FINANCIAL EVALUATION REPORT

Table of Contents

Brief introduction of Associated British Foods

The sudden outbreak of the Covid 19 pandemic has mostly affected the food retail chain around the world. The safety measures that were taken to curb the spread of the virus caused major losses to the food and beverage companies in the UK. Associated British food is the owner of the UK retail brand, Primark, and its finances are integrated. In the course of the study, it has been identified that the Associated British Foods which is popularly known as ABF has faced an economic loss of 40% due to both decreases in the sale of food and fashion clothes (Reuters.com, 2020). In addition to that, the brand owner-reported store closure in major places. In order to be exact, the owner of Primark, the ABF took the decision to close the Primark fashion retail stores i.e., 376 stores in 12 countries have been closed since March 22 (Reuters.com, 2020). Along with that, ABF announced that it could not pay interim dividends along with earning guidance to the shareholders as uncertainty prevailed during that time. The major reason for acquiring such losses is the higher input costs or higher operation costs of ABF that were unavoidable in those situations (Abf.co.uk, 2022). Major points have been noted that influenced such a massive downfall of the company. According to reports, supply chain issues, logistic issues, and changing market demand were the drivers of change in the economic performance of the company (Kumar *et al.,* 2021). Due to restrictions, it was difficult for ABF to make good contact with all its suppliers. With this, restrictions on logistics also increased the impact of the issue.

