



## Semester Two 2019

## ACCT10001

# Accounting Reports and Analysis

### Group Assignment (Part B): Business Memorandum based on Financial Statement Analysis

This part of the assignment constitutes 7% of your final grade in this subject. It is a requirement that this assignment be completed by students as a **group of three (3) or four (4)** unless an alternative arrangement has been formally approved.

All students have been allocated to groups. If you are unable to contact other members of your group, you must contact the subject coordinator at [ara-enquiries@unimelb.edu.au](mailto:ara-enquiries@unimelb.edu.au)

#### Submission Details

**Due Date:** 4pm Friday 18 October 2019

**Submission style:** A single PDF file including a signed coversheet attached to the front

**Submission mode:** Turn-it-in Assignment Tool via the ARA subject page on the LMS

## **ACCT 10001: Accounting Reports & Analysis**

### **Assignment Two – Financial Statement Analysis**

#### **Disclaimer**

The information provided in this assignment, including the financial statements, is based on an actual business. The circumstances of the case study and the names of the parties involved are, however, entirely fictitious. The business on which this information is based, has no plans to make itself available for sale to any private investors. Any similarity to actual investment opportunities past or present, or any people living or deceased, is purely coincidental.

#### **The context**

You and your fellow group members are employees of ARA Consulting Services. Ms Annette Mane, one of your biggest clients has approached ARA Consulting Services to obtain advice on what she describes as an ‘exciting business opportunity’. Ms Mane’s private company has excess funds to invest and she is keen to invest in Hair Factory Pty Ltd. She would however, like some reassurance regarding the financial stability and future prospects of this company prior to making such a large investment decision. Ms Mane is considering the acquisition of 51% of the shares in Hair Factory Pty Ltd for a cash payment of \$375M.

Hair Factory Pty Ltd is the leading haircare destination for Victorian consumers, offering both haircare services as well as a Victoria’s largest range of haircare products.

Your manager, Mr. Max Boss, has assigned your team to review and analyse the financial statements of Hair Factory Pty Ltd. He would like you to prepare a maximum 1,200-word internal memo detailing your analysis and recommendations as to whether the client should pursue this opportunity.

#### **Required**

Prepare a 1200-word business memo to your manager, Max Boss, advising him on whether to recommend the \$375M million acquisition of a 51% stake in Hair Factory Pty Ltd to the client, Annette Mane.

This part of the assignment is independent of any financial statement information or ratio calculation relating to Part A of this assignment. Your analysis should be based on the financial statements and ratios provided hereafter.

Your report should be in the form of an internal business memo, style guidelines for which will be made available from the LMS and through Academic Skills support resources.

Your report should include your key findings that support your recommendation, followed by your final recommendation. Your analysis should consider a range of issues, but not all of these will necessarily be included in your final report.

Your report should not simply quote ratios in narrative form. Rather, the purpose of the report is to investigate the reasons BEHIND the ratios and financial statements to highlight the underlying strengths and weaknesses of the company.

A glossary is not required; you can assume that Max has technical accounting skills and strong knowledge of ratio analysis.

## Word limit

The word limit for the body of the memo is 1200 words. This is a strict limit that must be adhered to. Any information presented beyond this limit risks not being graded. Any tables, diagrams, headings or charts you wish to include in the body of your report are excluded from the word count.

It should be noted that it is not possible to comment on every aspect, strength and weakness of the investment opportunity within this word limit. You are to identify the major points and keep your explanations as succinct as possible. Presenting your analysis in point form is acceptable.

## Format

The following requirements should be adhered to in your report:

- Minimum 1.5 line spacing
- Times New Roman font, size 12 for the text of the report (headings may be differentiated)
- Appropriate heading structure, numbering and format
- A minimum of 2.5-centimetre margins all around
- Above all, this is supposed to reflect a business memo, therefore your format, use of headings, spacing and white space are to reflect this style of report.

In addition to format requirements described above, the first page of the report should be the Faculty of Business and Economics (FBE) **Group Cover Sheet** available for download from the LMS.

It is also important to note that this is a single report, not a series of disjointed sections that amalgamates individuals' work. Marks may be deducted for noticeable differences in language, style, format and inconsistencies in argument that occur within your report.

