

Exercise-Pontoon plc

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You are required to advise the directors of Pontoon:

- **on the performance and position of their company;**
- **whether you believe their investment proposal will improve the company's situation;**
- **on which, if any, of their proposed methods of finance is the most appropriate.**

	<i>Industry</i>	<i>20X2</i>	<i>20X1</i>
Operating profit before interest and tax to capital employed (ROCE)	15.0%	20.1%	16.8%
Operating profit before interest and tax to sales	10.0%	10.6%	9.8%
Asset turnover (asset utilisation ratio)	1.5 times	1.89 times	1.72 times
Gross profit to sales	35.0%	31.9%	31.7%
Current (working capital) ratio	2.2:1	2.4:1	2.4:1
Quick (acid test) ratio	1.1:1	0.97:1	1.04:1
Average age of trade receivables (collection period)	- based on year-end	73 days	45 days
	- based on average	37 days	32 days
Average age of inventory (stockholding period)	- based on year-end	206 days	116 days
	- based on average	95 days	74 days
Interest cover	3 times	8.3 times	6.7 times
Gearing ratio (D/(D+E)) (long-term loan capital / (L-T loan capital + shareholders' funds))	50.0%	24.1%	25.1%

Profitability

	<i>Industry</i>	<i>20X2</i>	<i>20X1</i>
Operating profit before interest and tax to capital employed (ROCE)	15.0%	20.1%	16.8%
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ROCE: Improved over the year and is **significantly above** the industry average.

Possible explanation:

- Capital employed may be relatively low, as net profit margin is in line with the industry average and asset turnover is above average.
- Older machinery may be heavily depreciated, resulting in low carrying values and **potentially overstating ROCE**.
- This does seem to tie in with the fact that the directors are now seeking to re-equip.

Gross profit margin:

- **Below** the industry average.
- Potential issues with pricing, material costs, production efficiency or inventory management.

Profitability

	<i>Industry</i>	<i>20X2</i>	<i>20X1</i>
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Operating profit before interest and tax to sales	10.0%	10.6%	9.8%
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Recomputing the figures based on their estimates of €4m for the new machinery

- revised asset turnover of 1.63 times – closer to the industry.
- an improvement in both operating profit before interest and tax to sales and ROCE to 14.9% and 24.3% respectively.
- increase the gross profit margin to 36.2%, slightly above the industry average.

Liquidity

- There has been **little change** in either the **current ratio** or the **quick ratio** over the year, and both are **similar to the industry average**.
- Liquidity appears satisfactory, but ratios show a downward trend.
- **Recommendation:** Avoid further deterioration in liquidity and actions that could put additional pressure on the company's short-term financial position.

	<i>Industry</i>	<i>20X2</i>	<i>20X1</i>
Current (working capital) ratio	2.2:1	2.4:1	2.4:1
Quick (acid test) ratio	1.1:1	0.97:1	1.04:1

Interest cover

Interest cover has **improved** over the year and is well **above** the typical industry cover. It would appear that there is an ample 'safety margin', should the company wish to issue further loan stock.

	<i>Industry</i>	<i>20X2</i>	<i>20X1</i>
Interest cover	3 times	8.3 times	6.7 times

Trade receivables

The **average age of trade receivables** (the collection period) has **slightly increased**, but **still compares very favourably with the industry average**.

Sales have increased, despite the apparently less favourable credit terms offered.

Potential reasons:

- lower selling prices than industry?
- a unique or monopoly position?
- better and more efficient than their rivals at collecting debts?

Potential risk:

An overly strict credit policy may cause **customer dissatisfaction** and **loss of sales**, especially in a highly competitive market.

		<i>Industry</i>	<i>20X2</i>	<i>20X1</i>
Average age of trade receivables				
(collection period)	- based on year-end	73 days	45 days	34 days
	- based on average		37 days	32 days

Inventory

		<i>Industry</i>	<i>20X2</i>	<i>20X1</i>
Average age of inventory	- based on year-end	206 days	116 days	83 days
(stockholding period)	- based on average		95 days	74 days

The **average age of inventory (the stockholding period)** has **slightly increased**, but, again, compares **very favourably with the industry**.

