Performance Evaluation Summary

Methven LTD

Cy Messenger

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Introduction

Established in 1886, Methven Limited (Methven) is a New Zealand (NZ) based limited company and is the countries longest serving and largest supplier of showerheads, faucets and hot water valves. Methven was first listed on the NZ Stock Exchange in 1936, only to be delisted at the start of the Second World War. Methven has currently been listed since 2004. Methven has international holdings and distribution chains throughout Australia, the United Kingdom (UK) and the USA, as well as a procurement office in China, and employ more than 260 staff worldwide.

Methven's state of the art production plant is located in Auckland, New Zealand where they employ 70 staff. The company is recognised for its cutting edge design, environmental-mindedness and world leading innovation, and is honoured regularly with both domestic and international awards. (Methven Limited, N.D)

This report is a performance evaluation summary making comparisons and comments based on annual finances dated 2009 – 2011.

1.0 Company Structure

Methven is run as a limited liability company. There are many advantages for Methven being a company compared to being a partnership. These advantages include:

- Methven being able to be a separate legal entity, therefore not limiting the business life of the company, as a company has the legal capacity of a person in its own right. A partnership is limited to the life of the owners.
- Owners in a company structure have limited liability so are not responsible for any debt that other shareholders may incur, where as in a partnership each partner is responsible for the actions of other partners, creating greater asset risk.
- Companies have greater access to funding, potentially with a large pool of shareholding investors, as well as access to debt funding. Where as a partnership is limited only to the partners. A partnership can have a maximum of 25 partners.
- A company has the ability to employ management teams, which are separate from company ownership, therefore being able to select key specialist managers to run the company.
- In order to expand offshore a business must be registered as a company. Therefore if Methven were a partnership it would not have been able to expand into Australia and the UK.
- Finally there are potential tax advantages from being a company, as well as potentially seeing an increase in share prices if listing on the stock exchange.

The disadvantages of being a company compared to being a partnership may include:

- Companies have a higher establishment fee and are governed by extensive regulations, including the requirement of producing annual financial reports, where a partnership is not governed so extensively.

- With growth, company structure can lead to the loss or dilution of the original ownership control due to a loss in majority shareholding or the board of directors assuming greater company control. In a partnership the business is often managed by the business owners.

- Company's often have greater pressure for short-term performance and are subject to income tax on every dollar of profit earned, where as a partnership may have a tax threshold.
- Finally companies may be subject to greater scrutiny from analysts and the public, particularly if they are listed on the stock exchange. (Atrill, McLaney, Harvey, Jenner, & Weil, 2011)

2.0 Performance Analysis

Based on information gathered from Methven's 2011, 2010 and 2009 Annual Reports, my own calculations, and information gathered from the NZX company research database, the following is an analysis of publically listed company, Methven LTD.

2.1 Company Profitability

	2011	2010	2009
Return on ordinary shareholders funds (ROSF)	9.15%	14.05%	17.81%
Return on total assets (ROA)	5.49%	8.90%	9.08%
Return on capital employed (ROCE)	8.59%	14.51%	13.34%
Net profit margin	4.52%	7.70%	7.94%
Gross profit margin	40.67%	38.35%	40.56%

Figure 1: (see appendix 1 for calculations)

- <u>ROSF:</u> Shows a negative trend, seeing a fairly low return, but still see's better return than a term deposit.
- <u>ROA:</u> Shows a negative trend, seeing a lower return due to a significant reduction in net profit.
- <u>ROCE:</u> Shows a fluctuating trend with movement in share capital, but see's a lower return in 2011 due again to a significant reduction in net profit.
- <u>Net profit margin:</u> Shows a negative trend, seeing a lower profit margin. A significant reduction in 2011 is due mainly to a NZ$2m loss in the UK business as described later in this report.
- <u>Gross profit margin:</u> Shows fluctuation but has strengthened in 2011, seeing a better margin on lower sales, potentially due to more efficiency in operations with the new computer system in NZ. (Methven LTD[3], 2011)

2.2 Company Asset Efficiency

	2011	2010	2009
Average inventory turnover	4.13 mnths	4.20 mnths	4.59 mnths
Average debtors settlement period	2.24 mnths	2.28 mnths	2.29 mnths
Average creditors settlement period	2.12 mnths	2.05 mnths	2.01 mnths
Asset turnover period	9.88 mnths	10.19 mnths	10.50 mnths

Figure 2: (see appendix 2 for calculations)

- Average inventory turnover: Shows a positive decline in turnover time, inventory spending less time in the warehouses.
- Average debtors settlement period: Shows a positive decline in settlement time, debtors taking less time to pay accounts.
- Average creditors settlement period: Shows an increase in the time that Methven takes to settle creditor accounts.
- Asset turnover period: Shows a positive decline in turnover time, suggesting that assets are being used more productively.

