects (20m) were more than wiped out by the 31.1m actuarial loss on the group's defined benefit pension scheme

Balance Sheet

Total assets (and Equity + liabilities) have increased marginally. The main upward movements, all quite low have occurred in goodwill, inventories, trade and other receivables, and cash + cash equivalent.

Within the equity and liabilities section, the slight increase in equity is primarily due to the reduction in the negative foreign currency translation reserve (due to the positive currency translation effects shown in comprehensive income - and to a lesser extent - the appearance of non controlling interests)

Non current liabilities have increased by approx. €40m - mainly due to increases in long term borrowings (almost 20m, a figure which is almost exactly offset by a reduction in short term borrowings) and a near-doubling of retirement benefit obligations. Among the CL's, trade and other payables have increased by nearly 50m, while the income tax liability has dropped by more than 20m .. due to 2012 more favourable tax action

Cash Flow Statement

After falling by more than €100m in 2011 (to €135m), holdings of cash and cash equivalents recovered in 2012 by over €20m - more than 3m of which was due to favourable exchange rate fluctuations. Net cash inflows from operating activities increased by just over 8m (driven by the 24m increase in operating profit). Net cash outflow on investing activities increased slightly (by 4m). By far the most significant factor of GG's cash flow over the two years is the fall of over 115m in net cash outflows on financing activities in 2012 - due to the absence of any borrowing repayments that year, compared with the hefty outflow of more than 160m in 2011 (which was the main cause of the significant fall of €100m in cash holdings from just over 235m to under 137m a drop of 42%

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3.0 Analysis of Liquidity and Gearing

Short term perspective	2012		2011	
1 Current ratio	813.4/520.2	1.56 times	750/511.3	1.47 times
2 acid test	(813.4-305.5)/520.2	0.98 times	750.1-272.2/511.3	0.94 times
3 Inventory days*	305.5x365/2174.4	51.4 days	271.2x365/2053.8	48.2 days
4 Receivables days	332.4x365/2171.4	55.9 d	323 x365/2053.8	57.4 days
5 Payable days *	464.5x365/2171.4	78.4 d	421.7x365/2053.8	74.4
6 Operating cash cycle 3+4-5		28.4 days		30.7 days
7 Cash flow to maturing obligations	85.2/520.2	16.4%	77.2/511.3	15.1
8 Dividend payout ratio DPS/EPS	17.73/8.5	48%	1.09/7.5	68.8%
9 Profit retention ratio		52%		(58.8)%
Longer term perspective:				
10 Gearing	472.7/(472.7+1024)	32%	431/(431.4+982.3)	30.5%
11 Interest cover	46.8/13.2	3.5 times	22.7/12.6	1.8 times

*No GP figure compute inventory and payable days using sales revenue as denominator will work out lower than usual figure but they compensate for each other.

*Interest cover takes account of finance income

Both of GG short term liquidity measures have strengthened slightly and are at safe levels for an enterprise involved in large scale building materials merchandising + DIY and Garden Shed products. There are marginal changes in the three components of the OCC ratio: this has fallen by 2.3 days, largely on the back of a 4 day increase in trade payable days. In this context, the average interval between GG collecting from customers and payments to suppliers has stretched from 17.5 days to 23 days.

The more conservative net cash inflow from operating activities (rather than cash generated from operations) was used as numerator in ratio 7. The results for both years

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2013 Q3 Exam Paper Accounting Grafton Group

2.0 Analysis of Profitability & Efficiency (Managerial & Investor Perspectives)

	2012		2011	
1. Sales growth	2171 / 2054	+5.7 %	-	-
2. Gross profit %	-	-	-	-
3. Operating profit margin	47 / 2171	2.16 %	23 / 2054	1.12 %
4. Asset / capital efficiency	2171 / (1002 + 473)	1.47 times	2054 / (983 + 432)	1.45 times
5. ROCE 3x4	47 / 1475	3.19 %	23 / 1415	1.63 %
6. ROSF	41 / 1002	4.09 %	2.5 / 983	0.25 %
7. EPS	-	17.73c	-	1.10c
8. DPS	-	8.5c	-	7.5c
9. P/E ratio	500 / 17.73	28.2 times	-	-
10. Dividend yield	8.5 / 500	1.7 %.	-	-

