Question: Financial Accounting and Financial Statement Analysis (47 points)

Dot.co is a publicly listed company. Its financial statements for the year ended June 30th, 2017 including comparatives are shown below.

Statement of profit or loss and other comprehensive income for the year ended:

In USD 1,000		30/06/2017	30/06/2016
Sales		620,000	500,000
Cost of goods sold		-436,000	-372,000
Gross profit		184,000	128,000
Distribution expenses		-72,000	-48,000
Marketing and administration expenses		-44,000	-32,000
Finance costs	- loan interest	-3,000	-5,000
	- lease interest	-5,000	-2,000
Profit before tax		60,000	41,000
Income taxes		-20,000	-15,000
Profit for the year		40,000	26,000
Other comprehensive income for the year [note (i)]		27,000	nil
Total comprehensive income for the year		67,000	26,000

Statements of financial position as at:

In USD 1'000	June 30th 2017	June 30th 2016
Property, plant & equipment (incl. finance leases) [note (i) & (ii)]	280,000	214,000
Deferred development expenditure [note (ii)]	20,000	nil
Total non-current assets	300,000	214,000
Inventories	66,000	76,000
Trade accounts receivable	59,000	49,000
Cash and cash equivalents	1,000	21,000
Total current assets	126,000	146,000
Total assets	**426,000**	**360,000**
Share capital (USD 1.00 per share)	160,000	160,000
Revaluation reserve [note (i)]	27,000	nil
Retained earnings	64,000	35,000
Total equity	251,000	195,000
8% loan notes	28,000	62,500
Deferred tax liabilities	30,000	16,000
Finance lease obligation	24,000	18,000
Total non-current liabilities	82,000	96,500
Finance lease obligation	15,000	12,000
Trade accounts payable	53,000	42,000
Current tax liabilities	25,000	14,500
Total current liabilities	93,000	68,500
Total equity and liabilities	**426,000**	**360,000**

Notes:

(i) On October 1st 2016 Dot.co acquired additional plant under a finance lease that had a fair value of USD 30 million. On this date it also revalued its property upwards by USD 40 million. Dot.co has transferred USD 13 million of the resulting revaluation reserve thus created to deferred taxes. There were no disposals of non-current assets during financial year 2016/2017.

(ii) Depreciation of property, plant and equipment was USD 18 million and amortisation of the deferred development expenditure was USD 4 million for the year ended June 30th 2017.

a) Prepare a statement of cash flows for Dot.co for the year ended June 30th 2017, in accordance with IAS 7 *Statement of Cash Flows*, using the indirect method.
[Note: Table 1 provided below may help you with solving the problem at hand.]
(27 points)

Table 1:
Dot.co – Statement of cash flows for the year ended June 30th 2017

In USD 1,000	
Operating activities	
Profit before tax	…………………
Adjustments to reconcile profit before tax to net cash flows:	
Depreciation of property, plant and equipment	…………………
Amortisation of intangible assets	…………………
Finance costs	…………………
Working capital adjustments:	
Change in inventories	…………………
Change in trade accounts receivable	…………………
Change in trade accounts payable	…………………
Finance costs paid	…………………
Income tax paid	…………………
Net cash from operating activities	**…………………**
Investing activities	
Purchase of property, plant and equipment	…………………
Deferred development expenditure	…………………
Net cash used in investing activities	**…………………**
Financing activities	
Repayment of 8% loan notes	…………………
Repayment of finance lease obligations	…………………
Dividend paid	…………………
Net cash used in financing activities	**…………………**
Net decrease in cash and cash equivalents	-20,000
Cash and cash equivalents at 1 July 2016	21,000
Cash and cash equivalents at 30 June 2017	1,000

b) Fill Table 2 below and comment on the comparative performance (FY 2016/17 vs FY 2015/16) of Dot.co in terms of its (1) gross margin, (2) operating margin, (3) operating expenses in % of sales, (4) asset turnover, (5) return on capital employed (ROCE), and (6) gearing. (20 points)

Notes:

- ROCE = Operating profit / Capital employed = EBIT / (Equity + financial debt - cash & cash equivalents)
- Gearing = Financial debt (gross) / Equity
- For the sake of simplicity, base your calculations of (4), (5), and (6) on year-end balance sheet figures (and not on period averages).
- The ratios (1) to (6) for financial year 2015/2016 have already been calculated, see Table 2 below.

When commenting the comparative performance in terms of (1) to (6), also try to answer the following questions:

- (1) Gross margin
  What could be the reasons for the change in gross margin?
- (2) + (3) Operational margin and operational expenses in % of sales
  What could be the reasons for the change in operational margin? Do you see a correlation between operating costs and (higher) sales?
- (4) Asset turnover
  Did the heavy investment in PPE and in development negatively impact asset turnover? Does the most recent evolution bode well for future periods? Did working capital management help?
- (5) ROCE
  Which subcomponents of ROCE contributed positively, if any?
- (6) Gearing
  Where did the increase in equity come from (give 2 sources)? Where did the funds to repay debt come from (give 2 sources)? Why is debt in the case of Dot.co not necessarily a bad thing?

Table 2:
Dot.co – Ratios for comparative performance

	2016/17	2015/16
Gross margin	……………	25.6%
Operating margin	……………	9.6%
Operating expenses in % of sales	……………	16.0%
Asset turnover	……………	1.39x
Return on capital employed	……………	18.0%
Gearing	……………	47.4%