

Business analysis and valuation report

[Business](#)



BUSINESS ANALYSIS AND VALUATION REPORT Scheduled Class: Monday 2: 00pm to 5: 00pm

1. Introduction Harvey Norman is now a public company that is listed on the stock exchange, whose principal activities primarily consist of an integrated franchising, retail and property entity. It is one of Australia's most successful retail groups, operating more than 150 franchised department stores, which focus on selling computers, home entertainment equipment and home appliances. It offers Australian consumers an extensive product range, cutting edge technology and market leadership in most product categories.

In this report, an in depth industry and company analysis will be provided in order to gain an understanding of the qualitative aspects of Harvey Norman's operation.

2. Industry Analysis

2. 1 Main Products Harvey Norman belongs to the retailing industry. The main products offered by Harvey Norman consist of: electrical, computer, furniture, entertainment and bedding goods. However, being distinctive from its competitors, Harvey Norman is a franchise and the main brand owned by Harvey Norman Holdings Limited.

2. 2 Future Prospects In the next year, the competition in Australian retailing industry is likely to remain strong.

Benefited from the Government's stimulus package during the GFC, Australians' ability to consume has recovered. Therefore, this boost in consumption has caused a pressure of inflation. In order to mitigate the negative effect of inflation, there has been frequent increase of interest rate by the Reserve Bank. Therefore, with interest rate rising, consumption in retailing goods is likely to reduce in the short term. In the next five years,

the Australian Dollar is going to remain strong. As a result, imported retailing goods are likely to be cheaper for Australian consumers.

Retailers in Australia are likely to continue their expansion to the overseas market. It is because retailers demand further improvements to the operational performance. In the long run, retailers are likely to increase their share in key growth markets combined with the brand strength of their own company, in order to ensure future growth. These speculations are based on principles of economics, as well as assessments of the changes in Australian's consumption ability. 2. 3 Market Competition Review Harvey Norman competes in the five main retailing industries including: electrical, computer, furniture, entertainment and bedding goods.

Each industry has its own main player. The main players in the electrical and computer goods industry include: Clive Peeters, Dick Smiths and Bing Lee. 1) Clive Peeters's retail coverage is the most similar to Harvey Norman in Australia. Their main products include: Audio Visual, Kitchen appliances and white goods. Clive Peeters' stores carry more than 140 brands and over 20,000 individual models. This company can be seen as a major competitor to Harvey Norman because of their similarity in size. 2) Bing Lee specializes in consumer electronics, computer and telecommunication goods.

Unlike Harvey Norman, Bing Lee is a privately-held electrical retail business in New South Wales with 41 stores and a turnover of about \$490 million. Although it is the largest privately-held business in this industry, Bing Lee remains as a relatively small size retailer comparing to Harvey Norman. 3) Dick Smith (formerly Dick Smith Electronics) is an international electronics

retailer. It is a major competitor to Harvey Norman. Among all retailing industries where Harvey Norman competes in, the company remains dominant in the key product areas of audio, computers and visual products such as notebooks and flat panel televisions.

The company holds the number one position in the markets of white goods and technology products. 3Company Analysis 3. 1 Company Choice As one of Australia's largest and most successful retailers, Harvey Norman has business interests in various areas including electrical, computer, furniture, entertainment and bedding goods. With more than 160 stores located in Australia, New Zealand, Slovenia, Ireland, Malaysia and Singapore, Harvey Norman is a conglomerate/franchise, which provides millions of consumers with products ranging from notebook computers to sofas to beddings.

To run a successful business operation of Harvey Norman's magnitude requires not only operational excellence, but also strategic insight and vision on macro economic conditions, market trends forecasts and also a distinctive understanding and implementation of the company's business strength. The company's strong business operations across multiple product areas/industries make Harvey Norman an interestcase studyto analyze – both from an operations point of view as well as strategic. Furthermore, given the challenging market conditions in 2008 and 2009, it would be interesting to analyze how Harvey Norman responded to the economic downturn.