Potential benefits:

lower inventory costs

Potential reasons:

company may not be stocking sufficient variety or quantity of finished product fully to meet customers' and potential customers' requirements.

Potential risks:

Insufficient finished goods may lead to lost sales, while raw material shortages may disrupt production.

Recommendation: The company may use Just-in-Time (JIT) system. Balance inventory efficiency with adequate stock levels and contingency plans to minimise supply chain disruptions and additional costs.

Gearing

Although the company's **gearing** level has **remained constant** at 1:3; **very low in relation to the industry average**.

Potential reasons:

- The board may prefer a conservative financing strategy, typical of smaller, owner-managed businesses.
- High business risks: **wide-ranging fluctuations in sales and profits** in the industry, so Pontoon's reluctance deliberately to take on extra financial risk by borrowing

Overall assessment:

A conservative capital structure provides financial flexibility, although additional borrowing could support future growth.

	<i>Industry</i>	<i>20X2</i>	<i>20X1</i>
Gearing ratio (D/(D+E)) (long-term loan capital / (L-T loan capital + shareholders' funds))	50.0%	24.1%	25.1%

Conclusion

Strong financial position: Profitability and gearing are better than industry averages, while liquidity is broadly in line with the industry average.

Investment decision: The investment appears financially sound.

Liquidity concerns: Avoid placing excessive pressure on liquidity; using an overdraft to finance a long-term asset is not recommended.

Working capital management: Very short debtor collection and inventory holding periods may indicate efficient management, but could also suggest an overly aggressive approach.

Borrowing capacity: High interest cover suggests the company can probably meet additional interest payments, although profit fluctuations remain a risk.

Right issue: Raising equity finance without creating additional interest obligations.

Recommendation: A combination of financing sources.

Exam revision

General guidelines

- The emphasis of the exam is on **understanding** rather than rote memorisation.
- You are not required to memorise everything, but you need to comprehend the material.

Memory-You don't need to memorise	But you need to understand
Examples	Examples
The history of GRI, SASB, ISSB, ESRS	Why do we need these ESG disclosure standards What are the difference between them Benefits and potential costs
Literature: Authors and detailed research findings	Theoretical perspectives and implications behind research findings; use them to explain the practice
Detailed history of the development of IFRS and the full name of the corresponding organisational structure	Why IFRS is important and the potential challenges

Structure of the exam (20 marks)

☐ Multiple Choice Questions

- 8 marks
- 10 questions

☐ Open Short-Answer Questions:

- 4 marks
- 2 questions

☐ Calculation Questions:

- 8 marks
- 4 questions

1.5 hours

Multiple Choice Questions:

- Coverage: weeks 1-6
- Select the most appropriate option
- No discount for wrong answers

Open Short-Answer Questions:

- To prepare for this section, you can focus on the slides and discussions in class.
- Coverage: 1 for ESG reporting, 1 for financial reporting

☐ **Clear handwriting!!**

☐ A reasonable level of explanation is expected in your answers

☐ You may underline the keywords

Calculation Questions:

- Coverage: financial reporting (financial statements, WCR, ratio analysis)
- The calculation questions **will not** be longer than the in-class exercises, considering the time constraints.
- To prepare for this section, you should familiarize yourself with the following:
 - ☐ The structure of financial statements, particularly the balance sheet and income statement.
 - ☐ Understanding and calculating the working capital requirement.
 - ☐ The formulas for financial ratios and, importantly, the implications of each ratio.

Other information

- Group Work Deadline
- 3 Exam Classrooms: I will assign you to different classrooms and inform you of your room allocation before the exam
- 9-11 am (exam duration 1.5 hours)
- Remember to bring your pen, ID, and a calculator (without text editing function)
- Pedagogical Survey
- Exam paper review and repeat assessment (04/01/2027)