Financial needs of the body shop

Business

Three-year earnings and financial needs of The Body Shop. Due to lack of information, this forecast based on some key assumptions about the relationship between sales and other accounting ratios, firstly forecast sales then forecast other ratios In financial statements. Sales: It Is assumed that sales growth ratio will maintain at next three years due to the need of Increasing revenue of The Body Shop. This figure IS the average growth rate from 1999 to 2001.

COGS: The COGS ratio 2002 IS and It Is assumed that It would be decreased to 40. 5% In the forecast.

This figure moms from historical COGS ratio from 1999 to 2001 and the assumption Is based on Journals strategy of costs reducing. Operating Expenses: Is also assumed to be decreased In order to reduce costs. However, It Is assumed to Increase faster than sales.

Restructuring Cost Rates: are assumed to be decreased based on the reduced cost strategy because after restructuring the company has been done, these ratios will reduce because restructuring costs are one off occurrences that have low future costs. Interest rate: is assumed to remain the same at 6% for the next three years.

However, in fact, interest rate increased to 8% due to the expectation of rising global interest rates, which were later realized. Tax rate: is assumed to stay at the average historical tax rate of 31 . 7% for the coming years. Tax rate is calculated by dividing tax expense last year to OBIT (Earning before interest and tax).

Dividends: are assumed to increase to 60% of net income, which is too high in this circumstance because the firm has large debts but still pay much dividends. Excess Cash: was determined by the deference between assets and liabilities, therefore, the balance sheet is balance.

Overdrafts: is strongly linked to excess cash and was the different between assets and liabilities. It is a part of debts and is assumed to increase for the coming years. Long term Liabilities: are assumed to increase by the interest rate at 31. 7%.

Shareholder Equity: is controlled by the amount of retain earnings/losses from the previous year. Question 2 The level of financing needed in the future, which Is based on excess cash shortfalls, Is represented by the overdrafts category and external financing helps companies to be profitable and obtain growth.

In our pro format projections, It seems that The Body Shop Is In greater need of external financing In all three periods. According to the excel, the positive numbers In the overdrafts category which label as Plug demonstrate that additional financing will be needed. While looking at the trial assets and liableness In 2002, the Body Shop will need external financing due to the trial assets are approximately 410 million greater than trial liableness 205 million. Thus an additional 205 million is needed to achieve sustainable cash for the company.

In both 2003 and 2004, the debt plug also is in fact positive, with values of 213 million and 223 million respectively. This also implies that the company will need to somehow finance this shortfall in cash to still achieve a minimum

cash balance. This then some additional financing will be needed to facilitate this growth. Question 3 In this forecast, there are three key drivers: Sales, Cost of good sold and operation expenses. Sales: is the most obvious key driver, which affects the forecasting because this forecast used percentage-of-sales of accounting ratios.

Based on historical information, between 1999 and 2000, growth rate is 8.

7% and increase to 13. 3% at 2001. Thus, the forecast used the average growth rate at 11% for the years owing. As sales plays such an important roles in predicting future earnings and financial needs for the company, it is used to conduct sensitivity analysis to show how varying interpretations of sales growth can provide different affects on not only the financial success of The Body Shop, but also the need for financing.

The table shows how sales growth ratios changes affect the debt plug and it clearly presents that as you increase the levels of sales, there will be an increase in debts. Because when the company grows, they need debt to support the growth and it leads to greater profits n the future.

COGS: is the cost of producing the products which generate the company revenue. It acts as the main constraint against revenue, therefore COGS becomes the second key driver of this forecast. Due to this case study, the new CEO planed to reduce the cost in the future. It has varied between 39.

8% and 42. % over the previous 3 years and this paper use the historical average of 40.

5%, and assume it probably will decrease for the future. The reason is that once that change begins to take affect, significant changes can take place and the operating will become more reductive, hence reducing the COGS by more. The COGS sensitivity analysis clearly demonstrates that the more requirements on debt, the more percentage-of-sale of COGS is, thus, it leads to profit decrease. This also means that cost of products is the cause to this lower profit and it requires debt to cover this loss.

Operating Expenses: Similarly to COGS, Operating expenses will decrease due to the effects of the new strategies. Operating expenses ratio runs between 51 .

1% and 56. 9% of Sales over the last 3 years, therefore we assume Operating expense will run at the average of 54. % in his forecast. This high figure needs to be considered as another key driver and attention must be paid to any assumptions about this account. Because operating expenses make up such a large proportion of the income statement, as a result, it more likely have huge affects of the levels of financing and the profit.

The Operating expenses sensitivity analysis shows that there is a greater need for additional financing when it increases. These assumptions are so important because it can approaches and predictions about financing of the body shop in the future. First, the COGS is very crucial to any production entity and distribution organization as well. The changes in COGS may lead to the changes in many others in financial statement, such as profit, tax expense, cash flows relating to account payable, receivables which

accordingly result in the increase or decrease in assets and liabilities and equity.

The second assumption – operating expense is assumed to increase faster than sales.

Operating expenses, which maintain the normal operation of an entity, is also important because it accounts for 55. 6% on the average historical data. That also etches The Body shop’ s real situations in which its revenue went up while pretax on financing business, capital expenses and cost of good sold as well as many other relative expenses. Sale growth rate is quite essential because the decrease in sales may cause the decrease in profit and even the rise in expenses.

Question 4: These findings can be regarded as a tool for making decisions on financing or funding which affects a firm as a whole, therefore, general managers like Rowdier and Journey need to be aware of the importance of them. Some implications are highlighted in these findings.

Firstly, the demand of additional financing is increasing. As shown in sensitivity analysis table, the ratio of COGS to sales and the amount of debt needed have a positive correlation.

However, actually, a firm is not able to borrow as much money as they want because of lenders’ limitations, such as banks. Secondly, the findings have performed the importance of COGS because the increase or decrease of COGS may cause the huge increase and decrease in debt needed. Finally, it

is noted that operating expenses also has a noticeable impact on total profits and expenses.

As a result, the actions that need taking are reducing sots, building competitive strategies and manage operating costs efficiently.

The company can reduce costs by outsourcing production overseas where the costs such as construction expenses or labor costs are less expensive. The globalization has opened up competitiveness among almost all entities, among countries or multinational organizations, even local entities. So the strategies or research on improving quality and price of products are likely to be keys to attract customers to make money. Managers can manage operating costs effectively by decreasing rent, electricity expenses or wages for employees.