Accounting as an Information System Coursework

Financial Review of Nichols PLC

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# Executive Summary

Nichols group comprises two divisions; soft drinks and dispense operation. The brand portfolio consists of Vimto, Panda and Sunkist, available in over 65 countries.

## Financial Highlights

|  |  |  |  |
| --- | --- | --- | --- |
| Figures in (£’000) | 2009 | 2008 | Movement |
| Revenue | £72,378 | £56,221 | 22% |
| Operating Profit | £12,501 | £9,804 | 22% |
| Earnings | £8,568 | £7,306 | 15% |
| Dividend | £4,445 | £4,085 | 8% |
| Cash | £11,215 | £6,048 | 85% |
| Capital Employed | £29,301 | £24,988 | 15% |

Nichols continued to increase revenues, operating profit and earnings through acquisition and organic growth. Nichols is in a secure position with high cash reserves and low gearing with no formal borrowings. It has an opportunity to continue growth through the use of cash reserves or increasing gearing through borrowing. This would enable additional acquisitions or market expansion with a view to maximising shareholder returns.

## Major events

* International sales increased 33% to £12m (Middle Eastern sales grew 40%; African 11%).
* Marketing campaigns drove national and international growth, netting 1 million new customers.
* Acquired control of Dayla dispense operations (2008) giving access to the European premium juice dispense market.
* £5.5m goodwill impairment (2008) due to review of acquired brands.
* Post balance sheet acquisition of Ben Shaws ‘soft drinks on draught’ business.

## Strengths

* Out-performed the UK soft drinks market.
* Strong core international brand.
* Strong cash balance could fund future expansion or acquisitions, accelerating growth.
* Diversified into growing energy drinks market through acquisition.
* Acquisitions consolidated Nichols’ position as number three in the dispense market.

## Weaknesses

* Gearing could be considered too conservative and does not maximise shareholder returns for an outperforming business. For example, borrowing could be used to fund expansion in emerging markets, building upon their international growth pattern.
* Limited portfolio; high risk exposure to small number of core brands.
* High dependency on UK market and third party suppliers.
* Dispense operation dependent on pub growth which continues to contract within the UK.
* Deficit in return on pension scheme assets.
* Low investment in non-current assets despite high depreciation charges.

# Financial Analysis

## Profitability

|  |  |  |  |
| --- | --- | --- | --- |
|  | 2009 | 2008 | Movement |
| ROCE | 43% | 39% | 9% |
| Asset turnover | 2.47 times | 2.25 times | 10% |
| Operating profit margin | 17.3% | 17.4% | -1% |
| Gross profit margin | 50% | 51% | -2% |

**ROCE** increased 9% due to a rise in asset turnover which increased due to:

* Growing revenues (partly from acquisitions).
* Efficiency gains in working capital (reduction of inventories, and an increase in the use of supplier credit facilities).
* A decrease in the value of property, plant and equipment.

**Operating** and **gross profit margins** have been maintained. Although with significant increase in revenues and acquisitions there may be further opportunity toimprove marginsthrough further operational efficiencies such as Nichols’ increased buying power.

## Efficiency

|  |  |  |  |
| --- | --- | --- | --- |
|  | 2009 | 2008 | Movement |
| Inventory turnover period | 27 days | 37 days | -26% |
| Receivables collection period | 68 days | 79 days | -14% |
| Payables payment period | 39 days | 30 days | 30% |
| Cash operating cycle | 56 days | 86 days | -34% |
| Non- current asset turnover | 5.06 times | 3.95 times | 28% |

Working capital efficiency improved across all areas as reflected in the **cash operating cycle,** freeing cash tied up in working capital and reducing levels of capital required to sustain operating activity levels.

**Inventory turnover period** reduced showing better stock management achieved through improved demand forecasting and environmental initiatives (efficient packaging; more products per pallet). So long as this reduction still meets customer demand then these are excellent improvements.

**Receivables collection period** also reduced showing, on average, customers are paying faster. However this improvement may have increased the operational costs through increased credit control.

**Payables payment period** has also improved which is a good way to finance working capital. Caution is advised however, in over-extending and potentially harming supplier goodwill or prices.

**Non-current asset turnover** has increased demonstrating better use of fixed assets. However, depreciation of assets is high compared to non-current asset expenditure, which could indicate that Nichols is ‘sweating’ its assets possibly impacting future efficiencies and cash flows.

## Liquidity

|  |  |  |  |
| --- | --- | --- | --- |
|  | 2009 | 2008 | Movement |
| Current ratio | 2.10 | 1.93 | 9% |
| Acid test ratio | 1.90 | 1.69 | 13% |

Liquidity has improved due to increased cash balances at year-end even though overall liabilities have increased (most significantly trade payables which are up 70%). This improvement may be useful if debt needs to be raised for future expansion. Without industry benchmarks it is difficult to comment on the suitability of these results.

