

# [Analysis of financial ratios of next plc accounting essay](https://assignbuster.com/analysis-of-financial-ratios-of-next-plc-accounting-essay/)

UK retail market has huge scope with £138. 2 billion revenue during fiscal year 2011/2012. Next Plc. and MARK & SPENCER are direct competitors and listed in the FTSE100 UK companies. Analysis of financial statement gives an idea about the company’s performance, profitability, as well as future development forecast.

## Company Overview

## Next Plc.

Next Plc. is the major fashion retailer with wide range of customer appeal in the UK and abroad, now it has extended its online shopping facilities to the USA and other 50 countries. The parent company Gentlemen tailors established by J Hepworth & Son in 1864. it changed its name to Next Plc. In 1986, It’s has been always expanding its market share by implementing different business strategies by diversifying its products in the competitive market making its gross profit of about 1046 million in the fiscal year 2011/2012.

Next Plc. is one of the leading retailers in the UK with revenue in excess of £3441 million, employing over 30000 people with over 700 stores in 32 countries all over the world.

Here are some key financial summary from its annual report for fiscal year 2011/2012.

## Income statement

## 2012

## £M

## 2011

## £M

Turnover

3441. 1

3297. 7

Operating Profit

1045. 3

965. 1

Net Interest

28. 9

24. 3

Profit Before Tax

579. 5

543. 4

Profit After Tax

Cost of sales

430. 2

2395. 8

400. 9

2332. 8

Table

Balance sheet £M 2012 £M 2011

Fixed assets

581. 9

592. 4

Current Assets

1139. 9

1067. 3

Stock

372

368

Debtors

699

645

Creditors

545

544

Current Liabilities

742

832

Non-Current Liabilities

889

725

Table

## Cash Flow Statement

2012 £M

2011 £M

Cash and equivalent at the beginning

0

61. 1

Net cash generated from operating activities

260. 3

115. 9

Net cash flow from investing activities

200

200

Net cash flow from financing activities

(449. 7)

(377. 0)

Cash and equivalent at the end of the year

10. 6

0

Marks & Spencer

Marks & Spencer was founded 128 years ago and today operates over 1000 stores, including 370 stores abroad , and employs around 50, 000 people. It is a UK based retailer with business interests in fashion and food business. The company operates supermarkets, convenience stores, internet-based home delivery shopping service.

Marks & Spencer is one of the oldest clothing stores in the UK. The company has a market share of around 5% and serves over a million customers a week. The company also operates many stores offering internet-based home delivery shopping service.

Marks & Spencer also operates a significant non- fashion business and sells a range of products including foods, electronics, kitchen appliances, financial service and home wares.

The company recorded revenue of £9934. 3 million during the financial year ended March 2012. The operating profit of the company was £746. 5 million whereas net profit was £489. 6 million.

Key financial summary of Marks & Spencer for fiscal year 2011/12 in million

## 2012

## £M

## 2011

## £M

Turnover

9934. 3

9740. 3

Operating Profit

746. 5

836. 9

Net Interest

136. 8

96. 8

Profit Before Tax

658. 0

780. 6

Profit After Tax

Cost of sales

489. 6

6179. 1

598. 6

6120. 5

Balance sheet £M 2012 £M 2011

Fixed assets

5813. 2

5702. 4

Current Assets

1460. 1

1641. 7

Stock

681. 9

685. 3

Debtors

253

250. 3

Creditors

280. 8

262. 3

Current Liabilities

2005. 4

2210. 2

Non-Current Liabilities

2489. 1

2456. 5

## Cash Flow Statement

2012 £M

2011 £M

Cash and equivalent at the beginning

263. 5

202. 7

Net cash generated from operating activities

1352. 1

1385. 2

Net cash flow from investing activities

(757. 8)

(490. 5)

Net cash flow from financing activities

(511. 0)

(647. 4)

Cash and equivalent at the end of the year

195. 8

263. 5

## Compared financial ratios of Marks & Spencer and Next Plc.

Below I have calculated, and analyse financial ratios of Next Plc. Plc. and Marks & Spencer. This can be used to Measure Company’s solvency, liquidity, operational efficiency, and profitability as well as useful to measures and compare performance of two competitor businesses with each other.

## Profitability Ratios

Profitability Ratios tells company’s ability to generate profit related to its expenses during a specific period. Most ratios with higher value compared to previous year or competitor indicates that company has good performance.

Gross profit margin

Formula: Gross profit/salesÃ-100

Next Plc.

Marks & Spencer

2012

2011

2012

965/3297X100

= 29. 26

1016/3411X100

= 29. 8%

3755 / 9934. 3 X100%

= 37. 8%

Gross profit margin Measures Company’s profitability compared to its turnover. This ratio must be more than one to run a business. If ratio is less than one business cannot survive regardless of size of turnover of the business.

