Business report

STRIDE AHEAD (2010)

Prepared by:

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1. Introduction

This business report is aimed at shareholders, managers and at potential investors in Stride Ahead, a walking boots manufacturer based in the UK. The business report is to outline and analyse business performance of the duration of the life of the business (six months). The report provides recommendations as to the health of the business and areas which could be improved to increase profit.

In section 2 the report explains the main findings of Stride Ahead's financial situation; section 3 provides an analysis of performance and investigates potentials to improve; and section 4 provides a conclusion.

The elaboration of the report is based on the information of the clients (see annex V) as well as on research and academic literature (see chapter 5).

2. Main financial findings

The following section shall provide a comprehensive overview about key financial values the first 6 months of Stride Ahead's operations.

2.1 Summary of the first 6 months business operations

Figure 1 below provides an overview and the comparison of the sales receipts and accumulated monthly costs for the first 6 months of operations. The business has evolved positively after the 4th months when sales exceeded the monthly costs. After a decrease in August sales grew constantly, whereas it is not reported how far credit sales impacted to this result. It is to be expected that the shown curve is part of a seasonal peak, which might decrease throughout the year again. When comparing only the averages sales are lower than the average monthly expenses (considering cost of sales and other expenses, as well as taxes).

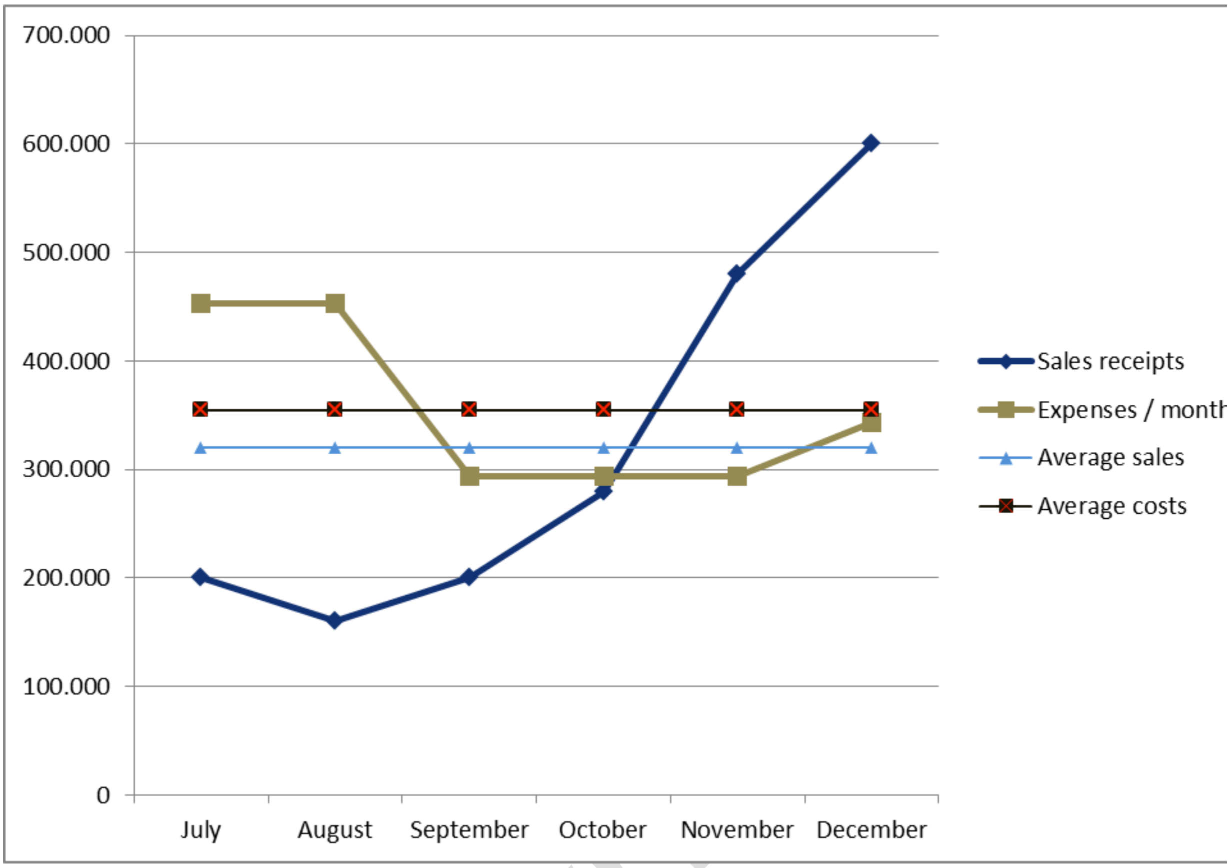

Figure 1: Monthly overview of sales receipts versus costs

2.2 Financial accounting statements

As basis for this business report the key financial accounting statements had been elaborated and are given as follows:

- Balance sheets from July and December 2010 in annex I
- Income statement from the period July – December 2010 in annex II
- Cash flow statement from the period July – December 2010 in annex III and
- Monthly cash flow forecasts for the period of July – December 2010 in annex IV.