As noted in the introduction, GG's profitable increase in sales and much more favourable tax expense in 2012 (ultimately a net credit of 7.6m compared with a 7.7m charge in 2011) helped to push up all of the profitability ratios. The OPM and ROCE ratios doubled (approx); the latter increase is driven entirely by the former, since the capital efficiency ratio remained steady. ROSF showed the most dramatic gain: this was due largely to the fact that in 2011 the 33.7m pre exceptional profit after tax was almost totally cancelled by the 31.2m exceptional item expense - leaving just over 2.5m for the shareholders that year.

Nevertheless in 2011 GG paid a dividend of almost 7 times its EPS, clearly unsustainable in the long run. The return to a more reasonable level of profitability in 2012, which generated an EPS of 17.73, allowed the Group to increase the DPS by 1.0c pps (to 8.5c per share out of 50s.) The high P/E ratio and low dividend yield indicate that the financial markets responded positively to the 2012 results and the group's prospects for 2013 and beyond

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(15 to 10x) are on the low side, indicating that annual cash flows are low relative to the level of current liabilities. However, taking account of the stability of its other liquidity ratios and its increased holdings of cash and cash equivalents (+19m before factoring in the 3.2m favourable translation adjustment), there doesn't seem to be any cause for concern.

The unsustainably high dividend payout ratio in 2011 followed by a 1.0c increase in DPS in 2012 [which consumed a relatively ~~to~~ high proportion (48%) of that year's EPS] suggests that the board was confident that the company's poor performance in 2011 was short term in nature and that it had come to terms with the challenging post 2007 period in the sector.

While GG gearing has risen slightly, it is at a safe level (we could possibly support further borrowing capacity?). The interest cover which was dangerously low in 2011 has recovered well. Further improvements in this measure would be welcomed by the management and the markets.

4.0 Summary & analysis of Cash Flows £ millions

1. Net cash inflow from operating activ.		85.2		77.2
2. Net cash outflow from investing activities	(38.4)		(34.5)	
3. Net cash outflow from financing activities	(27.2)		(143.7)	
Total outflows attributed to investing & financing activities		(66.1)		(178.2)
Increase/(decrease) in holdings of cash and cash equiv.		19.1		(101.0)
+ opening bal		134.6		234.3
+/- translation adjustments		3.2		1.3
= closing balance		156.4		134.6

1. Operating Activities G G net cash flows from operating activities increased by 8m (or just over 10%) in 2012 – from 77.2 to 85.2m. Three components of this part of the statement account for the bulk of this difference; profit before tax, non cash movement in operating provisions and working capital. The primary reason was the improvements ~~in operating~~ by 23m in profit before tax. A large proportion of this was offset by the significantly lower add back by 19.4m relating to non cash movements in operating provisions. The group managed to reduce its investment in working capital in both years. The main impetus to the 4.5m higher reduction in 2012 was increase in trade payables. There were small fluctuations in the remaining 4 primary components of cash FFOP, the majority of those were less than 1m.

Investing Activities The group's overall outflows on investing activities have dropped marginally in 2012 from 47.2m to 43.4m. This reduction of 4m was caused by a drop of 7m in organic investment, combined with an increase of 3m in the amount spent on acquisitions in 2012. There was a major switch in the pattern of investment – away from joint ventures towards acquisition of controlling interests. This may have been due to the different nature of the target enterprises involved over the 2 years rather than any fundamental shift in its M&A strategy.

The net decrease in outflows of 3.8m was offset by significant drop of 8.2m in inflows from sale of property, plant and equip – resulting in a net increase in outflow on investing activities 34.4m to 38.9m.

2013 Q3 Grafton Exam Paper Answer

Financing Activities Presents a picture of dramatic change. Overall there was a major fall of more than 116m in net cash outflows on financing activities. This decline was almost entirely due to difference in the amount of new borrowings and borrowing repayment over the 2 years. In 2011 borrowing repayments exceeded new borrowings by 96m — this accounting for the 101m fall in holdings of cash and cash eq that year. By contrast there was no repayment of borrowings in 2012, while fresh borrowings brought in 20m. Small difference in proceeds from the issue of shares, dividend payments moment in finance lease liability account for remainder of difference.