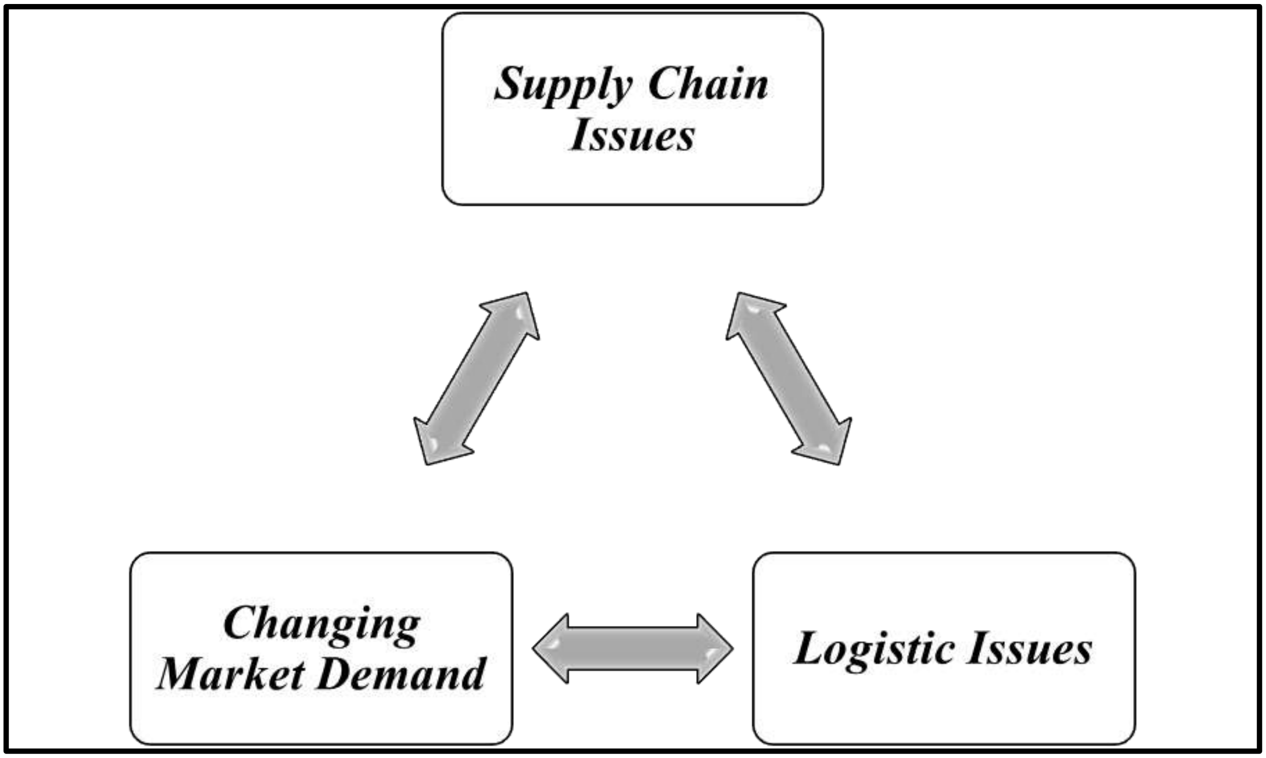

Figure 1: Recently found issues in ABF's business

(Source: Created by the learner)

This report focuses on the key financial highlights of Associated British Foods to evaluate its financial performance by considering its key financial ratios, financial budget, and investment appraisal plans. Based on these findings and investment risks for the new product and service launch, recommendations will be made at the end of this report.

Evaluate financial performance

Financial ratios play a major role in interpreting the fairness of a business entity. As per the views of Restianti and Agustina (2018), each ratio has its own unique feature that adds extra information to the company's financial picture. The annual report of a company holds significant information related to the business operations and financial considerations. In the course of the study, it has been identified that there exist 4 major categories in ratio analysis that finance managers mostly consider worthy of a company's performance. Profitability ratios, liquidity ratios, solvency ratios, and valuation ratios are considered by finance departments to understand the issues the business is currently facing and the way it is growing. In order to critically evaluate ABF's current financial performance and understand its previous journey before, 1 particular ratio from the above-mentioned 4 categories has been considered for 5 years.

5 years ratio analysis for each category

Profitability ratio	**2021**	**2020**	**2019**	**2018**	**2017**
Gross Profit margin	**22.5511**	**22.5084**	**22.9841**	**23.01271**	**23.48114866**
Liquidity Ratio	**2021**	**2020**	**2019**	**2018**	**2017**
Current Ratio	**1.86015**	**1.82461**	**1.82399**	**1.627155**	**1.64605138**
Solvency Ratio/Efficiency ratio	**2021**	**2020**	**2019**	**2018**	**2017**
Debt to Assets	**0.19254**	**0.19533**	**0.24033**	**0.253214**	**0.276893**
Valuation/Financial gearing Ratios	**2021**	**2020**	**2019**	**2018**	**2017**
P/E ratio	**2.42**	**1.64571**	**0.04742**	**0.057021**	**0.048005066**

Table 1: 5 different ratios computers from ABF'S annual reports

(Source: Self-created by the learner in MS Excel)

Associated British Foods	2021	2020	2019	2018	2017
Current assets	6105	5753	5596	5285	5190
Current Liabilities	3282	3153	3068	3248	3153
Inventories	2151	2150	2386	2187	2101
Short term debts	3177	2938	2946	3108	2935
Long term debts	76	318	361	359	612
Total assets	16895	16669	13760	13692	12810
Earnings Per Share	60.5	57.6	111.1	127.5	151.6
Market Value Per Share	25	35	2343	2236	3158
Net Sales	13884	13937	15824	15574	15357
Cost of Goods Sold	10753	10800	12187	11990	11751

Table 2: Important particulars to support the ratio results

(Source: Self-created by the learner in MS Excel)

Critically evaluation of various aspects of the financial position and performance of ABF

The first ratio identified in table 1 was the gross profit margin which is a type of profitability ratio that speaks about the profit-making scenario of a business. The gross profit margin for the last 5 years has not been extremely fluctuating except for the year when the pandemic actually started. The gross profit margin in 2017 and 2018 were 23%. However, in 2019, it was reduced by 1% (22.9841). In 2020, the gross profit margin got smaller and reached 22.5084. ABF has been trying to cope up with the difficult situations and their efforts reflect in their annual report as the gross profit margin in 2021 increased to 22.5511.

This means, that currently, the company is retaining 22.55% of the profit from every unit sold in the business which is good for the growth.

