Answers

Section C

Mims Co

(a) Statement of profit or loss for the year ended 31 December 20X5

	$'000
Revenue	24,300
Cost of sales (11,600 – 700 inventory)	(10,900)
Gross profit	**13,400**
Administrative expenses (10,900 + 1,400 provision + 1,300 promoting brand + 100 amortisation – 1,000 investment property depreciation – 3,000 dividend)	(9,700)
Distribution costs	(7,300)
Loss from operations	**(3,600)**
Finance costs	(1,400)
Investment income (500 + 2,000 investment property gain)	2,500
Loss before taxation	**(2,500)**
Taxation (140 – 1,200 current + 500 movement in deferred tax)	560
Loss for the year	**(1,940)**

(b) Statement of changes in equity for the year ended 31 December 20X5

	Share capital $'000	Share premium $'000	Retained earnings $'000
Balance at 1 January 20X5	60,000	–	43,200
Prior period error	–	–	(700)
Restated balance 1 January 20X5	60,000	–	42,500
Share issue	15,000	37,500	–
Profit for the year	–	–	(1,940)
Dividends paid (75,000 x $0·04)	–	–	(3,000)
Balance 31 December 20X5	75,000	37,500	37,560

(c) Extracts from statement of cash flows for the year ended 31 December 20X5

	$'000
Cash flows from investing activities	
Purchase of brand	(2,000)
Purchase of investment property	(20,000)
Net cash used in investing activities	(22,000)
Cash flows from financing activities	
Proceeds from issue of share capital	52,500
Dividends paid	(3,000)
Net cash from financing activities	49,500

Pinardi Co

(a) Gain on disposal:

	$'000
Proceeds	42,000
Less: Net assets at disposal	(35,000)
Less: Goodwill at disposal (W1)	(4,200)
Gain on disposal	2,800

(W1) Goodwill at disposal

	$'000
Goodwill at acquisition	6,000
Less: Impairment (6,000 x 30%)	(1,800)
Unimpaired goodwill at disposal	4,200

(b) **Explanation of Silva Co disposal**

Silva Co is likely to meet the criteria as it is a separate major line of operations which has been disposed of during the year.

As a discontinued operation, the results would be removed and presented separately on the face of the statement of profit or loss together with the gain (post-tax) on disposal of $2·8m.

As Silva Co was sold on 1 January 20X7, there are no results to incorporate for the current year. However, the results of 20X6 should be shown as a discontinued operation for comparative purposes.

(c) Ratio calculations:

Ratio	Working	20X7	Working	20X6
Gross profit margin	(50,700/98,300) x 100	51·6%	(50,600/122,400) x 100	41·3%
Operating profit margin	(17,000/98,300) x 100	17·3%	(13,200/122,400) x 100	10·8%
Interest cover	(17,000/3,200)	5·3 times	(13,200/5,500)	2·4 times
Inventory turnover days	(13,300/47,600) x 365	102 days	(22,400/71,800) x 365	114 days

(d) Analysis

Performance

The overall revenue is down by $24m, which may be largely due to the disposal of Silva Co which is in the 20X6 results but contributed no revenue in 20X7.

Last year, Silva Co contributed $36m in revenue. Removing this from the 20X6 results shows that there has been a like-for-like increase of $11·9m (($122·4m – $36m) – $98·3m) from the fragrance and cosmetics divisions.

The gross profit margin is up significantly from 20X6 to 20X7, from 41% to 52%. We can see that the gross profit margin of Silva Co in 20X6 was only 35% ($12·6m/$36m), so the other parts of the group were able to generate higher gross profit margins historically.

The operating profit margin has increased, although not quite as dramatically as the increase in gross profit margin. In fact, the operating expenses have only decreased by $3·7m, despite the $24·1m decrease in revenue. There are some factors to consider within the operating expenses for 20X7. There is a one-off exit fee of $3m for the cosmetics division to exit the lease. While this is expensive, the division would have been paying $25m over 10 years so will ultimately save a significant amount of money.

In addition to this, the effects of foreign exchange gains and losses are included in the operating expenses line. In 20X6, there was a gain of $3m but in 20X7 there was a loss of $1m which will have reduced operating profit. This shows that the Pinardi group have quite large exposure to foreign currency risk.

The interest cover has increased from 2·4 to 5·3 during the year, which is a combination of both an increase in operating profits and a decrease in finance costs. The finance costs are likely to have decreased due to the exit from the lease.

Position

The decrease in non-current liabilities is likely to be partly due to the removal of the lease liability for the cosmetics division, which had 10 years remaining.

Some of the non-current liabilities may also have been paid off from the proceeds from the sale of Silva Co. Silva Co was sold for $42m, but cash has only increased by around $17m. Therefore, the Pinardi group may have used some of the cash to reduce the non-current liabilities in the group.

It is also worth noting that in 20X6 the assets and liabilities would have included the Silva Co figures. It may have been that Silva Co had significant non-current liabilities which were removed when it was sold.

The inventory turnover figure shows that the Pinardi group is able to turn over inventory more quickly than previously. The inventory days are high, but the nature of the Pinardi group products will mean that they are not immediately perishable so this is unlikely to be a significant concern.

In 20X6, the Pinardi group inventory turnover period would have included the figures relating to Silva Co. The removal of this seems to show that the inventory turnover period relating to cosmetics and fragrance is lower than that of the jewellery sector.

Conclusion *(marks awarded for sensible conclusion)*

Whilst Silva Co does generate profits, the disposal seems to have been a good move. Silva Co's results have actually improved since disposal, showing it is not a struggling business. The additional focus on the remaining divisions has generated more profits for the Pinardi group, particularly now the cosmetics division is utilising the group property and no longer requiring leased premises.

Other comments which candidates may produce which could be given credit

It should be noted that there is now $2m revenue relating to the use of the Silva Co name which will be there each year. Removing this for comparability shows that the like-for-like increase in revenue is $10m.

The inclusion of the $2m income from Silva Co with no cost of sales will have increased the gross profit margin. Even removing this reduces it to 50·6% so has not accounted for a significant movement.

Whilst cash has only increased by $17m despite the $42m sale, it may have been that Silva Co had a significant amount of cash in the bank, which was removed from the group when Silva Co is disposed of.

The exclusion of the $36m revenue and $6·6m operating expenses of Silva Co from the 'continuing operations' consolidated statement of profit or loss for 20X6 suggests that operating expenses as a % of revenue in 20X6 were 35·6% (30,800 [37,400 – 6,600]/86,400 [122,400 – 36,000]), which is actually higher than that for 20X7 (34·2%). On a like-for-like basis this, along with the improvement in the gross profit margin, suggests a better financial performance for the Pinardi group without Silva Co.

Section C

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