In the year 2012 Next Plc. Has Generated 29. 26% of gross profit, which shows slight improvement than last year, whereas, its competitor Marks & Spencer gross profit margin is 7% greater than Next Plc.. It shows similar trend as Next Plc. and a little upgraded than 2011 from 37% to 37. 8% this year.

It shows that Mark and spencer is spending only 62% on its cost of sale while Next Plc. has 70%. This result illustrates that price of raw material of Next Plc. is higher than Mark & Spencer or the company is selling its products just only 29% percent higher than its cost. Next Plc. offers many promotional offers for its costumers than Mark & Spencer.. For instance, it offered half-price sale during Christmas period, Buy one-get one free and other occasional offers, which cut company’s gross profit margin.

Operating profit margin

Formula: Operating Profit/SalesÃ-100

Next Plc.

Marks & Spencer

2012

2011

2012

600. 3/3441. 1X100%

= 17%

565/3297. 7X100%

= 17%

746. 5/9934. 3 X100

= 7. 51%

Operating profit margin tells Company’s profitability compared to profit before interest and tax.

During the year 2012, Next Plc. Has 17% of operating profit which is constant as last year. While Marks & Spencer has only 7. 51%, its operating profit margin has unexpectedly decreased by nearly 1% from 2011 to 2012. Mark & Spencer also spending huge portion of its amount on its operational expenses, around 30% of its revenue is used to maintain its operation on both year while Next Plc. spend only 13% for same purpose.

It shows that Mark & Spencer has very higher operation cost than Next Plc.. Such as rent of the stores, staff cost, administration cost, electricity and other overhead might be too excessive.

Net profit margin

Formula: Net income/SalesÃ-100

Next Plc.

Marks & Spencer

2012

2011

2012

430/3441. 1Ã-100

= 12. 6%

400/3297. 7Ã-100

= 12%

489/9934. 3 Ã-100

= 4. 92%

Net Profit Margin considers all expenditures including interest. This method indicates effectiveness of the company regarding cost control.

In this case, Mark & Spencer has 4. 92% net profit margin, by losing its 1. 5% than last year . Whereas Next Plc. netted 12. 6% of net profit margin that gained 0. 6 % of more net profit compared to last year. Mark & Spencer is using loans to run its business, whilst Next Plc. considers to raise capital via selling more shares. As a result, Mark & Spencer have paid more interest compared to Next Plc. and it directly affects company’s net profit.

Return on Capital Employed

Return on capital employed tells the percentage of profit before interest and tax compared to its invested capital including long-term debt and shareholders fund.

Formula;

ROCE = earnings before interest and tax/long term debt + shareholders fund

Next Plc.

Marks & Spencer

2012

2011

2012

= 70%

= 69%

746/1948+2778X100

= 16%

Next Plc. Has very satisfactory ROCE percentage compared to its competitor Mark & Spencer. Next Plc. gained 1% growth than last year whilst Mark & Spencer unable to sustain and decreased from 18% to 16%. This indicates Next Plc. Has used its capital to maximize its profit whereas Mark & Spencer could not utilize its fund as required.

In brief, results from profitability ratios suggest that, Next Plc. is more profitable company despite Mark & Spencer have greater revenue. Mark & Spencer is earning higher gross profit margin but it is spending more on its overhead cost and interest expenses, whereas Next Plc. has lower gross profit margin. nonetheless, higher operating profit margin as well as net profit margin. It can be because of its promotional offers. Next Plc. is offering products in lower price and taking benefits of economies of scale.

Liquidity Ratios

Current ratio

Formula: Current Assets divided by current liabilities

Next Plc.

Marks & Spencer

2012

2011

2012

1139. 9/742. 4

= 1. 52

1067. 3/832. 9

= 1. 30

1460/2005

= 0. 72

Current ratio determines company’s capacity to meet its current or short-term liabilities by using its current assets including current assets. Generally, companies should have current ratio of around 2. 0; however, this can be different by industry to business.

Next Plc. have improved its current ratio from 1. 30 to 1. 52 compared to last year. At the same period, current ratio of Mark & Spencer has slightly reduced and tightened to only 0. 72, as both organisations are retail based, Next Plc. has satisfactory current ratio compared to Mark & Spencer. Because, Mark & Spencer’s current assets can cover 72% of its current liability if company goes to liquidation, which is below measure of safety condition.

Acid test ratio

Formula: Current assets -inventory/ liabilities

Next Plc.

