Strategic finance issues

Finance

This analysis will financially compare Santos Limiter's financial performance for the year ending 31st December 2013 with the previous year's results, by way of ratio analysis. It will also benchmark the latest result with that of Woodside Petroleum for the same period using the same ratio analysis of the 2013 financial statements of each company.

A copy of these ratio analysis are attached to this report as appendix 1, which contains a through time comparison for the last two years for Santos Limited ND the across time comparison with Woodside Petroleum for the most recent year. As Basely and Hancock (2013 p. 358) depict there are certain factors relevant to selecting an appropriate benchmark.

Woodside Petroleum has been selected as the benchmarking company as Woodside also operates in oil and gas production, focusing operations within the Australian area. While Woodside operations are larger than that of Santos, the relative size of these companies is comparable and both follow the accounting policies required by the Corporations Act 2001 , Australian Accounting Standards and other authoritative pronouncements of the Australian Accounting standards board.

Both companies are listed on the Australian Stock Exchange (ASS) which provides comparative data for the ratios analyzed and presented in Appendix 1 with the following tables; Table 1 - Profitability ratios Table 2 - Efficiency ratios Table 3 - Short-term solvency ratios Table 4 - Long-term solvency ratios and Table 5 - Market-based ratios A copy of Santos Limiter's 2013, 2012 and Woodside petroleum 's 2013 Annual reports are attached to this

report as Appendix 2, Appendix 3 and Appendix 4 especially, for reference to the findings and suggestions outlined in this review.

One limitation of the comparison is that Santos Limited reports their financial data in Australian (ALL'S) dollars, while Woodside Petroleum report their financial data in American (US) dollars. This is overcome by using ratios for a majority of comparisons and converting the US dollar amounts into ASS dollars when required. 2. 0 Ratio Analysis To look at the relationship between figures presented in the financial statements, this report uses a ratio analysis technique. To fully understand the ratios developed e will look at them in context of other information provided in various reports and the overallgoalsof the company.

From these ratios the report will then compare these against the benchmark and ultimately identify areas for improvement and, if necessary, change. 2. 1 Profitability. As we can see from Table 1 - Profitability ratios, the net profit margin and the gross profit margin fell 1 . 74% and 4. 26% respectively in 2013. While sales increased 1 1 . 76% for the year, the gross profit margin decreased as previously stated which, was the main driver for the decrease in net profit margin for the year as the interest expense o sales remained consistent.

There was a slight drop in return on assets, however asset turnover remained fairly constant, highlighting that the drop in net profit margin is due to the drop in gross profit margin and not a lower turnover of assets. The reduction in gross profit margin is due to the increase in financing costs like depreciation and depletion (up 1. 5% of sales for 2013) and third party

product purchases (up 5. 6% of sales). The reduction in financing income also played a major part in pushing down profits. In comparison Woodside has a higher return on assets Han Santos due to the 16. 8% higher profit margin and they turnover assets more efficiently. Also, Santos' continuing capital growth strategies in projects such as the Papua New Guiana Liquefied Natural Gas (PING LONG) and the Gladstone Liquid Natural Gas (GLEN) transformational projects which are outlined in the 2013 Annual report, are still in the developing phase, therefore not producing to generate sales until the following years. Woodside had a low commitment to capital expenditure for the same financial year and after selling off major capital in 2012 their use of debt as far less (shown as the leverage ratio in Table 4).

The return on ordinary shareholder's equity (ROE) ratio shows the return for the shareholders who supply equity to the business. The ROE is higher for Woodside due to their higher profit margins however, the higher financial leverage ratio in Table 4 will benefit Santos' shareholders when the return on assets increases compared to the financing costs. This will happen when the above mentioned projects begin production. This is congruent with the statement in a press release by Managing Director (M. D) and Chief Executive Officer (C.

E. O) Mr. David Knox on 21st of February 2014. " In particular, our natural gas reserve and resource base in eastern Australia, combined with our leading infrastructure position, leaves Santos strategically well placed to meet growing market demand,". 2. 2 Efficiency ratios For the 2013 fiscal year the sales and also the number of debtors increased. The use of efficiency ratios helps determine whether the increase in debtors is due to

the increase in sales alone or that it is caused by the debtors taking longer to pay.

These ratios show this by providing statistical relations on how effectively Santos Limited is electing its outstanding owingmoneyand converting the inventory into sales. From Table 2 we see that comparing the last two fiscal years for Santos Limited has made improvements in their debt collection practices. The number of days taken to collect debtors accounts has reduce from 78. 71 to 65. 53 days but is still outside Santos Limiter's standard 30 days for settlement of accounts. The closing balance is showing more debtors accounts being past the 65. 3 day average for 2013 fiscal year. Comparing these figures to Santos' competitor Woodside, whose debtor recovery is loser to the standard 30 days terms at 31. 63 days. An article in the Sydney Morning Herald depicts that the question has been asked whether there is a gas reservation policy by shareholders, of which Santos Chairman Mr. Board denies. The ratio analysis of days taken to turn inventory into sales shows a possible reason for this question arising as the number of days taken to convert inventory into sales has risen in 2013 from 52. 19 to 53. 62 days.

This is only a slight increase and with an expected increase in demand, this slight rise in inventory would be expected to cover n increase in demand. However, when comparing this level to the benchmark, Woodside inventory turnover is far less at 30. 46 days for a higher sales volume. 2. 3 Short-term solvency ratios While the previous ratios focus on performance of the company solvency ratios focus on assisting the company with decisions,

short term and long term. Table 3 shows the short-term solvency ratios which assist in the short term decision making.