## **Background Information**

Hair Factory Pty Ltd (hereafter referred to as Hair Factory) commenced as one hair salon established in the early 2000s by Mr & Mrs Bouff, both hairdressers, in the inner-city suburb of Fitzroy. The Bouffs' salon was very successful and when the opportunity to purchase another salon in neighbouring Collingwood arose, they went ahead with the acquisition. The Bouffs found that there were considerable cost savings in operating both salons concurrently. Therefore, over the next decade continued to acquire 3 more salons in surrounding suburbs when they came up for sale. They incorporated the business in 2010 and invited private investment to obtain access to equity funding to continue their expansion plans. An additional expansion via share offer followed in 2016. This enabled the company to acquire an additional 9 salons as well as 5 barber shops within the inner Melbourne suburbs. It also enabled Hair Factory to establish 3 mega stores selling everything a hair consumer might need – including general hair care consumable products and hair styling appliances. These stores sell direct to the public but also have large wholesale customers.

Hair Factory decided to expand the retail business with an online presence in 2015 with the development of a website; [www.hairfactory.com.au](http://www.hairfactory.com.au). This website is an online portal where customers can order the same products that are available from the Hair Factory retail stores and have them shipped to their address anywhere in Australia. Although successful, the website hasn't generated the level of additional sales initially anticipated, largely due to initial teething problems. Mr & Mrs Bouff believe that the shift to online sales has great potential if it is given the correct attention and resources.

The Bouffs have retained control of Hair Factory via their 51% shareholding. Although both highly skilled hairdressers and competent business owners, they admit that they don't have the necessary marketing and IT skills to take the business forward into its next phase of expansion. In addition, Mr & Mrs Bouff are both reaching age 65, and after 20 years of hard work are looking forward to winding up their role in the business. They have no family members who are interested in taking on their role. Therefore, they are looking to sell their 51% share for an asking price of \$375M.

## General Financial Characteristics and Accounting Policies

The following information relates to financial characteristics and accounting policies of Hair Factory and should be considered in conjunction with the financial statements that follow:

- Annual reporting date is June 30.
- All amounts reported in the financial statement are expressed in Australian dollars rounded to the nearest thousand ('000's).
- As a large proprietary company, the *Corporations Act 2001* requires Hair Factory to prepare general purpose financial statements and have their financial statements audited. The following financial statements have been prepared on an accrual basis applying Australian Accounting Standards. The financial statements have been audited and lodged with ASIC.
- **Cost of sales and services** includes cost of products sold in shops and online as well as products used in providing services to customers.
- Hair Factory employs a combination of permanent full-time, permanent part-time and casual staff members. Hair Factory's salaries and wages are in accordance with the Australian minimum wage laws. All salaries and wages are included within **employee costs**. The company offers industry standard employee entitlements such as annual leave, sick leave and long service leave for permanent staff. They also pay minimum superannuation contributions as required by law.
- **Occupancy costs** relate to items such as contents insurance, water usage, electricity, gas and cleaning.
- **Trade receivables** represent sales to wholesale customers via mega-stores.
- **Inventories** comprise mainly of all items carried through their retail stores as well as products sold through salons and barber shops. Costs are assigned on a weighted average basis.
- **Other current assets** include prepaid expenses and inventory paid for but not yet received. These assets are considered not to be readily convertible to cash.
- **Property, plant and equipment** are carried at cost and depreciated on a straight-line basis using the following useful lives:
  - Buildings – 20 years
  - Plant and equipment – 8 years
- **Intangibles** prior to 2016 relate primarily to goodwill on acquisition of other businesses. From 2016, intangibles include website development costs.
- **Impairment** of assets relates to goodwill. Accounting standards require that goodwill be assessed on an annual basis to determine if there are any indications of impairment. Such indications were identified in 2016 and 2019 and, after an extensive valuation process, impairment losses were recognised in both reporting periods.