Marks & Spencer

2012

2011

2012

1140-371/742

= 1. 03

1067-232/833

= 1

1460-682/2005

= 0. 38

‘ Acid test’ ratio also known as quick ratio measures company’s instant capacity to pay its short-term financial responsibilities. Normally it should not be less than 0. 5. if it is very low, it shows company is in risk of not meeting its current liabilities.

Next Plc. has very healthy ‘ acid test’ ratio of 1. 03 this year and 1. 0 last year, it demonstrates company has well managed its current assets and liabilities, whilst Mark & Spencer has poor quick ratio, which has below 0. 5 both year. Because Mark & Spencer has large amount of short term debt compared to Next Plc..

Efficiency ratios

Inventory turnover ratio

Formula: cost of goods sold/ average inventory

Next Plc.

Marks & Spencer

2012

2011

2012

2395. 8/372

= 6. 5 turns per year

2333/368

= 6. 33 times

6179. 1/682

= 9 times

This ratio determines the number of times inventory ‘ turned-over’ during a period. Generally, the higher this ratio the better use of inventory. Low numbers shows a huge amount of capital invested in inventory.

Marks and Spencer is turning its stock in to cash nine times a year, whereas Next Plc. plc is taking longer to sell its stock, which has only 6. 5 times turn over its inventory each year. It shows that Next Plc. has over-purchased or a sale has reduced since the stock was purchased.

Debtors’ turnover days

Formula: Net credit sales/ Average debtors

Next Plc.

Marks & Spencer

2012

2011

2012

3441/253

= 13. 6 or 27 days

3297/250

= 13. 2 or 28 days

9934/699

= 13. 35 or 27 days

Debtors’ turnover ratio tells how efficiently company is collecting its receivables from its customers. In this case, both companies have 27 days of collection period. Next Plc. has considerably cut its credit facilities to its customer whereas Mark & Spencer marginally extended the credit facility from 24 days to 27 days compared to last year. This ratio should be balanced in order to maintain company’s financial circumstance. Very high debtors’ turnover period specifies very restrictive credit policy, which leads to lose costumer to competitors and hampered sales. Whereas, very low debtors turnover ratio indicates that the company have relaxed credit policy to its costumer. This may harm company’s liquidity.

Creditors’ turnover ratio ( Creditors days)

This ratio tells how quickly or slowly company is paying to its supplier. This ratio must be balanced, because very higher ratio Means Company is taking too long to pay its supplier, which might leads to lose suppliers faith. Suppliers may stop supplying goods. Equally, very low debtor’s turnover ratio may harm company’s financial condition. If company pays very quickly to its supplier, company might not have enough funds to invest in other activities.

Creditors days= trade payables / cost of sales X 365

Next Plc.

Marks & Spencer

2012

2011

2012

545/3295X365

= 60 Days

544/2333X365

= 85 days

1449/6179X365

= 85 days

According to the table above, both companies are taking longer period to pay its supplier than companies are collecting payments from its customers. Next Plc. is taking 60 days to pay its suppliers; however, it reduced payment period by 25 days compared to last year, which is satisfactory, whilst Mark & Spencer has quite lengthy payment period of 85 days, which has increased by five days than last year. So, Mark & Spencer needs to be alert to maintain its supply.

Still, both companies are in retail business, therefore companies normally sell their product in cash, and the receive credit facilities from their suppliers. Because of this reason, there is a huge difference between its debtors and creditors ratio.

Asset turnover ratio

This ratio evaluates how well a company is using its assets to generate revenue. Higher rate of assets turnover ratio is mostly preferable. Nevertheless, Different industries might have different scenario as assets need to run a business can be different between industries to industry.

Assets Turnover= Sales revenue / total assets

Next Plc.

Marks & Spencer

2012

2011

2012

3441/1854

= 185%

3297/1792

= 183%

9934/7273

= 136%

Above table shows that assets turnover ratio are fine for both companies. However Mark & Spencer has much lower assets turnover of 136% compared to Next Plc., which has 185%. It indicates that Next Plc. is greatly utilizing its assets than Mark & Spencer through financing, using technologies, better management of inventory and enhanced quality control.

Gearing ratio

This ratio determines the balance between long-term debt and shareholders’ equity.

Gearing ratio = long term debt/shareholders fund + long term debt

Next Plc.

Marks & Spencer

2012

2011

2012

652/222+652

= 74%

471/232+471

= 67%

1948/2790+1948

= 41%

In the above table, Next Plc. has 74% gearing ratio, which is increased by 7% than last year, whereas, Mark & Spencer has 41% that decreased by 1% from the year 2011 to 2012. It shows that Next Plc. is more riskier business than Mark & Spencer, because it has much bigger portion of loan than Mark & Spencer. Moreover Next Plc. is highly geared than Mark & Spencer. Next Plc. should focus on growth through buying back its ordinary shares, and issue preference shares or debentures.