

# [A report of pace leisurewear ltd finance essay](https://assignbuster.com/a-report-of-pace-leisurewear-ltd-finance-essay/)

Pace Leisurewear Ltd is a manufacturer of casual wear and designer leisure clothes company. Jill Dempsey and Mike Greaves are two co-founder of Pace Leisurewear Ltd. Lots of fresh experience in similar business and new ideas for developing a new range of clothes for young people motivate Jill and Mike to form such business to attracts younger and higher income market. Under guidance of Jane Barker, who is experienced designer, company had taken lots of efforts and spend lots of money to recruit young and talented design team. As expected design team produced range of clothes and welcomed by enthusiasm buyers. With the help of marketing team lead by Jill Dempsey, the sales was growing and orders had reached their highest level ever. Recession period Pace Leisurewear Ltd started trading due to average sales. After economy coming out of recession, company’s sales started growing with new exports markets in France and Switzerland. Jill and Mike were very delighted when they received a order from Arena, which could be very important for companies growth over next few years in leisurewear business. Jill and Mike invested all their life time savings as well as taken out large mortgages on their houses to invest in companies business. Major contribution added by Keeble Estates Ltd, owned by Keeble brother, David and John Keeble. The board of directors of Pace Leisurewear Ltd are Jill Dempsey, Mike Geaves, Jane Berker, David Keeble and John Keeble.

## Difficulties faced by Pace Leisurewear Ltd.

The main problem which is company facing is reduction in bank overdraft by half over next six months. Even draft accounts details received from the auditors shows profit has more than doubled. Surprisingly company facing cash situation is so poor. Company invested a lots on additional plant and after selling old machines company didn’t manage additional expenses includes £2. 8 million for depreciation. It is already clear from Keeble brothers that addition investment is not possible.

Board director’s not have financial expertise and business had crossed the overdraft limit on several occasions. Because of poor cash situation company need large amount of money to successfully execute new order from Arena and override Pace Leisurewear’s liquidity problem.

## Financing ratio analysis in the tabular format with relevant formulas :

## Profitability ratio :

Ratio

Formulas

Year( 2008)

Year( 2009)

Return on capital employed (ROCE)

Profit before interest and tax x 100%

Capital Employed

2100 x100%

10474

= 20 %

4618 x100%

15600

= 29. 7%

Return on Equity(ROE)

Ratio

Profit after tax x 100%

Share holder equity

Formulas

1248 x100%

6874

= 18. 1%

Year( 2008)

2926 x100%

9000

= 32. 7%

Year( 2009)

Gross Profit Margin

Gross Profit x100%

Sales

6510 x100%

14006

= 46. 5%

10792 x 100%

22410

= 48. 15%

Net Profit Margin

Net Profit bf interest & tax x 100%

Sales

2100 x100%

14006

= 14. 99%

4618 x100

22410

= 20. 6%

## Efficiency Ratio :

Ratio

Formulas

Year( 2008)

Year (2009)

Stock Turnover in days

Stock held x365

Cost of sales

2418 x365

7496

= 117. 73 days

5820 x365

11618

= 182. 84 day

Debtors Turnover in days

Trade Debtors x365

sales

1614 x365

14006

= 42 days

3744 x365

22410

= 61days

Creditors Turnover in days

Trade creditor x365

Purchases

1214 x365

7496

= 59days

2612 x365

11618

= 82 days

## Liquidity Ratio :

Ratio

Formulas

Year (2008)

Year (2009)

Current Ratio

Current Assets =

Current Liabilities

4356

2482

= 1. 8: 1

9974

8844

= 1. 12: 1

Quick (acid – test) ratio

Current assets – Stock

Current Liabilities

4356 – 2418

2482

= 0. 8: 1

9974-5820

8844

= 0. 5: 1

## Gearing Ratio:

Ratio

Formulas

Year (2008)

Year (2009)

Gearing Ratio

Fixed Interest Capital x100%

Fixed interest capital + equity

3600 x100%

10474

= 34. 4%

6600 x100%

15600

= 42. 3%

## Financing position and performance of Pace Leisurewear Ltd

## Profitability Ratio:

Every company is looking for its profitability. Ratio analysis is calculated with the help of different types of formulas. Ratio analysis help business to provide financial statements. Concerned with how much the company owes in relation to its size. It is improving its situation. Ratio gives very clear view of the financial stability rather than companies individual mathematical figures. Profitability ratio is most frequently used tools in financial ratio analysis. It shows company’s performance and stability. Profitability ratio can be divided by margins and returns. All type of ratios can shows companies situation in the market, but ratios can not give any solution for any problem. Using company’s profit and loss we can calculate its profitability. Here we will discuss profitability ratio for Pace Leisurewear Ltd.

## Return on Capital Employed :

ROCE goes higher the company’s profitability will increase. In year 2008 ROCE was around 20% and in year 2009 it increased to 29%. Even in year 2009 Profit before tax and interest was higher as compare to year 2008, but company also increase fixed assets and current assets. That was the reason company’s ROCE is increased by 9% only.

## Return on Equity :

The amount of net income returned as a percentage of shareholders equity. It will help for comparing the profitability of two companies, which are in the same industry. ROE for the year 2008 is 18. 1% and in year 2009 was 32. 7%, that means is double than 2008. Equity shows the total investment of the company. Higher the ROE goes shareholder get higher return. Dividend increased almost double as well as net profit after tax also increased, it means company is getting good return from shareholder’s equity.

