# Financial analysis report examples

Business, Company

# Cadbury

Introduction

The aim of this report is to present financial analysis of Cadbury Company. In order to deliver the same, this report will distinctly describe and then differentiate between the three main exposures of foreign exchange that many companies experience. Further the report will provide definitions and explanations of the determinants of Cadbury Company working under the exposure of international framework. Solutions will be offered in this report for discussing the importance of instruments in finances and the techniques of internal associations through which Cadbury Company can manage its international exposure operation. In addition, it will be important to analyze the advantages and disadvantages of hedging the exposure of foreign exchange which is inclusive of over-hedging. This makes it important to discuss the how the currency futures should be used and whether there are any options for deciding the speculation within the market of foreign currency.

# Company Background:

Cadbury is a British Multinational Confectionary Corporation and is the world’s second largest confectionary brand after Wrigley’s. Headquartered in London, United Kingdom, the company has its operations in 50 countries around the world. The most famous brand of the company is ‘ Dairy Milk’ followed by Crème Egg. The company underwent multiple mergers and acquisitions since its inception in 1824. The latest in the list includes acquisition by Kraft Foods in 2010 and then by Mondelez International in

2012.

The concerned company Cadbury primarily faces foreign exchange exposure because of the establishment of its subsidiaries in numerous nations. The company is facing both fixed rate and floating rate debt mainly denominated in foreign currency which has negative influence on its income statement. The financial report of company 2013, clearly show the effect of 10 percent weakening of GBP against other currencies on its financial condition. Apart from that there are no major financial risks being faced by the company.

## Major Foreign Exchange exposures

Real assets value, liability and the incomes of operating in the domestic environment along with the associated sensitivity to the changes of exchange rates that cannot be anticipated are terms as foreign exchange exposures. Within Cadbury, the way to measure foreign exchange risk is through the domestic variance such as the assets of currency value, liability and the income of operating that has an attribute towards the exchange rate changes (Hekman, 2013). These exchange rate changes cannot be anticipated. The three main types of foreign exchange risk exposures associated with Cadbury are as follows:

- Exposure of accounting also known as Translation: it is that real value currency sensitivity within assets and liabilities of Cadbury that has an appearance within the financial statements with respect to the rates of exchange unanticipated change. Cadbury mainly faces translation exposure because of its establishment of subsidiaries in many other nations, however, the same has no major impact on the value of Cadbury as it mainly influences the elements within income statement and balance sheet which

are denominated in a foreign currency.

- Exposure of Contractual also known as Transaction: It is that value of currency sensitivity within the assets and the liabilities of Cadbury that is present when liquidation of assets and liabilities takes place especially with regard to the changes that are unanticipated in the export exchange rates, import exchange rates and the substituting firms import. Cadbury mainly faces transaction exposure due to the result of its contractual obligations which are primarily denominated in foreign currency.

- Exposure of economic also known as Operating: It is the value of currency sensitivity within the assets and the liabilities to the exchange rates that come with future incomes of operations within Cadbury and the changes that cannot be anticipated. This is mainly due to the fact that if the foreign economy appreciates against the domestic economy in the coming years, the concerned company Cadbury must have to pay more for the same quantity of the inputs in terms of the domestic economy that it pays today at the existing rate of exchange.

The following figure explains the process which by exchange rate shock occurs whenever there is any kind of instability in these exposures within Cadbury:

Figure 1: Exchange Rate Shock

(Source: Hekman, 2013)

The concerned company Cadbury mainly faces these foreign exchange exposure because of the depreciation of GBP against other currencies. The financial report of company clearly demonstrate that with the depreciation of GBP by 10 percent against other currencies, the currency exchange rate

contracts will increase by £2 million, borrowings by £351 million, and cash and cash equivalents by £36 million. The company because of the foreign exchange exposure has bank loans of £ 770 million. The company has floating rate debt in foreign currency, which include 5. 125 percent USD notes that is £501 million, 4. 25 percent EUR notes that is £501 million, all of these are due by 2014-2015.