## Financial Structure

|  |  |  |  |
| --- | --- | --- | --- |
|  | 2009 | 2008 | Movement |
| Gearing | 16% | 14% | 13% |
| Interest cover | 35 times | 187 times | -81% |

The change in **gearing** was due to the movement in the pension fund, Nichols does not have any short or long-term borrowing. The report describes a secure and growing business so the board could consider increasing gearing to accelerate market expansion or acquisitions to enhance shareholder returns.

**Interest cover** has decreased significantly due to reduced return on pension scheme assets and reduced finance income (attributable to a reduction of central interest rates which fell by over 90% between January 2008 and December 2009). Whilst not currently a concern, the liability of the pension fund deficit should be monitored.

## Shareholder Investment

|  |  |  |  |
| --- | --- | --- | --- |
|  | 2009 | 2008 | Movement |
| ROSE | 35% | 34% | 2% |
| PE ratio | 11.0 | 10.2 | 8% |
| Dividend cover (post-exceptional items) | 1.88 times | 0.72 times | 160% |
| EPS | 23.44 pence | 20.03 pence | 17% |

Although **EPS** has increased, growth was lower than operating profit growth due to an increase in the effective rate of tax (due to timing differences and prior year adjustments).

The rise in **PE ratio** reflected increased investor confidence. However the shares are listed in the relatively illiquid AIM stock market, which can exaggerate share price movements.

**ROSE** increased slightly because of higher earnings. This improvement may explain the higher investor confidence reflected in the PE ratio.

**Dividend cover** post-exceptional items improved from unsafe levels of below one to a much safer figure, enhancing investor confidence. It should be noted that the majority of this improvement was due to exceptional items in 2008.

The overall increased dividend paid reflects the Board’s confidence in the business and its future growth prospects.

## Cashflow

Cash balances have increased 85% from £6.0m to £11.2m despite falls in interest received again due to reductions in central interest rates.

This increase was due to:

* Increased operating profit.
* Lower levels of repurchase of company’s own shares.
* Significant cash outflow in 2008 for the joint-venture acquisition and settlement of pension obligations.
* This strong cash balance puts the company in a good financial position to enter new markets or use cash in new acquisitions.

## Treatment of Exceptional Items

* 2009 (£0.3m), 2008 (£0.2m) dispense operation restructuring.
* 2008 (£5.9m) soft drinks portfolio review.

Analysis is pre-exceptional items to allow more relevant year-on-year comparisons.

If there were another dispense operation restructure cost in 2010 we would however look to re-assess this.

## Additional Information to Improve Analysis

* Industry benchmarking would allow better comparison to Nichols’ market sector.
* Analyst reports forecasting future performance for the drinks market sector.
* Board minutes to understand directors’ rationale for low gearing when indicating optimism about future performance and to analyse future strategy (currently only analysing past performance).
* Market valuation of fixed assets. Undervalued assets could overstate ROCE so independent valuations could be sought.
* Detailed financials prior to 2008 to provide context around perceived improvements.
* Information about potential restructuring costs following acquisitions.