2.3 Company Liquidity

	2011	2010	2009
Current Ratio	2.11:1	1.17:1	2.01:1
Acid test ratio	1.05:1	0.62:1	0.97:1
Cash flow from operations ratio	0.37:1	0.36:1	0.53:1

Figure 3: (see appendix 3 for calculations)

- Current ratio: Shows fluctuation with a positive increase in 2011, seeing a good current ratio with current assets comfortably covering current liabilities.
- Acid test ratio: Shows fluctuation with a positive increase in 2011, seeing liquid current assets cover current liabilities.
- Cash flow from operations ratio: Shows fluctuation with a slight increase from 2010 to 2011, but a low ratio due to Methven have a relatively low cash flow from operations compared to debtors.

2.4 Company Capital Structure

	2011	2010	2009
Gearing ratio	31.77%	0.00%	31.38%
Interest cover ratio	4.32:1	9.72:1	4.27:1

Figure 4: (see appendix 4 for calculations)

- <u>Gearing ratio:</u> Shows a slight increase in long-term lending from 2009 to 2011, but is still not particularly high. 2010 may be misleading as no long-term lending was published for that year.
- <u>Interest cover ratio:</u> Shows fluctuation due to no long-term lending figure being published in 2010. Cover otherwise see's a slight positive increased from 2009 to 2011.

2.5 Company Market Performance

	2011	2010	2009
Dividends per share	10.00c	11.00c	11.75c
Dividend payout ratio	154.29%	93.70%	81.14%
Dividend yield ratio	6.40%	7.00%	9.80%
Earnings per share	7.10c	11.70c	15.10c
Operating cash flow per share	13.76c	9.49c	5.99c
Price earnings ratio	21.97:1	13.5:1	10.21:1

Figure 5: (see appendix 5 for dividend payout ratio and price earnings ratio calculations) Operating cash flow per share (Company Research, 2011) Dividends per share, dividend yield ratio, earnings per share (Methven LTD 2, 2011) (Methven LTD, 2010)

- <u>Dividends per share:</u> Shows a negative trend, but not significant considering the decrease in profitability.
- <u>Dividend payout ratio:</u> Shows a strong increase with the 2011 payout being 1.5 times the net profit, showing a strong commitment to shareholders.
- <u>Dividend yield ratio:</u> Shows a negative decline, but still better than a term deposit.
- <u>Earnings per share:</u> Shows a negative decrease, due to a significant reduction in net profit.
- <u>Operating cash flow per share:</u> Shows a significant positive trend.
- <u>Price earnings ratio:</u> Shows a positive trend, although profitability is down, the market shows confidence in Methven's ability to return to higher profits, with a low earnings per share rate relative to share price.

3.0 Geographic Segmentation

Methven operates businesses in three major countries; New Zealand, Australia (Aust) and the UK. Methven also operates to a lesser extent in the USA and China (Represented in financial statements as 'Other'). (Methven LTD[1], 2011)

Methven's 2011 net profit after tax (NPAT) for the year was down 39.3% on the previous year's NZ$7,820,000 to NZ$4,749,000. Of this figure:

- NZ sales contributed the highest profits with NZ$5,088,000.
- Aust sales contributed NZ$2,726,000.
- UK sales contributed the least profit with a loss of (NZ$3,152,000).
- Other countries contributed NZ$4,000.

(Methven LTD[1], 2011) (see appendix 6 to see figures presented in graph form)

We can look further into these figures with explanations as to what may have attributed to the 2011 segmented profits by country.