## Institutional practice for conducting foreign exchange risk management

In order to conduct foreign exchange risk management Cadbury conducts the same with respect to the planned business comprehensiveness. There is no way by which foreign exchange risk management can be conducted separately from the asset and liability risks and the considerations of the management such as the company of Cadbury will have to maintain its liquidity in an adequate way.

The institutional practice of management foreign exchange risk within Cadbury involves the management of prudent positions of foreign currency so that the same can be controlled inside the parameter sets and change impacts within the rates of exchanges over the position of finances within the company (Hull, 2006). There is change in the rate frequently and directionally and it seems obvious that the foreign exposure currency extent along with the counter parts ability towards which the obligations are honored have a significant role to play while risk of foreign exchange is managed.

## This follows that the institutional practice of maintaining and managing foreign exchange risk within Cadburywill be to:

- Establish and implement management policies of foreign exchange risk which are sound and have prudent framework involved within their development
- Develop and implement the control procedures which are appropriate and are effective for managing the foreign exchange risks

In the recent years, the concerned company Cadbury has utilized various institutional practices like netting, matching payments and receipts. The same has been highly beneficial for the company, however, netting has proven to be most beneficial of all for the concerned company Cadbury in the last fiscal year of 2013 as it significantly increased the net cash flow for the company and eventually contributed to the productivity and profitability. Below is the detailed description of all the financial strategies which a company can follow:

## Determinants of Cadbury Company operating exposure

The concerned company Cadbury has been facing one main risk, which include debt obligation. The company has both floating and fixed rate debt which eventually results into operating exposure. Due to the high level impact of operating exposure, the associated stakeholders are being forced to incline towards other companies. However, the strong brand reputation of the company all over the world is the key reason that all its stakeholders, including customers and suppliers have trust on the currency risk management policies of company. The stakeholders associated with the

company is well aware of the fact that these risks are bound to exist and no company can mitigate the same completely. However, the actions taken by the concerned company are highly effective and may decrease the negative impact of foreign exchange exposure on the income statement and balancesheet. The main cause of operating exposure faced by Cadbury is its engagement in international activities and sales affiliations abroad, because of which the cash flow of the company has become highly sensitive to the changes on exchange rates. The operating exposure of Cadbury Company will be determined through the following determinants:

- The market structure where the company has sourced its input and these are inclusive of man power, products and the products selling
- The ability of the company with regard to mitigating the changes in exchange rate and its effects through market adjustments, mix of products and the sources

With regard to these two determinants there have been evident improvisations of the revenues of Cadbury Company increasing to up to 15 per cent in a year. The price was increased by the company in its international operations in the year 2008 in order to balance the input cost rise. The cost base was also sleek for the company and this happened through sales decreasing for saving the labor cost, material cost and the reduction of general cost along with the cost of administration (Levi, 2008). Profit, efficient control and the rations of investment have all been evidently higher for the company especially with regard to comparing their financial statements with the past few years.

a. The Determinant for Profit

## Return over common funds of shareholders

Average shareholders’ fund = (3696+4173): 2 = 3934. 5

ROSF = (407 : 3934. 5) x 100 = 10. 344%

## In 2008

Average shareholders’ fund = (4173+3534): 2= 3853. 5

ROSF = (366 : 3853. 5 ) x 100 = 9. 5%

## Return over employed capital

Average total assets less current liabilities = ( 6855 + 6724 ) : 2 = 6789. 5

ROCE = (278 : 6789. 5) x 100 = 4. 095%

## In 2008

Average total assets less current liabilities = (6724 + 5507) : 2 = 6115. 5

ROCE = (388 : 6115. 5) x 100 = 6. 345%

## Profit margin operation

Operating profit = 278

Operating profit margin = 278 : 4699 x 100 = 5. 92%

## In 2008

Operating profit = 388

Operating profit margin = 388 : 5384 x 100 = 7. 21%

b. The Determinant for Efficiency

## Days of inventory

In 2011

Ratio = (821 : 2504) x 365 = 119. 67 days (120 days)

# In 2012

Ratio = (767 : 2870) x 365 = 97. 54 days (98 days)