## Financial Statements

### Hair Factory Pty Ltd - Statement of Profit or Loss for the year ended 30 June

	2019	2018	2017	2016	2015
Revenue - Service	558,565	525,704	473,923	446,201	313,845
Revenue – Stores	280,848	214,377	194,434	166,102	56,471
Revenue – Online	79,321	77,415	65,315	32,151	0
<b>Total Revenue from Operations</b>	<b>918,734</b>	<b>817,496</b>	<b>733,672</b>	<b>644,454</b>	<b>370,316</b>
Cost of sales and services	(383,989)	(364,509)	(324,949)	(294,002)	(189,146)
<b>Gross Profit</b>	<b>534,745</b>	<b>452,987</b>	<b>408,723</b>	<b>350,452</b>	<b>181,170</b>
Interest revenue	192	392	337	562	129
Employee costs	(257,525)	(212,926)	(190,442)	(167,950)	(81,015)
Depreciation and amortisation	(27,928)	(23,140)	(17,821)	(15,056)	(10,070)
Marketing costs	(12,697)	(12,676)	(10,880)	(10,376)	(6,426)
Occupancy costs	(91,312)	(88,006)	(77,056)	(69,606)	(39,556)
Administration costs	(43,174)	(37,073)	(40,128)	(30,106)	(18,621)
Impairment of assets	(13,034)	0	0	(130,000)	0
Acquisition costs	(1,412)	(1,751)	(2,012)	(9,477)	(8,046)
Finance costs	(14,411)	(14,264)	(15,986)	(13,580)	(9,816)
<b>Profit before income tax expense</b>	<b>73,444</b>	<b>63,543</b>	<b>54,735</b>	<b>(95,137)</b>	<b>7,749</b>
Income tax expense	(8,696)	(15,419)	(15,007)	(13,072)	(4,351)
<b>Profit after income tax expense</b>	<b>64,748</b>	<b>48,124</b>	<b>39,728</b>	<b>(108,209)</b>	<b>3,398</b>

**Hair Factory Pty Ltd - Statement of Financial Position as at 30 June**

	2019	2018	2017	2016	2015
<b>Current assets</b>					
Cash and cash equivalents	45,818	57,683	62,583	29,599	120,651
Trade receivables	37,719	11,545	8,575	14,172	6,818
Inventories	98,094	97,503	92,002	85,849	45,908
Other current assets	43,409	36,661	40,351	30,065	1,690
<b>Total current assets</b>	<b>225,040</b>	<b>203,392</b>	<b>203,511</b>	<b>159,685</b>	<b>175,067</b>
<b>Non-current assets</b>					
Plant & equipment	81,416	64,169	47,540	38,652	9,927
Land & buildings	430,625	398,899	373,470	361,700	220,066
Intangibles	352,686	348,374	323,227	301,427	288,066
<b>Total non-current assets</b>	<b>864,727</b>	<b>811,442</b>	<b>744,237</b>	<b>701,779</b>	<b>518,059</b>
<b>Total assets</b>	<b>1,089,767</b>	<b>1,014,834</b>	<b>947,748</b>	<b>861,464</b>	<b>693,126</b>
<b>Liabilities</b>					
<b>Current liabilities</b>					
Trade and other payables	104,564	100,752	81,872	56,189	64,644
Borrowings	11,572	679	4,389	1,354	2,165
Tax payable	1,106	6,963	5,601	1,478	883
Provisions	25,435	21,739	16,990	16,033	15,387
<b>Total current liabilities</b>	<b>142,677</b>	<b>130,133</b>	<b>108,852</b>	<b>75,054</b>	<b>83,079</b>
<b>Non-current liabilities</b>					
Borrowings	302,416	292,535	286,159	262,676	145,032
Provisions	20,645	21,695	28,367	28,200	13,376
<b>Total non-current liabilities</b>	<b>323,061</b>	<b>314,230</b>	<b>314,526</b>	<b>290,876</b>	<b>158,408</b>
<b>Total liabilities</b>	<b>465,738</b>	<b>444,363</b>	<b>423,378</b>	<b>365,930</b>	<b>241,487</b>
<b>Net assets</b>	<b>624,029</b>	<b>570,471</b>	<b>524,370</b>	<b>495,534</b>	<b>451,639</b>
<b>Equity</b>					
Contributed equity	590,000	590,000	590,000	590,000	437,506
Retained earnings	34,029	(19,529)	(65,630)	(94,466)	14,133
<b>Total equity</b>	<b>624,029</b>	<b>570,471</b>	<b>524,370</b>	<b>495,534</b>	<b>451,639</b>
Number of shares on issue (millions)	120	120	120	120	102