Overall Having increased its net inflows from operating activities by 10% largely on foot of higher profits and reductions in working capital, and reduced its net outflows on both investing and financing, GG holding of cash and cash equivalent improved by just over 105% during 2012. This increase goes some way toward rebuilding the cash reserves which had been depleted by over 60% in 2011 as a result of heavy repayments

5. Overall Summary and Conclusion

Overall GG has recovered well from a poor year in 2011. Its increased sales have underpinned a strong recovery in profits. It has also increased div and holdings of cash. It has invested organically and by acquisition but the amounts in 2012 led only to a very modest increase in level of NCAs on its balance sheet. All in all the results indicate its coping well with adverse economic environment that exists in Ireland

The high P/E multiple suggests investors have expectations [of] future improvements in profit[illegible] and [illegible]. However OPM is low even at the expected level it was 3.4% in 2012 ahead of 2011 at 2.7%. Its ROCE is around 3% ⇒ well below competitors' norms in this regional group & [illegible] to look for improvements in its asset efficiency [illegible] in order to compensate its low return. Use OPM in order to get better performance and better ROCE. Any continuation of its current low margins will leave it vulnerable to adverse movements in sales and costs.

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2013 Q3 Exam Paper Answers

3 a Analysis of Liquidity and Gearing

			2012		2011
A	Short-term perspective		2012		2011
1	Current ratio	813885/520207	1·56		1·46
2	Acid test	813885-305516/520207	0·98		0·93
3	Inventory days	305516×365/ — cost of sales			
4	Receivable days	332143 39×365/	55·89		57·4
5	Payable days	—			
6	Operating cash cycle 3+4-5.				
7	Cash flow to maturing obligations	85205/520	0·1637	77193	0·15
8	Dividend payout ratio	8·5/17·73	48%	7·5/11	68%
9	Profit retention		52%		negative
	Longer Term		32%		
10	Gearing		32%		30%
11	Interest cover		3·5 times		1·82

Grafton's short term liquidity has strengthened marginally and it appears to be at a safe level. A small reduction in inventory days (x days) together with a more significant reduction in receivable days (-2 days), and a slight lengthening of its payable days (y days) all combined to reduce its operating cash cycle OCC by just under a week. The reduction in receivable days is noteworthy - especially in a stagnant economic environment. Grafton may wish to consider whether this could indicate a measure of over-zealous collection of its sales receivables - to an extent that might alienate customer goodwill. However the average collection period still exceeds two months, so this is probably not the case. The payable days (over 3 months) is long by most standards; this indicates that a significant proportion of Grafton's working capital requirement is being financed through supplier credit. It should be observed that if Grafton paid its suppliers of goods and services quicker (thus lengthening its OCC) its current and acid test ratios would be affected accordingly

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Grafton's longer term financial structure has remained inline with it's short-term prospective. Although the gearing rate has increased marginally by 2%. It remains low by most standards and indicates that deleveraging is not needed in the current future. Borrowings remain relatively low at 335000. The interest rate cover, though doubled in 2013. is still at a low level of 3.2 times which is a conservative estimate. With such a low ratio, interest cover may come under attack in future.

Graftons low level of indebtedness is likely to act in their favour in the future regarding expansions and acquisitions. It will also reward shareholders through more handsome payout rates.

4. Summary And Analysis Of Cash Flows.

	2012		2011	
1. Net cash inflow from operating activities		85205		77193
2. Net cash outflow from investing activities	(38900)		(34494)	
3. Net cash outflow from financing activities	(27240)		(143 715)	
4. Total outflows attributable to I + F activities		(66140)		(178209)
Increase/decrease in holdings of cash and equivalents		19065		(101016)
+ opening balance		134600		234275
+/- translation adjustments		3211		1341
= Closing balance		156876		134600

Holdings of cash and cash equivalents improved further in 2012 by almost 20000 including a positive translation adjustment of £3211 to reach £156876. All three areas contributed to the increase - the £1300 increase (10%) hike in net cash flow from operating activities being complemented by falls in outflows.