During the making of this report, it has been identified that the ideal current ratio for any company is 2:1 (Pasquin *et al.*, 2018). In case of table 1 is critically observed, it will be identified that ABF has been earning a good current ratio in the last 5 years as they are near to 2:1. 1.86015 is the highest current ratio obtained by the company in 2021. The most impressive fact about the company is that even in 2020, the company maintained a good current ratio of 1.8246. This indicates that ABF has a transparent and standard liquidity condition to pay its immediate debts.

The next ratio category was the efficiency ratio where the debt to assets (D-E) ratio was computed. As per accounting guidelines, a D/E ratio up to 0.4 or 40% is considered the standard limit for companies (Investopedia.com, 2021). Table one represents a good set of D/E ratios as in all the years, ABF has been successful in maintaining the D/E ratio maximum up to 0.27%. Thus, it depicts the strength of the assets that the company holds.

Lastly, the P/E ratios of the company were calculated to identify whether the company is capable of paying higher dividends to the shareholders. A lower P/E ratio is considered good for the companies (Park, 2021). In 2017, 2018, and 2019, the P/E ratios were smaller than the P/E ratios earned in 2020 and 2021. Thus, after the pandemic, ABF's dividend policies have been negatively impacted.

Analyzing the problems and limitations of financial ratios

Ratio analysis is considered to be one of the most impactful financial tools used by companies worldwide. However, critics have highlighted some weaknesses of the above-mentioned tools which have been discussed below.

- While comparing the financial performances of two or more than one company, users often forget the nature of the businesses is different. This leads users to have an incorrect perception of the business entities.
- A lot of changes in the market segments and macroeconomics factors are experienced by business organizations over time which ratio results cannot justify (Corporatefinanceinstitute.com, 2022).
- Ratio analysis helps organizations to predict the future of the business. However, entirely depending on the ratio results sometimes misguide the authorities.

Budgeting and performance management

Advantages of making a budget

- The first benefit of making a budget plan for ABF is to tighten the cost expenditures of the company. In the course of the study, it has been identified that the company has faxed the issue of increased input costs in pandemic which can be resolved by making a strict budget plan (Stevcevska-Srbinoska, 2018). With the help of a budget plan, the finance department will be able to conduct a better controlling and monitoring process on operation activities. Along with that, the budget plan will serve as a better financial resource allocation sheet that will help the company to use the resources well in the business.
- Another major advantage of using a budget plan is to ensure that short-term plans are well executed to enhance the profitability factor (Ouassini, 2018). In other words, management teams often forget to keep an eye on the day-to-day activities which later cause them trouble. With the help of a precise budget plan, ABF will be able to design an everyday budget or weekly budget to ensure that profit maximization is considered in every aspect of the business.
- The budgeting tool serves as a financial advisor for the companies (Stevcevska-Srbinoska, 2018). Appropriate utilization of a budget tool helps organizations to attract more investors as the budget helps organizations to enhance the liquidity factors of the business.

The Disadvantages of making a budget

- Similar to the ratio analysis tool, budgeting is also considered a tool for predicting future business values. However, due to changes in external business circumstances, a budget cannot be fully trusted as they forecast the business future on the basis of the current circumstances (Akhmetshin *et al.*, 2018).

- Another major disadvantage of using a budget plan is adding more expenses to the business (Kenno *et al.*, 2018). Budget planning requires hiring a cost analyst which needs organizations to incur more expenses than usual.

However, it is important to mention here that besides having some disadvantages, organizations tend to focus on the positive aspects of budget planning and make one for their safety. ABF needs to do the same to be a wiser and wider market player.

The ratio analysis done in the upper section highlights the need for budget preparation. It showed the vulnerability of the company as it could not pay higher dividends to the shareholders. Thus, the increased cost factor needs to be addressed by ABF with help of budgeting.

Explain two different approaches to drawing up a budget for the business.