- NZ NPAT was down 5.16% on the previous year's NZ$5,326,000 due to record low levels of new building and renovations, as well as the negative impact of the Christchurch earthquake. However due to Methven being so well established in the NZ market, controlling a 50% market share in 2009, (Methven LTD, 2009) the business still generates higher profits than the other regions.
- Aust's NPAT grew 104.8% from NZ$1,331,000 due to the continued roll out of new products and a proven sales methodology, leading to growth in market share.
- Other countries NPAT grew 100.9% from (NZ$443).
- UK NPAT was down 428.3% from NZ$736,000 due mainly to losing major customer; Focus (DIY) LTD who entered into voluntary administration, costing Methven NZ$2,000,000. The UK market was also experiencing difficult economic conditions. (Methven LTD, 2011)

4.0 External Performance Factors

A major factor in Methven's 5.16% decline in profit from 2010 to 2011 in NZ was due to the negative impact on the building and renovation industry, caused by the Christchurch earthquake. (Methven LTD, 2011) Fitting into Canterbury Earthquake Recovery Authority's (CERA) 'Phases of Recovery' plan, heading into 2012 the restoration and rebuilding of Christchurch will really kick into gear with the reconstruction process due to begin. (CERA, N.D) This reconstruction process will have a significant positive impact on Methven's sales and therefore profit in New Zealand during 2012 and into the short-term future.

Methven's UK business has seen a significant decline in profit from 2009 to 2011. This overall has been caused by difficult economic conditions (Methven LTD, 2011) as well as the loss of major customer, Focus (DIY) LTD, impacting the 2011 profit. 2012 will potentially see the UK fall back into recession. (The Independent UK, 2012) Assuming recession does appropriate, Methven may find trading even more difficult in the UK region, causing a negative impact on profit during 2012.

Conclusion and Recommendation

Considering the unforseen circumstances that have affected Methven's profitability over the past two periods; UK's difficult economic conditions, the Christchurch earthquake and the loss of Focus (DIY) Ltd in the UK, I believe that Methven are quite capable of returning significant profits over the next periods. They are continuing with their R&D and are committing to reviving the UK business with investment in infrastructure, as well as; expanding further into the luxury hotel market worldwide, developing distribution chains through Europe and Asia, further expanding product ranges into Australia and benefiting from sales related to the Canterbury rebuild. (Methven LTD[4], 2011)

Profitability overall has been badly impacted by the above-mentioned circumstances, accept however the gross profit margin, which has seen a slight increase. Profitability will, I believe recover into the next period.

Asset efficiency has steadily improved over the past three periods and will continue so with the introduction of a new computer system and warehousing into the UK as well as product and supplier rationalisation across the Group. (Methven LTD[4], 2011)

Company liquidity has shown good signs with a positive trend developing, and company capital structure is in a strong position.

Methven's market performance has seen negative impacts on dividends, but the company is staying committed to its shareholders and the market remains confident in Methven's ability to bounce back, maintaining its share price and showing a very high price earnings ratio.

To conclude I would recommend holding on to any shares held and to buy further shares as I believe the share price will increase as performance improves over the coming period.

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Appendices

Appendix 1

Company Profitability

	2011			2010			2009		
ROSF	4749 / 50547 + 53309 / 2	x 100	9.15%	7820 / 53309 + 58008 / 2	x 100	14.05 %	10056 / 58008 + 54931 /2	x 100	17.81 %
ROA	6789 - 1276 / 99999 + 100958 / 2	x 100	5.49%	11027 - 1029 / 100958 + 119564 / 2	x 100	8.90%	13453 - 2553 / 119564 +120638 /2	x 100	9.08%
ROCE	6789 - 1276 / 74983 + 53309 / 2	x 100	8.59%	11027 - 1029 / 53309 + 84535 / 2	x 100	14.51 %	13453 - 2553 / 84535 + 78823 / 2	x 100	13.34 %
Net profit margin	6789 - 1276 / 122087	x 100	4.52%	11027 - 1029 / 129822	x 100	7.70%	13453 - 2553 / 137321	x 100	7.94%
Gross profit margin	49657 / 122087	x 100	40.67%	49792 / 129822	x 100	38.35 %	55694 / 137321	x 100	40.56 %

Appendix 2 **Company Asset Efficiency**

	2011			2010			2009		
Average inventory turnover period	25742 + 24113 / 2	x 12	4.13	24113 + 31849 / 2	x 12	4.20	31849 + 30546 / 2	x 12	4.59
	72430			80030			81627		
Average debtors settlement period	21613 + 24024 / 2	x 12	2.24	24024 + 25307 / 2	x 12	2.28	25307 + 27458 / 2	x 12	2.29
	122087			129822			137321		
Average creditors settlement period	14607 + 11555 / 2	x 12	2.12	11555 + 13167 / 2	x 12	2.05	13167 + 14594 / 2	x 12	2.01
	(72430+25742)-24113			(80030+24113)-31849			(81627+31849)-30546		
Asset turnover period	99999 + 100958 / 2	x 12	9.88	100958 + 119564 / 2	x 12	10.19	119564 +120638 /2	x 12	10.50
	122087			129822			137321		