Improvement in operating activities: Improvement of £1300 driven by a number of factors. Firstly a doubling of operating profit

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by 25000 (from 22 to 46). Other than this improvement there was no other noteworthy movement. Against this there was unfavourable movements in non cash movement in operating provision dropping from 70 to 9, non cash movement on asset impairment (-2000) and contributions to pension scheme -1000.

4000 increase in outflow attributed to investing activities: this can be attributed to a number of factors. Inflows have decreased from 12000 to 4000 mainly due to drop in proceeds in sales of assets and interest received. Grafton invested 18000 in subsidiary undertaking further deepening this situation but was boosted by 5000 in cash from subsidiary. Overall this resulted in a decrease of around £4000.

116000 reduction in outflow from operating activities: This can be explained by two movements. Firstly proceeds from borrowing were down by nearly 50% (40000), this had a negative impact on inflows. Compared to last year Grafton did not repay any borrowing compared to 16100 last year. Other than this figure, the remaining items remained static.

Overall due to "favourable" movements (increase in net inflows and reductions in net outflows) Grafton's holding of cash and cash equivalent improved by £20000 during 2012 - thus providing it with increased - though still limited - capacity to take advantage of any investment opportunities that may arise in the near future.

5. Overall Summary & conclusion

Among the most significant points made concerning the financial statements / results are:

- Increase in revenue and resulting increase in ratios including ROCE, ROSF and EPS

- Overall changes in short term measures have been slight but improving more the less measures related to working capital saw reduction in receivable days and increase in payable days

- Gearing has disimproved but is at a suitable level, interest cover may be a concern

- Due to increase in profit and decrease in loan repayments, holdings of cash and cash equivalents improved by 2000

2013 Q3 EXAM PAPER ACCOUNTING.

Introduction

Compared with 2011, Grafton's financial performance showed financial gain in almost every area. However, with plans of expansion, Grafton must maintain this financial performance in order to have a chance of success.

Income Statement

Overall, Sales revenue increased by just under 6% from 2011, this resulted in a doubling of Operating profit. Finance expense was down and thus the end result was a 1600% increase in net profit. Compared to last year this is a strong performance.

Statement in Change of Equity

The Benefit Plan made a larger loss than last year but this was offset by smaller losses from flow of hedges and a strong income of 41120 which resulted in a net gain of overall 3 times.

Balance Sheet

Overall there was little movement in non current assets (+ 5607). There was an increase in CA by +63168 mainly attributed to larger inventories (+ 34299) and cash holdings of + 22276.
As with Equity and liabilities there was little movement overall. The main notable was a doubling of retirement benefits obligation to 62 971.

Cash flows

Grafton has showed improvement in their cash flow ending with an outflow of 27240 less than quarter of the outflow from last year (14370) This is due to the fact that last year 101411 was paid back from a bank loan. Other than this change in financing activities the cash flow has been very much in line with last year's activities

Analysis of Profitability & efficiency

			2011	2010
1	Sales growth.	2171388/2053...	5.7%	—
2	Gross profit %		—	—
3	Operating profit margin	46766/2171388	2.2%.	1.12%.
4	Asset Efficiency	2171388/(1001881+472071)	1.47 times	1.45 times
5	ROCE :	OPM (Return).	3.2 %	1.6 %
6	ROSF :	net profit/equity	4.1%	0.26 %.
7	EPS :		17.73c	1.1 cent
8	DPS:		8.5	7.5.
9	P/E ratio	500/17.7	= 28.2 times	—
10	Dividend yield	DPS/MP 85/500	1.7 %.	—

Thus ~~State~~ Grafton managed to generate a significant increase in sales of (>5%) and an improved profit margin is impressive. Furthermore operating costs increased marginally. Coupled with a ~~reduction in finance expense~~ Consequently the economics of scale associated with higher sales and fixed "overheads" boosted opm to 2.2%, double last year's figure. This when combined with the marginal increase of asset efficiency boosted the critical ROCE to 3.2%, again double last year's figure. This in turn boosted ROCE's two subsidiary ratios ROSF and EPS by even more significant levels due to the positive effect of financial gearing. Most notably EPS increased from 1.1c to 17.73c per share. The group paid out 8.5 cent p/s representing a p/e ratio of 28 times.