The company observed “ a significant improvement in net profit from underlying business operations during the last 6 months of FY2009”,

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according to Harvey Norman's 2009 Annual Report. It would be insightful to see what strategies and tactics were used by Harvey Norman to achieve this result, especially in the integrated, franchise and property system sectors since these were reported by the company to be "resilient in achieving strong results and growing market share in all key product categories." 3. 2

Company History Date Significant Event(s) 961 Gerry Harvey & Ian Norman established the Norman Ross chain of stores 1979 Norman Ross became one of the largest appliance retail chains; controlled 42 stores with sales exceeding AUD240 million 1982 Norman Ross was sold and a single Harvey Norman store was started in Auburn, Sydney. 1987 Harvey Norman Holdings Limited was listed on the Australian stock market Early 1990s Harvey Norman adopted the superstore format and entered the computer and furniture markets 1998 Joyce Mayne acquisition 2000 The chain grew to 100 stores 3. 3

Competitive Advantage

Harvey Norman's competitive advantage can be classified into "hardware" and "software" perspectives with the "hardware" component incorporating corporate strategy and business structure while the "software" component incorporating leadership skills and management style:

- Corporate Strategy: Harvey Norman embraces and successfully maximizes benefits bought forth by the economies of scale (both on the purchasing as well as market side); achieves seamless integration of its retail, franchise and property systems; has excellent brand awareness, which translates into brand loyalty from customers. Business structure: Harvey Norman has successfully setup, adopted and utilized the franchising operation which enables it to generate revenue from multiple sources; it has a diversified product base which can

help mitigate risks and capture a wider customer base. •Leadership skills: Harvey Norman has the ability to identify and acquire property associated with HN's development of retail stores in growth areas, which is a crucial element of the integrated retail and property strategy. Management style: Leadership is able to respond to market change and demand effectively – both in terms of products and operations. For example, Harvey Norman has expanded its product offerings and operations into various countries in response to increased demand (from both local and foreign markets).

3. 4 SWOT Analysis

Strengths

- Franchising Operation
- Improved technology and supply chain management systems. (Global Merchandise Management System)
- Economies of scale both in purchasing and marketing. Effective integrated retail, franchise and property system and low gearing supports to capitalize competitors' failure.

Weaknesses

- Issue of low profit margin putting continuous pressure
- Closure of its export and distribution businesses in Singapore and Malaysia has negatively impacted on the profitability in Asia market.
- Own only little market shares in the gaming industry.

Opportunities

- The strong performance of the franchising operating segment
- Expand franchising operations in potential geographical areas and extending product offerings using stable financial capability. Growing market shares in many overseas market such as Malaysia, New Zealand, Slovenia and Ireland
- OFIS brand is expanding in Australian market as a discount retailer of stationery

Threats

- High inflation, capital market liquidity crisis and decreased demand because of Global financial crisis are affecting the business both locally and internationally.
- Fall in price on electrical items due to rise of Australian dollar are directly lowering profit margin and increasing expenses.

3. 5 Future Prospects for Harvey Norman Next Year

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There has been 10 new franchised complexes opened in Australia and a total of 8 leased stores were closed in 2009. A number of stores were also opened in offshore markets including the new OFIS brand, which implies that Harvey Norman is continuously growing its operations and expanding geographically. Net profit from underlying business operations was down by 15.2% as a result of many write down of assets, revaluation of assets and expenses taken place in the first half year of 2009. However, franchise sales revenue increased by 4%.

With the continuous expansion and write down done in the financial year ended in June 2009, it is obvious that sales revenue and net profit will improve in the next year. Next Five Years The company's strong financial position and low gearing allow it to invest to expand its operations and adds value to its brands and businesses across its value chain in the next five years. As shown in the financial highlight 2009, the net profit after tax had declined from 358.45 million to 214.35 million as a result of the increased amount of expenses and trading loss of some segments.

However, the gross profit has increased, concluding that business is improving and growing. Moreover, the consolidated equity has increased by \$1.12 billion, which dropped the debt/equity from 26.61% to 26.56%. It means the company is trying to strengthen their equity position for the next five years as well as the long run. In the Long Run In the long run, Harvey Norman has many opportunities to continuously grow in the future. It has an effective integrated retail, franchise and property system that allows the company to make substantial profit from its owned operations, franchised operations and leased property.