As can be seen from the balance sheet in annex I the worth of the Stride Ahead has increased from £300,000 to £410,000. This is an increase of 110,000 £ in the first 6 months which corresponds to the profit of the period as extracted from the income statement (annex II). The income statement further demonstrates a gross profit of £720,000 and an operating profit of £160,000 before tax. Labour costs are part of the gross profit calculation, as well as manufacturing – all of which are an integral cost of sales.

Finally a view on the cash flow statements are revealing that despite a promising sales within the first 6 months and the increase of the companies value of 36% the business is under threat. The cash flow statement (see annex III) provides an overdraft of £130,000 and the monthly cash flow projections (annex IV) are indicating overdrafts in September and October beyond 530,000 £. The business' liquidity issue is confounded by the fact that walking boots sales tends to be seasonal; high monthly costs; open receivables from debtors; and, outstanding payables to creditors.

3. Analysis

In the following chapter the above stated findings are to be brought into the context of the information given by the client in order to draw a first conclusion upon Stride Ahead's current economic situation. This is followed by a reflection on key ratio indicators and finally investigations on how to increase the companies efficiency.

3.1 Initial analysis in context of the three financial statements

In relation to the overall sales of £2,400m, a gross profit of 30%, an operating profit of 6.6% and an overall profit of 4.6% has been identified. Compared to the overall revenue this seems to be low. Further it has been identified that in average monthly expenses are higher than the average sales (figure 1). Labour costs are classified as integral part of the costs of sales (annex II) which limits the options to optimize the financial structure, The negative cash flow created (annexes III and IV) is potentially a threat to the existence of the company, as Stride Ahead will need to negotiate a bank overdraft of at least £530,000 to survive and meet unforeseen costs. The bank overdraft will put even more pressure on the already cash strained company because of interest rates, which have not been accounted for in the current financial statements. Finally Stride Ahead doesn´t seem to having a systematic accounting framework in place. Particularly in the view of the business' seasonality a reliable accounting on a monthly basis should be in place, e.g. to better plan with receivables and payables.

All this aspect together collates to a critical situation, whereas a very first step should be to ensure through negotiations with the bank, that account facilities allow an extent of minimum 300,000 £ overdraft. This would reflect monthly 120,000 £ labour costs, 90,000 £ other expenses, 80,000 £ purchase (see annex IV) as well as 10,000 £ for unforeseen. It does not consider sales income and not the current overdraft but reflects the ongoing monthly costs to continue operations for at least one month without sales. Another opportunity would be to increase the capital with an appropriate sum contributing to current liquid assets, but not without careful consideration of the given results.

3.2 Ratio analysis

A next view shall be on financial ratios which can be used to examine various aspects of financial position and performance and are widely used for planning and control purposes (Atrill and McLaney, 2011). They provide a quick and simple means of assessing the financial health of Stride Ahead.

There are three broad categories that can help support management or investment decisions: profitability, efficiency and liquidity.

Profitability: is Stride Ahead creating wealth for its owners and thereby future investors?

Return on capital employed (ROCE) is the fundamental measure of business performance. This explains the link between the operating profit generated and the average capital invested in Stride Ahead during the six month period.

ROCE for the six months to 31 December 2010 = 23,4%.

Operating profit margin compares the operating profit to the sales revenue and measures operational performance.

OPM for the six months to 31 December 2010 = 7,5%.

This demonstrates that Stride Ahead has a weak performance for these six months. Due to the nature of the business, Stride Ahead will not have a high level of sales volume, but rely on a seasonal spurts with high profitability per unit sold

Gross profit margin demonstrates Stride Ahead's level of profitability in producing and selling boots before any other expenses are taken into account. Cost of sales represents a significant expense for Stride Ahead; a change in one part of this area can have a significant effect on its profit.

GPM for the six months to 31 December 2010 = 30%.

Efficiency: has Stride Ahead used its resources efficiently?

Sales revenue to capital employed examines how effectively Stride Ahead's assets are being used to generate sales revenue.

Sales revenue to capital employed = 7,7times.

Liquidity: does Stride Ahead have enough liquid resources to meet its future obligations (ie tax, salaries etc)?