Appendix 3 **Company Liquidity**

	2011			2010			2009		
Current Ratio	53580 / 25379	:1	2.11	53451 / 45755	:1	1.17	63421 / 31514	:1	2.01
Acid test ratio	53580-(1298+25742) / 25379	:1	1.05	53451-(1085+24113) / 45755	:1	0.62	63421-(861+31849) / 31514	:1	0.97
Cash flows from operations ratio	9419 / 25379	:1	0.37	16441 / 45755	:1	0.36	16547 / 31514	:1	0.53

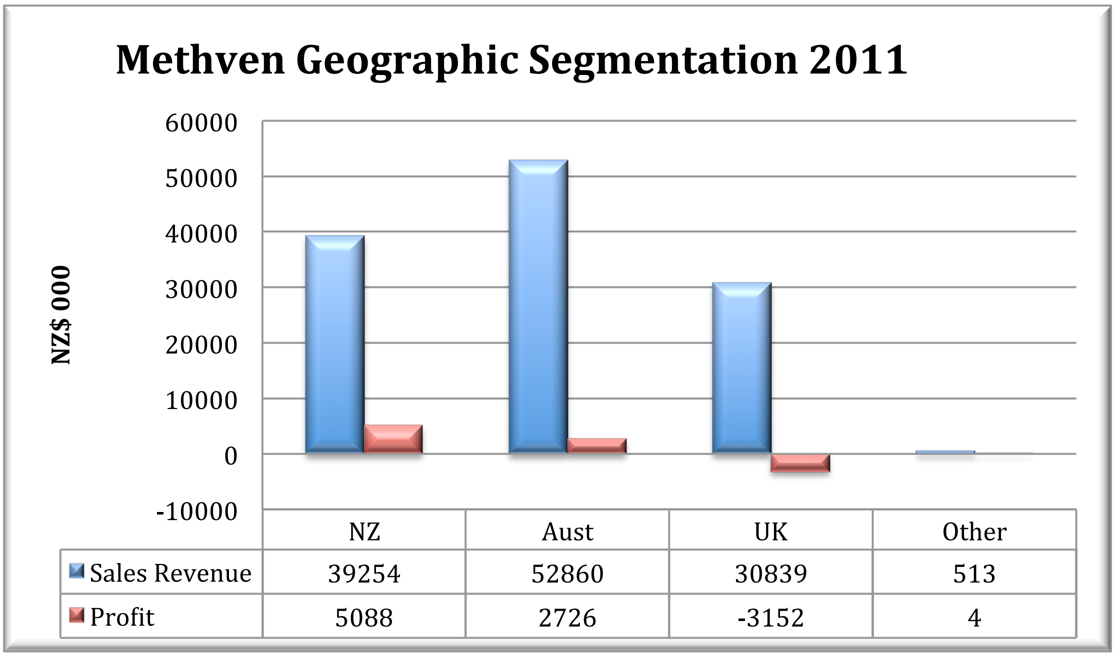
Appendix 4 **Company Capital Structure**

	2011			2010			2009		
Gearing ratio	23536 / (23536 + 50547)	x 100	31.77%	0 / (0 + 53309)	x 100	0.00%	26527 / (26527 + 58008)	x 100	31.38 %
Interest cover ratio	(6789 - 1276) / 1276	:1	4.32	(11027 - 1029) / 1029	:1	9.72	(13453 - 2553) / 2553	:1	4.27

Appendix 5 **Company Market Performance**

	2011			2010			2009		
Dividends per share		c	10.00		c	11.00		c	11.75
Dividend payout ratio	7327 / 4749	x100	154.29%	7327 / 7820	x100	93.70%	8159 / 10056	x100	81.14%
Dividend yield ratio			6.40%			7.00%			9.80%
Earnings per share		c	7.10		c	11.70		c	15.10
Operating cash flow per share		c	13.76		c	9.49		c	5.99
Price earnings ratio	1.56 / 0.071	:1	21.97	1.58 / 0.117	:1	13.50	1.2 / 0.1175	:1	10.21

Appendix 6



	NZ	Aust	UK	Other
Sales Revenue	39254	52860	30839	513
Profit	5088	2726	-3152	4