Appendix A – Financial Calculations

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Profitability** |  |  | | |  | **2009** | | | | | | | |  | **2008** | | | | | | | |  | **Relative Movement** |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Return of capital employed (ROCE)** |  | Operating profit | | |  | 12,501 | | | x | 100 | **=** | **43%** | |  | 9,804 | | | x | 100 | **=** | **39%** | |  | **9%** |
|  |  |  | Capital employed | | |  | 42,932 | - | 13,631 |  | 36,613 | - | 11,625 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Asset turnover** |  | Sales revenue | | |  | 72,378 | | | | | **=** | **2.47** | **times** |  | 56,221 | | | | | **=** | **2.25** | **times** |  | **10%** |
|  |  |  | Capital employed | | |  | 42,932 | | - | 13,631 | |  | 36,613 | | - | 11,625 | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Operating profit margin** |  | Operating profit | | |  | 12,501 | | | x | 100 | **=** | **17.3%** | |  | 9,804 | | | x | 100 | **=** | **17.4%** | |  | **-1%** |
|  |  |  | Sales revenue | | |  | 72,378 | | |  | 56,221 | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Gross profit margin** |  | Gross profit | | |  | 36,180 | | | x | 100 | **=** | **50%** | |  | 28,701 | | | x | 100 | **=** | **51%** | |  | **-2%** |
|  |  |  | Sales revenue | | |  | 72,378 | | |  | 56,221 | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Efficiency** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Inventory turnover period** |  | Inventory | | |  | 2,694 | | | x | 365 | **=** | **27** | **days** |  | 2,758 | | | x | 365 | **=** | **37** | **days** |  | **-26%** |
|  |  |  | Cost of sales | | |  | 36,198 | | |  | 27,520 | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Receivables collection period** |  | Trades receivables | | |  | 13,517 | | | x | 365 | **=** | **68** | **days** |  | 12,215 | | | x | 365 | **=** | **79** | **days** |  | **-14%** |
|  |  |  | Credit sales revenue | | |  | 72,378 | | |  | 56,221 | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Payables payment period** |  | Trades payables | | |  | 3,866 | | | x | 365 | **=** | **39** | **days** |  | 2,264 | | | x | 365 | **=** | **30** | **days** |  | **30%** |
|  |  |  | Credit purchases | | |  | 36,198 | | |  | 27,520 | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Cash operating cycle** |  | Inventory turnover period + receivables collection period - payables payment period | | |  | 27 | + | 68 | - | 39 | **=** | **56** | **days** |  | 37 | + | 79 | - | 30 | **=** | **86** | **days** |  | **-34%** |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Non-current asset turnover** |  | Sales revenue | | |  | 72,378 | | | | | **=** | **5.06 times** | |  | 56,221 | | | | | **=** | **3.95 times** | |  | **28%** |
|  |  |  | Non-current assets | | |  | 14,293 | | | | |  | 14,232 | | | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Liquidity** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Current ratio** |  | Current assets | | |  | 28,639 | | | | | **=** | **2.10** | |  | 22,381 | | | | | **=** | **1.93** | |  | **9%** |
|  |  |  | Current liabilities | | |  | 13,631 | | | | |  | 11,625 | | | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Acid test ratio** |  | Current assets - Inventory | | |  | 28,639 | | - | 2,694 | | **=** | **1.90** | |  | 22,381 | | - | 2,758 | | **=** | **1.69** | |  | **13%** |
|  |  |  | Current liabilities | | |  | 13,631 | | | | |  | 11,625 | | | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Financial Structure** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  | Funds that require regular payments | | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Gearing ratio** |  |  | 4,744 | | | x | 100 | **=** | **16%** | |  | 3,567 | | | x | 100 | **=** | **14%** | |  | **13%** |
|  |  |  | Funds from all sources | | |  | 4,744 | + | 24,458 |  | 3,567 | + | 21,266 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Interest cover** |  | Operating profit + Interest receivable | | |  | 12,501 | | + | 78 | | **=** | **34.94** | **times** |  | 9,804 | | + | 288 | | **=** | **186.89** | **times** |  | **-81%** |
|  |  |  | Interest payable | | |  | 360 | | | | |  | 54 | | | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Shareholder investment ratios** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Return on shareholders' equity** |  | Earnings for the year | | |  | 8,568 | | | x | 100 | **=** | **35%** | |  | 7,306 | | | x | 100 | **=** | **34%** | |  | **2%** |
|  |  |  | Total equity | | |  | 24,458 | | |  | 21,266 | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **P.E. ratio** |  | Market price share | | |  | 257 | | | | | **=** | **10.96** | |  | 204 | | | | | **=** | **10.18** | |  | **8%** |
|  |  |  | EPS | | |  | 23.44 | | | | |  | 20.03 | | | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Ordinary dividend cover** |  | Earnings for the year | | |  | 8,354 | | | | | **=** | **1.88** | **times** |  | 2,957 | | | | | **=** | **0.72** | **times** |  | **160%** |
|  | ***(post exceptional items)*** |  | Dividend for the year (interim + final) | | |  | 1,482 | | + | 2,963 | |  | 1,374 | | + | 2,711 | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **EPS** |  | Earnings for the year | | |  | **23.44 pence** | | | | | | | |  | **20.03 pence** | | | | | | | |  | **17%** |
|  |  |  | Weighted average number of ordinary shares | | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Cash Flow** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  | | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Free cash flow** |  | Net cash inflow from operating activities - cash flows from investing activities | | |  | 11,026 | | - | 1,522 | | **=** | **9,504** | |  | 6,819 | | - | 4,125 | | **=** | **2,694** | |  | **253%** |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Cash and cash equivalents** |  |  |  |  |  | **11,215** | | | | | | | |  | **6,048** | | | | | | | |  | **85%** |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **EBITDA** |  |  |  |  |  | **12,219** | | | | | | | |  | **10,038** | | | | | | | |  | **22%** |

Appendix B – Assumptions

* Unless stated otherwise, all calculations and interpretations are stated before exceptional items;
* Payables and Receivables days have been calculated assuming 100% credit sales and purchases spread over 365 days as opposed to the use of the information supplied in the financial statements;
* All calculations and interpretations are based on Group figures and on information in Nichols’ Financial Statement 2009.

Appendix C – Acronyms

|  |  |
| --- | --- |
| **Acronym** | **Meaning** |
| ROSE | Return On Shareholders’ Equity |
| PE | Price/Earnings |
| ROCE | Return on Capital Employed |
| EPS | Earnings Per Share |