Harvey Norman and many of its brands have become the market leaders in its industry and it will continuously extend its product offering across all the brands to maintain its market position. It is confident that Harvey Norman will continuously perform well in the long run. 3. 6 Recent performance Table 1-3 represents the recent 3 years' performance of HVN: During last three years, there is a slightly incensement in its revenues, the revenue (exclude interest) raised from 2008 to 2009 by 2. 4% as well as from 2007 to 2008 grew by 6. 6%.

Table1 HVN Revenues, Expenses and Cash Flows FY2009 (\$m) Revenues (Exclude Int) Expenses (Exclude D&A)EBITDAExpenses (D&A)EBITNet Cash Flows \$2436. 0\$1963. 28\$472. 7\$91. 04\$381. 7\$82. 71 Table1 HVN Revenues, Expenses and Cash Flows FY2008 (\$m) Revenues (Exclude Int)Expenses (Exclude D&A)EBITDAExpenses (D&A)EBITNet Cash Flows \$2378. 4\$1873. 24\$505. 2\$84. 39\$420. 8\$-127. 18 Table1 HVN Revenues, Expenses and Cash Flows FY2007 (\$m) Revenues (Exclude Int)Expenses (Exclude D&A)EBITDAExpenses (D&A)EBITNet Cash Flows \$2229. 8\$1819. 82\$410. 0\$74. 88\$335. 1\$50. 58

Sales revenue for the Harvey Norman consolidated group consists of sales made by New Zealand, Ireland, Northern Ireland, Slovenia and the controlling interest held in Pertama Holdings Limited in Singapore. Consolidated sales revenue also includes Harvey Norman's controlling interest in several retail partnerships and the company-run OFIS stores in Australia Consolidated sales revenue for the year ended 30 June 2009 was \$1. 44billion compared to \$1. 43billion for the year ended 30 June 2008, an increase of 0. 83%,

despite the sales revenue decreased in some regions like public of Ireland and New Zealand.

The reduction in sales in these regions was due to extremely challenging retail's trading conditions and lack of consumer confidence. However, for the purpose of financial report, all the foreign currency is translated in to Australia dollar. Since the depreciation in Australia dollar in the last year, sales revenue decreased in some local markets might show an increase in the financial report in Australia dollar. EBIT reported a loss of \$39. 1m in 2009 compared with 2008 due to an increase in depreciation and amortization and operating expenses, comparing with 2007, there is an increase of \$95. m in 2008.

3. 7 Accounting Analysis Manager's Incentive of Earning Manipulation

There are empirical evidence linking the character of executive compensation with earnings manipulation and fraud. With regard to earnings manipulation, Keith J. (2006) finds that firms with relatively high amount of equity incentives to CEOs, in the forms of unrestricted stock and immediately exercisable options, are more likely to engage in earnings management by reporting small earnings increase, and also by reporting long strings of increasing earnings.

In this case, Harvey Norman's executive remuneration packages involve a balance between fixed and performance cash incentives (PCI) which includes short term such as base salary and long-term payments such as superannuation. Equity based remuneration can also potentially induce managers to manage earnings, by understating earnings prior to option grants to lower the firm's current share price and exercising option later on.

Evidence of Earning Manipulation When managers have accounting

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flexibility, they can use it either to communicate their firm's economic situation or to hide true performance.

Possible distortion Detail & Explanation Accelerated recognition of revenues Managers typically have best information on the revenue recognition to decide whether or when the cash collection is reasonably likely. And they may have incentives to accelerate the recognition of revenues. They can adopt new accounting or use managers' discretion to alter revenue recognition of, for instance, franchise fees or rent.

Underestimated reserves From Note 5, provision for doubtful debt has decreased from 4.7 m to 4.3 m; from Note 5(a) the aging analysis of trade debtors, number has increased from 952 k to 1,038 k.

