FINANCIAL ANALYSIS OF THE TRADING COMPANY (PTY) LTD

Holistic over view of operating performance
(Using a traffic light system to quickly highlight performance)

	2010	2009
1. RONA - Return on Net Operating Assets	18.4%	21.2%
Net Operating profit (Income Statement)	135	84
Net Operating Assets (Balance Sheet)	735	396

Note: Net Operating Assets - take total net Assets, and add back cash, overdraft balances, tax and dividends.
These are financing factors, and are not part of operations' responsibility

	2010	2009
1 a. Profitability	9.0%	7.0%
Net Operating profit (Income Statement)	135	84
Sales	1500	1200
1 b. Asset efficiency (sweat)	2.04	3.03
Sales	1500	1200
Net operating Assets	735	396

Conclusion:
Management has delivered a weaker RONA over the past year, despite improved profitability from operations.
the marginal drop in RONA is a result of the following factors:
While profitability has improved, Asset sweat has declined significantly (by 32%), and has more than off-set the good work in managing top - line improvement.

Further analysis now needs to be done, with an eye on those indicators which are driven by the use of assets

Now dive deeper into the company's performance, keeping the big picture in mind.
This allows you to focus on items that drive the above three ratios

	2010	2009
2. Profitabi Trading Margin (Gross Profit)		
2 a. Gross Margin	28.5%	25.0%
Net Operating profit (Income Statement)	427	300
Sales	1500	1200
2.b Net income after tax (NIAT)	2.5%	3.0%
NIAT	38	36
Sales	1500	1200
2 c. Return on Owners Equity	11.2%	11.3%
NIAT	38	36
Owners Equity	340	320

Conclusion:

Management has improved the trading margin of the company, either by improving price, and or improving the direct input costs, such as transport costs of the delivery fleet - this could be via improved usage of the assets, better configuration of the vehicle fleet and better routing of deliveries

However, the NIAT figure has declined - so between margin and after tax income, inefficiencies have crept in , and negated the good work done by sales and distribution departments

ROE reflects this, as there has been no growth in the return on investment to Shareholders - we need to understand why - remember the low / declining Asset Sweat in RONA, so we already have an idea - lets check this out now.

3. Operational Efficiency	2010	2009
3 a. Inventory Turnover / turn	5.1	10.0
Sales	1500	1200
Inventory	295	120
3 b. Receivables Collection (days)	80	53
Accounts Receivables	375	200
(Sales + VAT) divided by 365 days	4.68	3.75
3 c. Fixed Asset Turnover / usage	9.7	10.3
Sales	1500	1200
Fixed Assets	155	116

Conclusions:

Operational efficiency has deteriorated over the prior year - significantly!
Inventory turnover has declined by 50% - a huge decline - what has happened:
obsolete stock building up? Unaccounted for write offs for dead stock?
purchasing department buying too much product, despite increased sales?
product mix changed and procurement not advised?

Receivables is a disaster - in both years! Normal terms in SA is 30 days.
The current year has seen credit management deteriorate significantly - the longer
or older the debt owing to the company, the greater the likelihood of bad debt write offs
Are there large amounts of disputed invoices - credit notes outstanding - this will effect profitability
If so, has the company really done so well on its profit generation as indicated?

Fixed asset usage, despite increased turnover (proceeds), has declined by 6% - are the years asset
purchased justified?
Is there idle plant - can we improve the usage by increasing the number of shifts.
Too many delivery vehicles - check optimisation of fleet.

4. Liquidity	2010	2009
4 a. Current ratio	6.7	5.7
Current Assets	700	344
Current liabilities	105	60
4b. Quick ratio	3.9	3.7
current assets - inventory	405	224
current liabilities	105	60
4c. Interest Cover	2.3	7.0
Profit before Interest and Tax	135	84
Interest	60	12

Conclusion:

In the prior year, there was too much capital tied up in Working Capital, with a extremely high ratio of over 5.
This has not changed in the current year, as the current assets have climbed significantly over the prior year.

The Current ratio indicates a further deterioration with the ratio moving upwards to a more elevated level, the performance
remains very weak, with expensive capital tied up in short term assets.

The Quick ratio reflects the cash flow challenges as a level of 3.9 is far too high - too much funds stuck in
receivables and inventories.
Just how quickly can the company realise Receivables and Inventories to settle the short term debt facing the company?

Interest cover has declined significantly as a result of increased long term debt, and related finance charges.
While still well within tolerance, an eye must be kept on developments over time - i.e. trend analysis

5. Capital Structure	2010	2009
5 a. Gearing - long term debt	120.6%	25.0%
Long Term Debt	410	80
Equity	340	320
4b. Gearing - total Debt	151.5%	43.8%
Total Debt (Long term debt plus current liabilities)	515	140
Equity	340	320

Conclusion:

Long term gearing is a problem and is well above the agreed level set by the Board of Directors (40%).
By being so highly geared, the company runs the risk of high interest rate expense, as well as tight scrutiny from the lenders of the funds.
Further borrowings will be out of the question - stunting future growth.
Working capital, all round, requires significant improvement, and a task team should be implemented to investigate and put forward proposals on what needs to be done, after identifying the root causes of the issues at hand.

Overall Summary:

Profitability has increased, but due to large inefficiencies in inventory and credit management, the increased profitability has not materialised into cash.
Indeed, the poor working capital management has resulted in the company exceeding its Gearing target and RONA has declined over the previous year as a result of a deterioation in asset usage and control - both current and long term.
Management has also missing the ROE target of 20% (for the 2nd year running), as NIAT is severely impacted by the interest cost resulting from the high borrowings.

Thus the major agreed Financial targets have been missed.

Operationally, management have missed two of the three targets, viz. to generate operating cash and to ensure productive use of operating assets.
The third target, that of generating adequate operating profit was met.

Profitability however, may be at risk, as the may be hidden write offs in obsolete inventory and bad debts.
Sweating of Fixed Assets needs some more attention as the asset turn has declined marginally.

Overall, the company is making profits at the operating level, but high gearing and poor working capital management, resulting in negative cash flow, is putting the company at risk of failure.