Activity-based budgeting

Activity-based budgeting which is popularly known as ABC is the first budget approach discussed in this report. The core concept of activity-based budgeting or ABC is to adjust the cost operations to satisfy the business goals or objectives (Al-Aamaedeh, 2020). Activity-based budgeting does not prioritize the past budget history of an organization. Rather, under the ABC method, activities are thoroughly analyzed to predict the operational cost of the business (Wahab *et al.*, 2018). The ABC method closely observes the activities to identify other ways to increase efficiency and reduce the cause volume. Thus, it identifies the cost drivers and settles problems on the basis of its observations.

Zero cost budgeting

The concept of zero-cost budgeting or zero-based budgeting is considered to be a traditional budgeting approach in cost management. In the course of the study, zero-based budgeting finds justification for performing each activity in the workspace (Ibrahim, 2019). In other words, zero-based budgeting critically analyzes the activities and judges their needs in the business. The budget for each activity starts from 0 under this method and then rises above as per the circumstances and needs. Unlike the ABC method, Zero-based budgeting considers the past budget experience of the company to determine the present budget for activities.

Use of budget by performance management to make better financial decisions

In this case, for ABF, activity-based budgeting needs to be prepared by the cost analyst. This is because the current condition of the business has changed especially after Covid. Thus, considering past budget plans would not work for the company. Based on the needs of the activities and identifying whether any other ways can be adopted to decrease activity costs, ABC's budget will help the company to run the business systematically.

Also, with the help of better performance management practices, ABF will be able to develop clear goals and establish a fairer work atmosphere for the employees (O'Shea, 2018). By introducing the reward policy, ABF can inspire employees to work harder to achieve significant goals for the company. In this way, better results will be obtained which will ensure higher productivity and profitability.

Investment appraisal

Critical evaluation of NPV and IRR techniques

NPV stands for "net present value" whereas IRR stands for "internal rate of return". In order to define net present value, it can be stated that NPV is the difference between the PC and CI's of a business (Investopedia.com, 2022). In simple words, the amount of difference between the present value of cash inflows and the present value of cash outflows over a period of time is recognized as NPV. Business organizations often calculate NPV for investments or projects to identify whether a project or investment is profitable or not (Investopedia.com, 2022). A similar term needs to be mentioned here which is IIR which represents a percentage of the return value of the future project or investment. As per the views of Hansen *et al.*, (2019), the IRR is a proportion of the invested amount that investors are project managers can expect to get as a return over a particular time. Thus, if NPV is the present value of a project or investment, IRR is the expected portion of the investment that investors can expect to get a return on after a particular period. Thus, calculation of both NPV and IRR is important to get a clear view of the profitability factors of future projects.

Calculations for NPV and IRR in the chosen format

ABF's NPV and IRR calculations	**In Euro million**		
Year	**PAT (PROFIT AFTER TAX) IN MILLION**	**<u>DF@10%</u>**	**PV pf Cash flow**
1	£ 583.00	0.909090909	€ 530.00
2	£ 634.00	0.826446281	€ 523.97
3	£ 783.00	0.751314801	€ 588.28
4	£ 524.00	0.683013455	€ 357.90
5	£ 821.00	0.620921323	€ 509.78

6	£ 1,211.00	0.56447393	€ 683.58
7	£ 1,022.00	0.513158118	€ 524.45
8	£ 896.00	0.46650738	€ 417.99
9	£ 465.00	0.424097618	€ 197.21
10	£ 498.00	0.385543289	€ 192.00
The 10 years range has been shown from 2012 (year 1) to 2021 (year 10)		**Total PV of cash flow**	**€ 4,525.14**
		Initial investment	**€ 50.00**
		NPV	**€ 4,475.14**

Table 3: The NPV calculation table

(Source: Created by the learner in MS Excel)

The above table shows the net present value calculation for Associated British Foods by using the NPV formula ***[Refer to appendix 1]***. The NPV of the concerned project is **€4,475.14 million.** A ten years time period has been considered for the calculation starting from 2012-2021.