# Turnover of total assets

In 2010

Fixed assets + current asset = 8667 + 2600 + 71 = 11338

Average = (10233 + 11338) : 2 = 10785. 5

Ratio = 4699 : 10785. 5 = 0. 448

# In 2011

Fixed assets + current asset = 8667 + 2600 + 71 = 11338

Fixed assets + current asset = 5990 + 2635 + 270 = 8895

Average = (11338 + 8895) : 2 = 10116. 5

Ratio = 5384 : 10116. 5 = 0. 532

# Turnover of net assets

In 2010

Average total assets less current liabilities = ( 6855 + 6724 ) : 2 = 6789. 5

Ratio = 4699 : 6789. 5 = 0. 688

# In 2011

Average total assets less current liabilities = (6724 + 5507) : 2 = 6115. 5

Ratio = 5384 : 6115. 5 = 0. 88

c. The Determinant for Ratios of Investment

## The Cover of Dividend

In 2010

Profit available for dividend = 149 + 258 = 407

Ratio = 407 : 311 = 1. 31

## In 2011

Profit available for dividend = 370 + (-4) = 366

Ratio = (366 : 295) = 1. 24

## Ratio of Dividend Payment

In 2010

Profit available for dividend = 149 + 258 = 407

Ratio = (311 : 407) x 100% = 76%

## In 2011

Profit available for dividend = 370 + (-4) = 366

Ratio = (295 : 366) x 100% = 81%

## Usefulness of Financial Instruments

Operating exposure otherwise termed as economic exposure is a measure if the changes current value of the concerned company Cadbury which mainly arises due to the fluctuations in the rates of exchange. Operating exposure is incorporated with the transaction exposure but is highly extensive and effective than the same. The operating exposure is inclusive of the future transactions and operations of the concerned company Cadbury which are to be booked in future. For instance, Cadbury in today's world of globalization sometimes sources inputs from other nations and face operating exposure in

context of the increasing prices of inputs. This increase in the prices of inputs may not be occurring in the current situation but can occur in future if the foreign economy appreciates under some circumstances against the domestic economy (Shapiro, 2009). This is mainly due to the fact that if the foreign economy appreciates against the domestic economy in the coming years, the concerned company Cadbury must have to pay more for the same quantity of the inputs in terms of the domestic economy that it pays today at the existing rate of exchange.

Thus, to manage the operating exposure the concerned company Cadbury utilizes the benefits associated with the internal techniques and financial instruments. The financial instruments utilized by the Cadbury include cash, loan, borrowings, and other creditors. The company usually avoids trading in financial instruments. However, the main risks that may arise with the utilization of these financial instruments are interest rate risk and credit risk. Cadbury manages these risks through matching the conditions and terms of its liabilities and assets. The company believes that the early measures are needed to be undertaken to monitor the management of risk (Hodder, 2012). The company has outlined some policies which effectively limit the amount of operating exposure to any individual financial agency. The utilization of the mentioned financial instruments has been highly beneficial for the company as last year; company had no considerable concentration of operating exposure till the end of the financial year of 2013. The company has been utilizing the same for enhancing the savings within the target market place.

## Managing Operating Exposure: Hedging Foreign Exchange Exposure

The concerned company Cadbury is highly determined to manage the operating exposure it has been facing in recent years. The company is focused on stabilizing its cash flows in opposition of changing exchange rates. The company needs to consider the management of operating exposure as a long term strategic planning as the main influence of changes in exchange rate is on its competitive position. The company can efficiently utilize the following strategies for operating exposure management:

- Financial Hedging
- Product Differentiation
- R & D efforts
- Diversification of Market
- Flexible sourcing Policy
- Selecting the low cost production sites

