CHAPTER 5

FINANCIAL PERFORMANCE OF ET SHOPPE

5.1 Forecasted Cash Flow for ET Shoppe

In the initial business plan, the forecasted balance sheet for the ET Shoppe is attached in appendix 3. Summarized in Table 6 is the forecasted cash flow for the first five years for estimated sales, number of retail and new outlets, total outlets and net profit.

TABLE 6

FORECASTED CASH FLOW FOR ET SHOPPE

	Year 1	Year 2	Year 3	Year 4	Year 5
Retail Sales value	456,000	6,120,000	16,320,000	30,672,000	38,808,000
Franchise Sales Value	0	4,992,000	17,856,000	35,136,000	55,872,000
No. Retail outlet	1	4	9	15	15
No.of franchising outlet	0	9	21	39	57
Total Outlets	1	13	30	54	72
Net Profit	-13%	0.6%	2.5%	3.1%	3.8%

(TNRD (1994))

It is rather ironic that the decision to carry out the setting up of ET Shoppe was approved despite the fact that the projected profit margin for year 5 gave a poor return of only 3.8% for sales value of RM38 million

5.2 Actual Financial Report of ET Shoppe for 1995 and 1996

The audited financial report for ET Shoppe in 1995 and 1996 is as attached in Appendix 4 and the financial analysis is in Table 7.

TABLE 7

FINANCIAL ANALYSIS FOR ET SHOPPE FOR 1995 & 1996

	Formula	1996	1995
Profitability Ratio			
Gross profit Margin	Gross Profit X 100% / Sales	10%	21%
Net Profit Margin	Net Profit X 100% / Sales	-73%	-81%
Liquidity Ratio			
Current ratio	Current Asset / Current liability	0.67	1.03
Quick ratio/acid test ratio	Current Asset -Stock / Current liability	0.13	0.24
Asset Management Ratio			
Stock Turnover Ratio	Average Stock X 365 / Cost of goods	6.63 month	19.4 month
Total Asset Turnover Ratio	Sales / Total Asset	0.58	0.25
Current Asset Turnover Ratio	Sales / Current Asset	0.82	0.31

5.2.1 Profitability Ratio

The profitability ratio can be analyzed in terms of gross profit margin and net profit margin .Profitability ratios reflect the effectiveness of all managerial policies and decisions. A company's production, marketing, and financial activities all culminate in a particular level of profitability. The higher the percentage the better the company's financial standing is. (Cooley (1994))

The gross profit margin has reduced from 21% to 10% and the net profit margin has correspondingly reduced by 8% in 1996 compared with 1995 with the net profit of below 73% in 1996 compared with below 81% in 1995.

The main reason for this decline is the provision for stock obsolescence which is RM 27,561. The Office repair and maintenance cost has also increased by over RM 4000 per year. The promotion at campaign has also increased. However, the training and meeting cost have reduced. The rental cost remains the bulk of ET Shoppe expenses (about 30%)

The cost of stock obsolescence is high although the company had just been established for one year. Stock obsolescence is mainly due to the stock value that is carried by the company had reduced price in the open market. To avoid this loss , management must make sure that the stock carried is sold to avoid it being obsolete. Special promotions must be carried out even to sell it at cost price rather than suffer losses.

ET Shoppe should consider the possibility of using TNB's available office space in TNB districts so that the overheads like rent and utilities expenses can be substantially reduced.

5.2.2 Liquidity Ratio

Liquidity ratio show a company's potential for paying its short-term and maturing long-term debt. Without adequate liquidity even the most profitable companies find themselves in financial trouble. The current ratio measure current assets per dollar of current liabilities. It indicates the extent to which current assets can meet the claims of short-term creditors which is a company's most pressing claims. A trade-off exist between liquidity and expected profitability. Financial managers view excessive liquidity as an investment in unproductive assets. Excessive liquidity depresses the total asset turnover (Net sales/Total asset) and, in turn, the return on total assets (and on common equity). Extremely low liquidity, however, is a signal that the company may have trouble paying its bills. Prudent financial management calls for moderate liquidity, trending upward for highly levered companies and downward for conservatively financed companies (Cooley, (1994))

The current ratio for ET Shoppe dropped from RM1.03 in 1995 to RM0.67 in 1996. The performance in terms of liquidity ratio has dropped in 1996 compared with 1995. This means that ET Shoppe is in worse off position in 1996 to meet the claim of short term creditors.

The quick ratio, acid test shows how effective the company is to settle its short terms obligations immediately. Cash, marketable securities, and accounts receivable are more liquid than inventory. Cash is completely liquid, the conversion of marketable securities to cash takes little time, and accounts receivable are one step away collection from cash. Inventory, on the other hand, is two steps away from cash sales and collection. Thus the quick ratio (also called the acid test ratio) excludes inventory from its calculation and shows the cash and near-cash assets per dollar of current liabilities. (Cooley (1994))

The acid test ratio has declined in 1996 compared to 1995 from 0.24 to 0.13 .ET Shoppe is not a good position to settle its immediate obligations.

5.2.3 Asset Management Ratio

The asset management ratios measure the efficiency of using assets to generate sales revenue. Asset management ratios are called turnover ratios, net sales divided by a balance sheet item. A turnover ratio shows the sales revenue generated per dollar invested in assets. The assets management ratio indicates the efficiency in the management in utilizing the assets of the company.(Cooley, (1994))

The Stock turnover ratio indicates how long it takes to clear the stock of goods. In 1996 this situation is improved tremendously from 19.14 months to 6.6 months.

The total asset turnover ratio test is to indicate whether the assets have been fully utilized to generate sales. Larger turnovers indicate that more sales dollars are being squeezed from each dollar invested in total assets. Excess assets in the form of idle plant and equipment decrease total asset turnover. the same result occurs with a liberal credit policy leading to a buildup of accounts receivable: or slack inventory control may cause slow moving inventory to accumulate excessively. For successful asset management, managers must strike a balance in company policies between too large and too small an investment in assets. The higher ratio indicates a better performance. For ET Shoppe the asset turnover ratio has improved from 0.25 in 1995 to 0.58 in 1996. This implies that the ET Shoppe management are utilising their assets better.

The current asset turnover ratio shows company sales revenue per dollar of current assets. The current asset turnover ratio has increased from 0.31 in 1995 to 0.82 in 1996.

However, the company is still in the red after the first two years of operations with the situation financially getting into more unfavorable position.

5.3 Comparison Between Forecasted Cash Flow And Actual Performance Of ET Shoppe

The estimated forecast for actual financial performance of ET Shoppe and the actual performance differs mainly due to the following reasons:

- The estimated sales are much higher than the actual sales. In the first year the estimated sales was RM 456,000 whereas the actual sales achieved is RM 143,336 or 31% of target. For the second year the actual sales was RM 208,080 instead of the projected sales of RM 6,120,000 from 4 retail outlets and RM 4,992,000 sales from the 9 franchise stores.
- The projected cash flow was too optimistic to plan for 13 new outlets in the second year which did not materialize.