Year	**Revenue**	**Salary and wages**	**PBIDT**	**PBDT**	**Depreciation**	**PBT**	**PAT**	**Interest rate**
$ -	-£ 50.00	£ -	-£ 50.00	-£ 50.00	£ -	-£ 50.00	€ -50.00	10 %
1	£ 55.00	£ 10.00	£ 45.00	£ 45.00	£ 10.00	£ 35.00	€ 35.00	
2	£ 57.75	£ 10.50	£ 47.25	£ 47.25	£ 10.00	£ 37.25	€ 37.25	

3	£ 60.64	£ 11.03	£ 49.61	£ 49.61	£ 10.00	£ 39.61	€ 39.61	
4	£ 63.67	£ 11.58	£ 52.09	£ 52.09	£ 10.00	£ 42.09	€ 42.09	
5	£ 66.85	£ 12.16	£ 54.70	£ 54.70	£ 10.00	£ 44.70	€ 44.70	
6	£ 70.20	£ 12.76	£ 57.43	£ 57.43	£ 10.00	£ 47.43	€ 47.43	
7	£ 73.71	£ 13.40	£ 60.30	£ 60.30	£ 10.00	£ 50.30	€ 50.30	
8	£ 77.39	£ 14.07	£ 63.32	£ 63.32	£ 10.00	£ 53.32	€ 53.32	

9	£ 81.26	£ 14.77	£ 66.49	£ 66.49	£ 10.00	£ 56.49	€ 56.49	
10	£ 85.32	£ 15.51	£ 69.81	£ 69.81	£ 10.00	£ 59.81	€ 59.81	
The IRR is more than 50% which means the project has a high potential to do well in the market and bring amazing returns within a short period of time.							**IRR**	**76 %**

Table 4: The IRR calculation table for ABF

(Source: Created by the learner in MS Excel)

The IRR stands at 76% which is a good score for any company to achieve. In the course of the study, it has been identified that a higher IRR represents a higher profitability factor of the projects (Investopedia.com, 2022). Thus, the new product or service launch idea must be carried forward by ABF.

Financing methods for the project

As the new product or service launch would require 50 million euros, the management team of ABF should look for some additional funding help from the outside world. In short, it is suggested to ABF to keep the 3:2 ratio where 3% will be its own investment and 2% will be invested by shareholders or investors.

Risks in the plan and recommendations

As the company has got a bad reputation for dividend payment during the pandemic and also failed to pay higher dividends to shareholders due to the same reason, it can be difficult for the company to attract new investors for the project.

Thus, the company is recommended to introduce a modified dividend policy to regain the trust of the shareholders and investors. This will create a good repetition for ABF in the market and convincing the investors will be easier for the company as well.

Conclusion

This report has been an overview of what is the most popular food retail chain situated in the United Kingdom, the "Associated British Foods". "Associated British Foods", which is popularly known as ABF has a huge company data to identify its current business operations and practices. ABF is the owner of Primark which is why their financial operations are interconnected. In the course of the study, it has been identified that higher input costs have been one of the major problems for ABF in times of COVID. Not only that, the company has faced supply chain disruption, logistics disruption, and so on due to the said circumstances. The 5 years ratio chart of the company revealed a good financial condition of the business in terms of strong assets and sales. However, the company failed in making higher dividend payments to shareholders. In fact, in 2020, the company did not pay dividends at all. The new launch idea has a strong IRR (76%) which the company can be hopeful about. However, to attract new investors, ABF has to rebuild its reputation first in front of the shareholders. Or else, the risk factor of the project can become higher.

References

Abf.co.uk, (2022). Interim Results Announcements. Available at: https://www.abf.co.uk/content/dam/abf/corporate/Documents/investors/results-and-presentations/2022/ABF-Interims-results-announcement-26-April-2022-final.pdf.downloadasset.pdf [Accessed on: 04.05.22]

Akhmetshin, E.M., Kovalenko, K.E., Mueller, J.E., Khakimov, A.K., Yumashev, A.V. and Khairullina, A.D., (2018). Freelancing as a type of entrepreneurship: Advantages, disadvantages and development prospects. Journal of Entrepreneurship Education, 21(2), pp.1528-2651.