Hedging Foreign Exchange Exposure has been highly significant for the concerned company Cadbury; however there are certain consequences of the same which may negatively affect the financial performance of the company. The key benefits of Hedging Foreign Exchange Exposure are that it enables the management team to recognize the actual risks and resolve the same in least time possible (Bartram, 2013). Moreover, it also reduces the occurrence of bankruptcy and improves financial planning. Hedging Foreign Exchange Exposure is a method utilized by the concerned company Cadbury to completely hedge or eliminate the risk associated with the foreign exchange, these risks mainly occur because of the financial activities or transactions performed in foreign currencies. Cadbury performs the same

either by a fair value method or cash flow hedge. The past clearly demonstrate the fact that by setting up a hedge, the company may also earn high profits only if motions in the rates of exchange are advantageous for the company. The Hedging Foreign Exchange Exposure mainly transfers the risk associated with foreign exchange to a business which carries the risk, such as a financial institution or bank, directly from the investing or trading company (Stulz, 2012). The management of the Cadbury mainly conducts hedging for the beneficiary of the management.

The operation exposure management within the concerned company Cadbury maintains preferred stock allowed to be at capped or fixed rates and maximum and minimum levels of the total net debt in various time bands. The capped rates outlined by the company range from 50 to 100 percent for the time up to half a year, and 0 to 30 percent if the permitted time period is more than 5 years.

The consequence associated with the Hedging Foreign Exchange Exposure is the cost to the concerned company for setting up a hedge. Other consequences of Hedging Foreign Exchange Exposure include:

- The organizational managers cannot outguess effective and most profitable market place. Management have been criticized for forex losses many times but not for the costs spent for avoiding the forex losses.
- Investors of the concerned company already factored Hedging Foreign Exchange Exposure into valuation
- Shareholders become more capable of diversifying the exchange risk
- It may not increase the expected cash flows significantly under the condition where exchange rates are not favorable

- Currency risk management is highly costly

Figure 2: Hedging Foreign Exchange Exposure

(Source: Bartram, 2013)

Despite of the certain consequences associated with hedging foreign exchange exposure, hedging has proven to be beneficial for the concerned company Cadbury in the last fiscal year of 2013 asit significantly increased the net cash flow for the company and eventually contributed to the productivity and profitability.

## Foreign Currency Market

Foreign Currency Market or exchange market or forex is a global decentralized market for the trading and investment of economies. The concerned company needs to use currency futures if it decides to speculate in the foreign currency market. Currency future can be defined as a futures contract to exchange one currency for another at an exchange rate or priceand at a pre-decided date in the future (Gregory, 2010). The exchange rates need to be fixed on the date of purchase. Generally, one of the currencies within currency future is United States Dollar and thus, the price of future is evaluated in context of this US dollar per unit of the other currency involved. Thus the same can be highly significant for the concerned company as it is slightly different from the other methods of estimating in the spot markets of foreign exchange.

Cadbury buys 12 June CME Euro FX Futures at $2. 3456 per €. At the end of the day, the futures close at $2. 3506 per €. Thus the change in price is $ 0. 0050 per €. Since, the company has 12 such contracts and each contract is over €1, 00, 000, the company can earn a profit of $6, 000. As with any

future, the same will be paid to the company immediately.

Cadbury if it decides to speculate in the foreign currency market can also make use of the currency future to hedge against the risk associated with foreign exchange. For example, if the concerned company receives a cash flow not expressed in the domestic currency with the date of future, the company can significantly lock in the existing rate of exchange through entering in a balanced position of currency futures which would decease on the date mentioned on the received cash flow (Bodnar, 2012). Moreover, Cadbury if it decides to speculate in the foreign currency market can also make use of the currency future to speculate and attempt to earn profits from falling or increasing rates of exchange, by incurring a risk.

## Recommendations and Conclusion

The concerned company Cadbury is highly focused on operating exposure management which has been the key aim of company. The company needs to stabilize its cash flows in opposition of changing exchange rates. The company also needs to consider the management of operating exposure as a long term strategic planning as the main influence of changes in exchange rate is on its competitive position. The company can efficiently utilize come of the strategies for operating exposure management, which include Financial Hedging, Product Differentiation, R & D efforts, Diversification of Market, Flexible sourcing Policy, and Selecting the low cost production sites. Thus, it is evident from the above made arguments that the financial instruments and the internal techniques are highly significant for the Cadbury to manage its international exposure operation. The report also

suggested that the concerned company need to use currency futures if it decides to speculate in the foreign currency market.

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