## Gross Profit Margin :

Gross profit margin prove the percentage of amount remaining after paying cost of sales. Company’s total sales minus its cost of goods sold, divided by the total sales, which is represent in percentage. The higher percentage means more the company retain on each sales to its other costs. Gross profit margin for year 2008 was 46. 5% and in year 2009 it’s increased to 48. 15%. Because of cost of sales increased by 55% between last two years, it effected on gross profit margin. Company’s gross profit increased by 65% over sales which is increased by 60%.

## Net Profit Margin :

Net margin will vary from company to company and most companies will report their net margin both quarterly. it shows business net profitability. Net profit margin for 2008 was 14. 99% and in year 2009 it increased by 20. 6%. Net Profit after tax increased by around 134. 5% over the same period. Increase in net profit after tax is a very good news for company’s future.

## Efficiency Ratio:

Company should invest in assets to run its operations. Efficiency ratio calculate how effectively company use its assets. It needs to be managed carefully. A good system of credit control is essential to any organisation.

## Stock Turnover ratio :

It shows the number of days on average money is fixed up in stocks. Stock turnover shows how quickly goods move through the business. Profits must be increased if the rate of stock turnover can be increased. Stock is the part of working capital. It’s important for working capital to as early as possible convert stock into cash to save from liquidity problem. In year 2008 stock turnover was 117. 73 days and in year 2009 it increased to 182. 84 days. Big turnover in days is not good for business because fund’s are very hard to use somewhere and fund’s got freeze with stock.

## Debtor’s turnover ratio ( days ):

It will shows, how efficiently business can collecting its debts and how quickly company can solve debt problem. Short period of debt is not a big harm to company but the longer debt can effect on business badly. In year 2008 debtor turnover was 42 days and in year 2009 it increased to 61 days. It means longer time money will be stuck with debtors.

## Creditor’s turnover ratio (days) :

This ratio shows , how many days it takes to paying its debts. Cash must be retained within the organisation for longer period. Creditor turnover days must be always greater than debtor’s turnover days. Business holding creditors money for longer period so longer days with creditors turnover is good for company’s business. In year 2008 creditors turnover in 59 days and in year 2009 it increased to 82 days. It seems to be good compare to debtor’s turnover days.

## Liquidity Ratio :

Liquidity ratio shows company’s ability to repay short term creditors out of its total cash. Current ratio must be in excess of 1. If it is greater than 1, it means , its fully acceptable. There are two liquidity ration which is very simple to use and very important as well. These ration are : Current ratio and acid test ratio. It can pay its suppliers by having enough working capital.

According to balance sheet for 2008, current assets are trade debtors, stock, cash and other debtors. Current liabilities are trade creditors, taxation, dividends, other creditors and bank overdrafts.

## Current Ratio:

Current assets in year 2008 calculated as 4356k and in year 2009 is calculated as 9974k and current liabilities calculated for year 2008 as 2482k and in year 2009 is calculated as 8844k. As if we calculated current ratio should be 2: 1, it means business has sufficient current assets to pay current liabilities. Current ratio in year 2008 is 1. 8: 1, it means company has sufficient liquidity to pay its debts, as year 2009 current ratio shows 1: 12. Its increase shows company can pay its short term debts.

## Quick (acid-test) Ratio :

Acid-test ratio does not includes value of stock so this ratio can calculate liquidity more accurate than current ratio. Fast stock turnover company’s can keep acid test ratio comfortably less than 1.

To calculate acid test ratio we will take out stock value from current assets. In 2008 acid test ratio was 0. 8: 1, which seems to be not bad. Next if we calculate for year 2009 the acid test ratio shows to 0. 5: 1which seems to be very unhealthy. Stock calculated in year 2008 was 2418k and in year 2009 is 5820k, it means company keeps more than doubled its stock. Acid test ratio for current year is showing company is in big trouble with its liquidity.

## Gearing Ratio:

Gearing ratio calculate of financial leverage which demonstrate the percentage to which business activities are funded by owner fund versus creditor funds. There is no limitation to how much gearing ratio responsible to be. Company having less than 50% gearing ratio can be specify as a low geared. Also if company having more than 50% gearing ratio can be specify as a high geared ratio. In year 2008 gearing ratio was 34. 4% and in year 2009 gearing ratio shows 42. 3%. Comparing with this two years, in 2009 company is higher geared than in year 2008. Company top up loan amount by 6600k which is approximately 83%. Company have to pay more interest because of its higher loan and it can be effected company’s capital, which they will end up in paying dividends.

Last two year ratio clearly shows that company is having difficulty with liquidity in coming years. Top of that bank is going to reduce overdraft by half percent in next six months and this is not affordable by company to fulfil new order which is come from Arena, Pace Leisurewear Ltd have to complete this order to stay in the leisurewear market.

## Plan of Action :

After writing this report for Pace Leisurewear Ltd , there are few points, which need to be look into, as follows :

1. One positive point is company is highly profitable, but it is very difficult to convince potential investors to invest in company because its gearing ration is high and facing a liquidity problem . Some investor can invest with risks in exchange for future high returns.

2. There is chance to small investment from suppliers and customers after explaining company’s future plan and current orders proposal.

3. Try to convert stock in cash for short term. Efficiency ratio shows large number of stock turnover effecting company’s cash.

4. Pace Leisurewear Ltd need to be appoint some one who is expertise in financial activities to take control of the finances and investment of the business.

5. Company should be take a total control to expanding business activities, like concentrate on order completion in time.

6. Reduce stock level and minimize debtors collection period for short term.

7. Try to lease, so company can save money on purchasing fixed assets.

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