**Hair Factory Pty Ltd - Statement of Cash Flows for the year ended 30 June**

	2019	2018	2017	2016	2015
<b>Cash flows from operating activities</b>					
Receipts from customers	892,560	814,526	739,269	637,100	368,086
Payments to suppliers and employees	(790,990)	(701,795)	(635,099)	(642,818)	(302,231)
Interest received	192	392	337	562	129
Interest paid	(14,411)	(14,264)	(15,986)	(13,580)	(9,816)
Income taxes paid	(14,553)	(14,057)	(10,884)	(12,477)	(5,441)
<b>Net cash from operating activities</b>	<b>72,798</b>	<b>84,802</b>	<b>77,637</b>	<b>(31,213)</b>	<b>50,727</b>
<b>Cash flows from investing activities</b>					
Payments to acquire businesses	(37,712)	(36,288)	(10,116)	(281,676)	(383,170)
Payments to acquire PPE	(44,791)	(45,639)	(43,024)	(40,465)	(26,852)
Payments to acquire intangibles	(11,744)	(8,418)	(7,139)	(7,271)	(3,160)
Proceeds from disposals of PPE				636	
<b>Net cash from investing activities</b>	<b>(94,247)</b>	<b>(90,345)</b>	<b>(60,279)</b>	<b>(328,776)</b>	<b>(413,182)</b>
<b>Cash flows from financing activities</b>					
Proceeds from issue of shares	0	0	0	152,494	414,862
Proceeds from borrowings	34,484	3,864	29,123	125,770	199,679
Repayments of borrowings	(13,710)	(1,198)	(2,605)	(8,937)	(134,599)
Dividends paid	(11,190)	(2,023)	(10,892)	(390)	(5,185)
<b>Net cash from financing activities</b>	<b>9,584</b>	<b>643</b>	<b>15,626</b>	<b>268,937</b>	<b>474,757</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>(11,865)</b>	<b>(4,900)</b>	<b>32,984</b>	<b>(91,052)</b>	<b>112,302</b>
Cash and cash equivalents at beginning	57,683	62,583	29,599	120,651	8,349
<b>Cash and cash equivalents at end</b>	<b>45,818</b>	<b>57,683</b>	<b>62,583</b>	<b>29,599</b>	<b>120,651</b>

## Common-Sized Financial Statements

### Hair Factory Pty Ltd

#### Common-sized Statement of Profit or Loss for the year ended 30 June

	2019 %	2018 %	2017 %	2016 %	2015 %
Revenue – Service	60.8	64.3	64.6	69.2	84.8
Revenue – Stores	30.6	26.2	26.5	25.8	15.2
Revenue – Online	8.6	9.5	8.9	5.0	0.0
<b>Total Revenue from Operations</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Cost of sales and services	(41.8)	(44.6)	(44.3)	(45.6)	(51.1)
<b>Gross Profit</b>	<b>58.2</b>	<b>55.4</b>	<b>55.7</b>	<b>54.4</b>	<b>48.9</b>
Interest revenue	0.0	0.0	0.0	0.1	0.0
Employee costs	(28.0)	(26.0)	(26.0)	(26.1)	(21.9)
Depreciation and amortisation	(3.0)	(2.8)	(2.4)	(2.3)	(2.7)
Marketing costs	(1.4)	(1.6)	(1.5)	(1.6)	(1.7)
Occupancy costs	(9.9)	(10.8)	(10.5)	(10.8)	(10.7)
Administration costs	(4.7)	(4.5)	(5.5)	(4.7)	(5.0)
Impairment of assets	(1.4)	0.0	0.0	(20.2)	0.0
Acquisition costs	(0.2)	(0.2)	(0.3)	(1.5)	(2.2)
Finance costs	(1.6)	(1.7)	(2.2)	(2.1)	(2.7)
<b>Profit before income tax expense</b>	<b>8.0</b>	<b>7.8</b>	<b>7.5</b>	<b>(14.8)</b>	<b>2.1</b>
Income tax expense	(0.9)	(1.9)	(2.0)	(2.0)	(1.2)
<b>Profit after income tax expense</b>	<b>7.0</b>	<b>5.9</b>	<b>5.4</b>	<b>(16.8)</b>	<b>0.9</b>