The current ratio is the most basic test as to how liquid a company is. It expresses a company's ability to meet its short-term liabilities with its short-term assets. A current ratio greater than or equal to one indicates that current assets should be able to satisfy short-term obligations. A ratio less than one indicated an inability to meet short term requirements. The quick ratio calculated for 2013 compared to 2012 shows the company's ability to pay is has reduced to below the 1: 1 ratio, expressing that should the company be required to pay all current debts immediately, they could not do so.

Due in part to the reduction in cash levels reducing the current assets from 34. 6% to 20. 3% of net assets. Also increases in the amount of short term interest bearing borrowings increases the current liabilities from 13. 6% of net assets to 16. 9%. With the less cover to pay the increase in short-term liabilities, there is a higher financial risk. When comparing these ratios to that of Woodside, Canton's short term debt paying ability is carrying greater risks, but comparable with this benchmark. While the quick ratio decline to . 3: 1 is cause for concern, the Cash flow from operations to current liabilities ratio shows that 94% of current liabilities can be covered with operational cash flow. Compare this to Woodside, which can easily cover rent liabilities with 141% of its current liabilities covered with operational cash flow. 2. 4 Long-term solvency ratios As the short-term financial risk has previously been expressed, the long term decisions can be assisted by the long-term solvency ratios expressed in Table 4. The debt to equity ratio compares the

total liabilities of Santos Limited and compares it to the each dollar of shareholder's equity.

During 2013 Santos' reliance has risen due to the increased borrowings and interest bearing loans, so for every $1 of shareholder's equity there is $1. 02 worth of debt obligations. This level of debt is double than that of our benchmark, Woodside Petroleum however, the debt to total asset ratio suggests there is enough assets to cover the debt long term. This might put the company under financial risk and indicate high use of debt compared to shareholder's equity and a greater financial risk long term. This increases the cost of interest in operation, effecting negatively on profitability.

The interest coverage while currently is below the industry benchmark, there is sufficient coverage to ensure interest payment obligations will be met. The amount contributed to the long term room each $1 of operating cash flow has also been significantly reduced, moving further away from the benchmark company. This will increase interest costs long term however, also effecting profit margins. 2. 5 Market-based ratios The price per earnings ratio shown in Table 5 show how much the market would pay for shares of stock of the company per dollar of reported profit.

About. Coma's businessfinancereporter Rosemary Palaver suggests that the average price to earnings ratio is around 19 with Santos' ratio higher at 27. 68 and the benchmark, Woodside, ratio marginally lower at 17. 49. Reasons for Santos' higher than average price per earnings ratio would be due to the potential for Santos increase earnings per share in the foreseeable future and investors are trading accordingly. Other reasons for a high ratio are

when companies are in a growth phase, which Santos' financial statements suggest it currently is not.

A high ratio also suggests that the company has financial risk which was expressed in the short-term and long-term solvency ratios. While the market is willing to pay a higher price for investment in shares per dollar Santos reports as profit, the earnings yield assists in evaluating whether returns on investment compensates the risk adequately. The yield of 3. 61% for 2013 is down on sass's 4. 53% and short of Woodside 5. 72%, which is at a lower risk. Thus, Santos' shares did not perform to the industry benchmark and shareholders are not getting the yield expected for their investments.

Dividends are also low, reflecting the company's growth positioning for the coming few years. 3. 0 Recommendations The increase in growing demand as expected by Mr. David Knox in a release and the move into production phase of the PING project will generate extra operating ash, primarily with already obtained assets. Therefore the focus moving forward should be reducing the financing costs involved in the cost of goods sold. This will in turn increase profit margins, giving a greater return on assets due to lower interest costs, moving margins closer to that of the benchmark Woodside Petroleum.

The rate at which inventory is used to generate sales should be reviewed as it is slightly behind the benchmark. One suggestion to come from these ratio findings is that debtor control needs to be tightened which in turn will improve operations cash flow. Steps have been taken during the last fiscal year to reduce the number of days to collect outstanding debtor accounts,

further improvement will also increase operating cash flow which will reduce the financial risk of the company to pay its current liabilities.

The inventory level should be reduced to be more comparable to Woodside and increasing the quick assets level used to repay current liabilities. Further to assist in reducing the risk associated with the company's short-term solvency would be a focus on reducing the current interest-bearing loans and borrowings. 4. Conclusion. Through the usage of ratio analysis this report has analyses Santos Limiter's financial performance over the last two years and benchmark it against Australia's largest oil and natural gas producer.

There are several other factors influencing position and performance like international economies, competition and major long term growth projects etc. These play a decisive role in the changes in profits, earnings yield and dividend yield. The last two years have seen Santos' profits and stock performances below industry averages but this is large in part to the investment in growth opportunities, which will begin production in the near future. Some findings and recommendations have been made to improve the financial position of the company so the entity and the shareholders that have invested in it can prosper.

Although the companies are in the same field, factors like subsidiary companies or having some different end product can create problem in comparing the companies. The economic condition in the different region and the accounting techniques adopted by these companies while computing ratios and financial tenement also decreases the credibility of the calculation

(Charles and Patricia, 1983) 5. 0 References Charles H. Gibson & Patricia A. Brush-off. 1983. Z ND Edition. Kent Publishing Company.