Due to the global financial global crisis and its influence to the debtors and consumers, it is not convincingly reasonable to reduce provision for doubtful debt, which intends to overstate receivables. Understated depreciation on long-term asset Firms are required to recognize impairment in values of the long assets when they arise. However, estimates of asset valuation and impairment are highly subjective. As a result, managers intend to delay or reduce write-down, or even not show impairments. This issue is especially crucial or asset-intensive firms in volatile markets. A review of Note 12, the economic situation in Ireland has continued to deteriorate and severe recession has impacted all Irish retailers resulting in large trading losses in Ireland during the year, while an impairment loss in plant and equipment assets is slightly lower than expected. Capitalized R&D outlays The economic benefits from research and development are highly uncertain. In this case,

the company capitalize IT projects, which cannot clearly show us a certain future benefits. Adjustment Recommendation

Although there are reasonably large chances for the managers to manage and manipulate earnings, these managements are not materially enough to make adjustment. PCI may become incentives for managers to manipulate earnings but also can be seen as incentives for managers to work on their best for the company as the higher earning achieved the higher incentives they can be awarded. Therefore, no adjustments have been made on all the accounting numbers, which will be used for analysis afterwards. References

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South-Western College Publishing, 2007. Appendix Appendix A
Standardized Financial Statement Appendix B SWOT Analysis

Strengths: As mentioned above, its franchising operation is one of the company critical success factors and as well is their strength. In addition, Harvey Norman has a commitment to improve technology and supply chain management systems in response to the market growth, which becomes its business strength. In Australia the company benefits from enormous economies of scale in both purchasing and marketing. Also, the company is one of the biggest media spenders in the country, contributing to a high level of brand recognition throughout Australia.

Another strength is their strong financial position, which is indicated in the financial highlight in the annual report 2008, as a result of their effective integrated retail, franchise and property system, it has built a strong financial position and low gearing that has placed Harvey Norman in an excellent position to capitalise on any competitor failure in the market place and to take advantage of emerging opportunities. Weakness: According to a review by David Richards (2009), David Ackery, the general manager of Electrical at Harvey Norman comments that they are facing the issue of its margin with its vendors and retailers.

Although the gross profit margin in 2008 is stable and slightly increased in comparison to 2007 from 25.9% up to 26.7% (calculated from the income statement 2008), the vendors and retailers are continuously placing pressures on its margin. Furthermore, the closure of its export and distribution businesses in Singapore and Malaysia has negatively impacted

on the profitability in Asia market. Another weakness is the gaming market that had not performed as well as JB Hi Fi with Ackery (2009) admitting that it was a booming area of the market, where Harvey Norman had not taken much market shares in this area.

Opportunities: Harvey Norman is being the market leader in the industry and has improved and maintained its market share position in Australia, which makes it difficult for new entrants to enter into the market. Harvey Norman has the opportunities to continuously expand its operations into international markets as it has been proven in its successful operations in overseas such as New Zealand. As a result of its strong financial position, Harvey Norman has the capability and ability to invest in expanding its operations in other geographical areas that are potentially profitable as well as extending its product offerings.

Threats: Global economic recession is a major threat to any industries and companies including Harvey Norman. Also, capital market liquidity crisis, contracting monetary policy, high inflation and petrol prices are negatively impacting on consumer sentiment, which decrease the demand and thus, profitability. Prices on electrical items had been falling due to a rising Australian dollar and the rapid obsolescence of many technology products, which lower its profit margin and increases expenses. Appendix C

Project and Team Work Source/Information Origin and Significance Source and information used for this project would come from Harvey Norman's corporate website (which includes corporate profile, investor relations sections, past annual reports). Also media coverage of the company, its

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competitors, and market landscape/environment will also be used as reference to allow for ample understanding and analysis of Harvey Norman and its business operations. The Difficulties of Analysis on the Industry and Company

Harvey Norman has business operations in multiple segments including electrical, computer, furniture, entertainment and bedding goods, with more than 160 stores located in Australia and abroad. Because Harvey Norman is a conglomerate/franchise, which provides products ranging from notebook computers to sofas to beddings, so it is slightly hard to label its business, which consequently leads difficulty finding fair industry benchmark. It is hard but interesting to analyse this case.

Some other problem may be that the major information are from internal statement, and external source are either somewhat trivial or lack of detail. The Contribution of Each Group Member The work of this group project is equally allocated to each group member based on his or her strength and weakness and each group member contributes a hundred percent to their work. They are able to meet the deadline even though; everyone has their own personal commitment. Issues with Team Work and Solution