**Hair Factory Pty Ltd**

**Common-sized Statement of Financial Position as at 30 June**

	2019 %	2018 %	2017 %	2016 %	2015 %
<b>Current assets</b>					
Cash and cash equivalents	4.2	5.7	6.6	3.4	17.4
Trade receivables	3.5	1.1	0.9	1.6	1.0
Inventories	9.0	9.6	9.7	10.0	6.6
Other current assets	4.0	3.6	4.3	3.5	0.2
<b>Total current assets</b>	<b>20.7</b>	<b>20.0</b>	<b>21.5</b>	<b>18.5</b>	<b>25.3</b>
<b>Non-current assets</b>					
Plant & equipment	7.5	6.3	5.0	4.5	1.4
Land & buildings	39.5	39.3	39.4	42.0	31.7
Intangibles	32.4	34.3	34.1	35.0	41.6
<b>Total non-current assets</b>	<b>79.3</b>	<b>80.0</b>	<b>78.5</b>	<b>81.5</b>	<b>74.7</b>
<b>Total assets</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Current liabilities</b>					
Trade and other payables	9.6	9.9	8.6	6.5	9.3
Borrowings	1.1	0.1	0.5	0.2	0.3
Tax payable	0.1	0.7	0.6	0.2	0.1
Provisions	2.3	2.1	1.8	1.9	2.2
<b>Total current liabilities</b>	<b>13.1</b>	<b>12.8</b>	<b>11.5</b>	<b>8.7</b>	<b>12.0</b>
<b>Non-current liabilities</b>					
Borrowings	27.8	28.8	30.2	30.5	20.9
Provisions	1.9	2.1	3.0	3.3	1.9
<b>Total non-current liabilities</b>	<b>29.6</b>	<b>31.0</b>	<b>33.2</b>	<b>33.8</b>	<b>22.9</b>
<b>Total liabilities</b>	<b>42.7</b>	<b>43.8</b>	<b>44.7</b>	<b>42.5</b>	<b>34.8</b>
<b>Net assets</b>	<b>57.3</b>	<b>56.2</b>	<b>55.3</b>	<b>57.5</b>	<b>65.2</b>
<b>Equity</b>					
Contributed equity	54.1	58.1	62.3	68.5	63.1
Retained earnings	3.1	(1.9)	(6.9)	(11.0)	2.0
<b>Total equity</b>	<b>57.3</b>	<b>56.2</b>	<b>55.3</b>	<b>57.5</b>	<b>65.2</b>

## Financial Statement Ratios

	2019	2018	2017	2016	2015
Return on equity (%)	10.8	8.8	7.8	(22.9)	1.4
Return on assets (%)	8.4	7.9	7.8	(10.5)	4.1
Gross profit margin (%)	58.2	55.4	55.7	54.4	48.9
EBIT profit margin (%)	9.6	9.5	9.6	(12.7)	4.7
Operating cash flow to sales (%)	7.9	10.4	10.6	(4.84)	13.7
Asset turnover (times p.a.)	0.87	0.83	0.81	0.83	0.86
Days inventory	93	95	100	82	78
Days sales	9.8	4.5	5.7	5.9	5.6
Days purchases	97	90	76	66	81
Current ratio	1.58	1.56	1.87	2.13	2.11
Quick ratio	0.59	0.53	0.65	0.58	1.53
Debt ratio (%)	42.7	43.8	44.7	42.5	34.8
Interest coverage (times)	6.10	5.45	4.42	(6.01)	1.79
Debt coverage	4.44	3.71	4.05	(9.32)	3.12
Net tangible asset backing (\$)	2.26	1.85	1.68	1.62	1.60
Earnings per share (\$)	0.54	0.40	0.33	(0.90)	0.03
Dividends per share (\$)	0.09	0.02	0.09	0.00	0.05
Dividend payout ratio (%)	17	4	27	0	153