Acid test ratio = 0.89 times or 0.89:1.

The minimum level for tis ratio is 1.0 times (or 1:1), as this means that current assets equals current liabilities. Businesses that have adequate liquidity should have at least 1.0 times. As Stride Ahead has a lower ratio, it demonstrates its problem with liquidity.

3.3 Investigations to increase efficiency

Beyond the liquidity constraints the most important measure to increase the efficiency of that business should be renegotiating trade terms with suppliers. Negotiating better prices for materials will improve Gross Profit Margin, and Operating Profit Margin, while credit lines for payment to suppliers will immediately improve cash flow and the Average Settlement Period for Trade Payables. Hohner et al.'s research (2003) illustrates how both customer and supplier profit from organising contracts that bundle a package of materials required over a certain period of time.
While Stride Ahead will certainly profit from better prices and payment terms, suppliers will benefit from bundled packages that bring higher revenue and the security of long-term contracts.

Improving the average collection period for accounts receivable is advisable. Trade terms with customers should be negotiated to cash on delivery or otherwise very short payment terms. Special promotional activities for cash sales is one way to give incentives to customers to pay cash and improve cash flow in this way. Pears (2001) calls this sort of promotion one of advancing receipts. For Deo (2013) maintaining healthy cash flow issue is important enough to refuse some projects.

Improve inventory management and efficiencies inside the factory by implementing Just in Time (JIT) measures. Pull inventory in-house only when it's really needed, and shorten manufacturing throughput time in the factory to a minimum by boosting efficiencies and minimizing waste, and with it Work In Progress inventories.
Research by Kinney and Wempe (2002) shows that the main benefit of JIT is not

company to ensure long term profit, but they need time to take effect and are therefore not solving the firm’s current liquidity and profit margin issues.

A last aspect should be to explore the structure of the labor costs in detail, given the fact that as part of the cost of sales those should be directly correlating to the sales and production performance. But, as given by the client labor costs are throughout the reporting period constantly at 120,000 £.

4. Conclusion

The report analysed the financial data of Stride Ahead and finds the prospects of the company in its current position are critical. The major areas of weakness are profitability, cost structure, liquidity in a nonsystematic accounting framework. Results of data analysed show that most areas are below recommended levels. In particular, comparative performance is poor in the areas of liquidity management.

Measures to strengthen the company's situations are identified as follows:

- negotiating sufficient credit lines with banks in order to ensure short term liquidity for ongoing business operations or increase of current liquid assets.
- improving the average collection period for accounts receivable.
- improving inventory management by implementing Just in Time measures with suppliers.
- negotiating credit lines with suppliers to immediately improve cash flow.
- renegotiating better prices for materials to improve Gross Profit Margin and Operating Profit Margin.

5. References

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ANNEX I: Balance sheet Stride Ahead 2010

Balance Sheets Stride Ahead	1-Jul-10	31-Dec-10
Non-current assets	200,000	220,000
	200,000	**220,000**
Current assets		
Inventories		80,000
Trade receivables		480,000
Cash at bank	100,000	
	100,000	560,000
Total assets	**300,.000**	**780,000**
Equity		
Opening balance	300,000	300,000
Profit (for the period)		110,000
Drawings		
	300,000	**410,000**
Non-current liabilities		
Current liabilities		
Trade payables		240,000
Bank overdraft		130,000
	0	370,000
Total equity and liabilities	**300,000**	**780,000**

ANNEX II: Income statement Stride Ahead - 2010

Income Statement 1 July 2010 to 31 December 2010		
	£	**£**
Sales		2,400,000
Receivables		0
		2,400,000
Less: Cost of Sales		
Opening Stocks	240,000	
Add: purchases	800,000	
	1,040,000	
	960,000	
Less: closing costs	(80,000)	
Less: manufacturing labour	(720,000)	
		(1,680,000)
Gross profit		**720,000**
Less: other expenses		
	(560,000)	
		(560,000)
Operating profit		**160,000**
Less: tax		(50,000)
Profit for the period		**110,000**

ANNEX III: Cash flow statement Stride Ahead - 2010

Cash Flow statement - Stride Ahead – 1 July 2010 - 31 December 2010	Values
Profit before taxation	160,000
Depreciation	(20,000)
Interest payable/receivable	
Dividends payable	
Interest expense	
Increase/decrease trade receivables	(480,000)
Increase/decrease trade payables	240,000
Increase/decrease inventories	(80,000)
Cash generated from operating activities	(**140,000**)
	(50,000)
	(**190,000**)
	(40,000)
	(**40,000**)
	0
	(**230,000**)
	100,000
	(**130,000**)