Al-Aamaedeh, Z.O., (2020). REQUIREMENTS AND OBSTACLES OF ACTIVITY-BASED BUDGETING (ABB) IMPLEMENTATION IN JORDANIAN PUBLIC-SHARING PHARMACEUTICAL COMPANIES. International Journal of Management (IJM), 11(8).

Corporatefinanceinstitute.com, (2022). What is Ratio Analysis? Available at: https://corporatefinanceinstitute.com/resources/knowledge/finance/limitations-ratio-analysis/ [Accessed on: 04.05.22]

Hansen, L.P., Roberds, W. and Sargent, T.J., (2019). Time series implications of present value budget balance and of martingale models of consumption and taxes. In Rational expectations econometrics (pp. 121-161). CRC Press.

Ibrahim, M.M., (2019). Designing zero-based budgeting for public organizations. Problems and Perspectives in Management, 17(2).

Investopedia.com, (2021). Total-Debt-to-Total-Assets Ratio. Available at: https://www.investopedia.com/terms/t/totaldebttototalassets.asp [Accessed on: 04.05.22]

Investopedia.com, (2022). Internal Rate of Return (IRR). Available at: https://www.investopedia.com/terms/i/irr.asp#:~:text=It%20is%20calculated%20by%20taking,an%20outcome%20can%20be%20measured. [Accessed on: 04.05.22]

Investopedia.com, (2022). What Is the Formula for Calculating Net Present Value (NPV)? Available at: https://www.investopedia.com/ask/answers/032615/what-formula-calculating-net-present-value-npv.asp [Accessed on: 04.05.22]

Kenno, S.A., Lau, M.C. and Sainty, B.J., (2018). In search of a theory of budgeting: A literature review. Accounting perspectives, 17(4), pp.507-553.

Kumar, A., Mangla, S.K., Kumar, P. and Song, M., (2021). Mitigate risks in perishable food supply chains: Learning from COVID-19. Technological Forecasting and Social Change, 166, p.120643.

O'Shea, J.P., (2018). Viability of Zero-Based Budgeting Methods in the City of Albuquerque.

Ouassini, I., (2018). An introduction to the concept of incremental budgeting and beyond budgeting. Available at SSRN 3140059.

Park, S., (2021). The P/E Ratio, the Business Cycle, and Timing the Stock Market. The Journal of Portfolio Management, 47(8), pp.165-183.

Pasquin, M.P., Cheung, P.Y., Patel, S., Lu, M., Lee, T.F., Wagner, M., O'Reilly, M. and Schmölzer, G.M., (2018). Comparison of different compression to ventilation ratios (2: 1, 3: 1, and 4: 1) during cardiopulmonary resuscitation in a porcine model of neonatal asphyxia. Neonatology, 114(1), pp.37-45.

Restianti, T. and Agustina, L., (2018). The effect of financial ratios on financial distress conditions in sub industrial sector company. Accounting Analysis Journal, 7(1), pp.25-33.

Reuters.com, (2020). AB Foods earnings fall 40% on Primark's COVID-19 hit. Available at: https://www.reuters.com/article/ab-foods-results-idUKASN000HKC [Accessed on: 04.05.22]

Reuters.com, (2020). AB Foods omits dividend, says can't give guidance due to coronavirus crisis. Available at: https://www.reuters.com/article/coronavirus-health-ab-foods-idUKFWN2C81KS [Accessed on: 04.05.22]

Stevcevska-Srbinoska, D., (2018). The Advantages of Budgets: A Survey of Macedonian Legal Entities. Business and Economic Research, 8(2), pp.33-55.

Wahab, A.A., Mohamad, M.H.S. and Said, J.M., (2018). The implementation of activity-based costing in the Accountant General's Department of Malaysia. Asian Journal of Accounting and Governance, 9, pp.63-76.

Appendix 1: NPV formula

If analyzing a longer-term project with multiple cash flows, then the formula for the NPV of a project is as follows:

$$NPV = \sum_{t=0}^{n} \frac{R_t}{(1+i)^t}$$

where:

R_t = net cash inflow-outflows during a sin

i = discount rate or return that could be ea

t = number of time periods

(Source: Investopedia.com, 2022)