Financial Ratios Analysis of 7-Elaven: An Analysis of Five Years Financial Statement

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Abstract

The purpose of the study is to analyse the financial ratios of the 7-Eleven Malaysia Sdn Bhd. A number of financial ratios are estimate and analyse. For example, profitability ratios, liquidity ratios, solvency ratios, working capital management, and stock market performance. Data is collected from the Annual Report of the 7-Eleven. The study concludes that the liquidity ratios of 7 eleven were not efficient at all. The gearing ratio trend indicates that 7 eleven suffered a huge risk of going bankrupt in 2016 and 2017, it just managed to do fine in 2018. Moreover, there was an extremely low return on investment recorded for all the five years. Hence, keeping all the findings in consideration, it can be said that even though 7 eleven is doing good in terms of profitability, it is still not a good idea to invest in the company.

Keywords: 7-Eleven, profitability ratios, liquidity ratios, solvency ratios, working capital management, stock market performance

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1.0 Introduction

The importance of analysing financial statement is knew no bound. It provides a snapshot of the financial scenario to the organization. Based on the financial ratios, an organization can take corporate strategic decisions. It helps the organization in terms of maintaining a proper flow of profitability, liquidity management, manage working capital, ensure solvency, continuous growth of the organization and so on. The purpose of the study is to analyse the 5 years (i.e., from 2014 to 2018) financial statement of 7-Eleven which is a listed company under Bursa Malaysia Stock Exchange. A number of ratios are estimate and analyse such as profitability ratio (i.e., net profit margin, return on equity, gross profit margin, and return on capital employed) , working capital management (i.e., asset turnover, stock turnover, payable turnover and receivable turnover), liquidity (i.e., current ratio and acid test ratio), solvency (i.e., gearing ratio) and stock market performance (i.e., return on investment).

2.0 Financial Ratios Analysis

2.1 Five Years Financial Information of 7-Eleven

7 Eleven						
		2014	2015	2016	2017	2018
Sales		1,893,104	2,006,284	2,103,367	2,187,102	2,217,049
Cost of Sales		1,348,384	1,387,965	1,456,798	1,495,772	1,400,333
Gross Profit		544,720	618,319	646,569	691,330	816,716
PBIT		93,038	78,155	73,407	79,728	83,767
Net Profit		63,074	55,801	52,173	50,107	51,330
NCA		158,909	165,444	160,513	164,506	177,929
CA		480,955	418,611	418,669	408,865	390,695
Liquid Assets		332,057	237,906	154,721	186,908	166,013
TA		383,843	370,065	334,526	573,371	568,624
CL		483,303	558,808	690,324	651,698	584,166
NCL		15,638	14,667	47,992	69,236	72,723
TL		498,941	573,475	738,316	720,934	656,889
Equity		236,209	170,194	35,189	74,034	92,478
Capital Employed		251,847	184,861	83,181	143,270	294,658
Interest		3,724	313	2,590	9,232	9,908
Stock		148,898	180,705	263,948	221,957	224,682
Trade payables		369,154	410,980	461,506	392,617	345,735
Trade receivables		85,527	105,814	92,003	113,526	93,465

Source: Annual Report of 7-Eleven 2014 to 2018

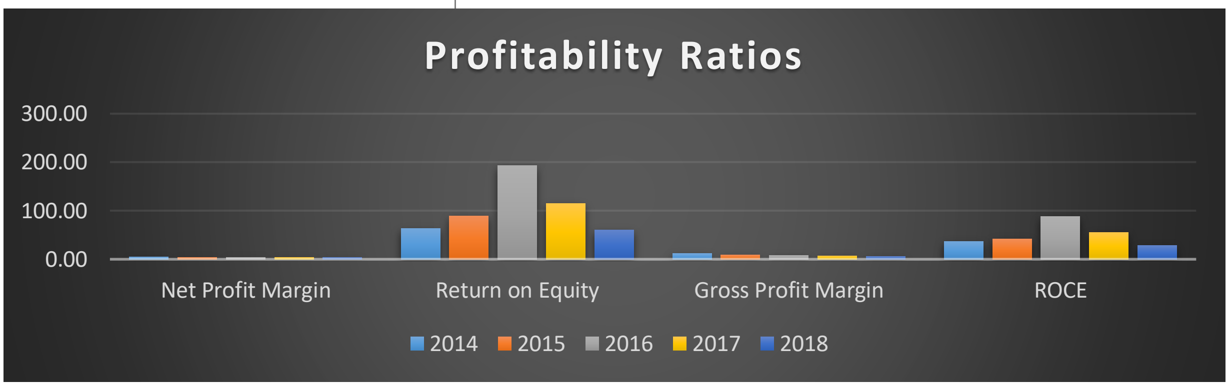
2.2 Estimation of the Financial Ratios

C&C	2014	2015	2016	2017	2018
Profitability					
ROCE	36.942	42.28	88.25	55.65	28.43
Gross Margin	28.774	30.82	30.74	31.61	36.84
Net Profit Margin	4.9146	3.90	3.49	3.65	3.78
Return on equity	26.703	32.79	148.27	67.68	55.51
Working Capital Management					
Asset turnover	4.932	5.42	6.29	3.81	3.90
Stock turnover	9.06	7.68	5.52	6.74	6.23
Debtor collection	16.49	19.25	15.97	18.95	15.39
Creditor collection	99.93	108.08	115.63	95.81	90.12
Liquidity					
Current ratio	1	0.75	0.61	0.63	0.67
Acid test	0.69	0.43	0.22	0.29	0.28
Solvency					
Gearing ratio	6.21	7.93	57.70	48.33	24.68
Stock market performance					
Return on investment	0.27	0.33	1.48	0.68	0.56

Source: Author's calculation

2.3 Profitability

	2014	2015	2016	2017	2018
NET PROFIT MARGIN	4.91	3.90	3.49	3.65	3.78
RETURN ON EQUITY	26.70	32.79	148.27	67.68	55.51
GROSS PROFIT MARGIN	28.77	30.82	30.74	31.61	36.84
ROCE	36.94	42.28	88.25	55.65	28.43

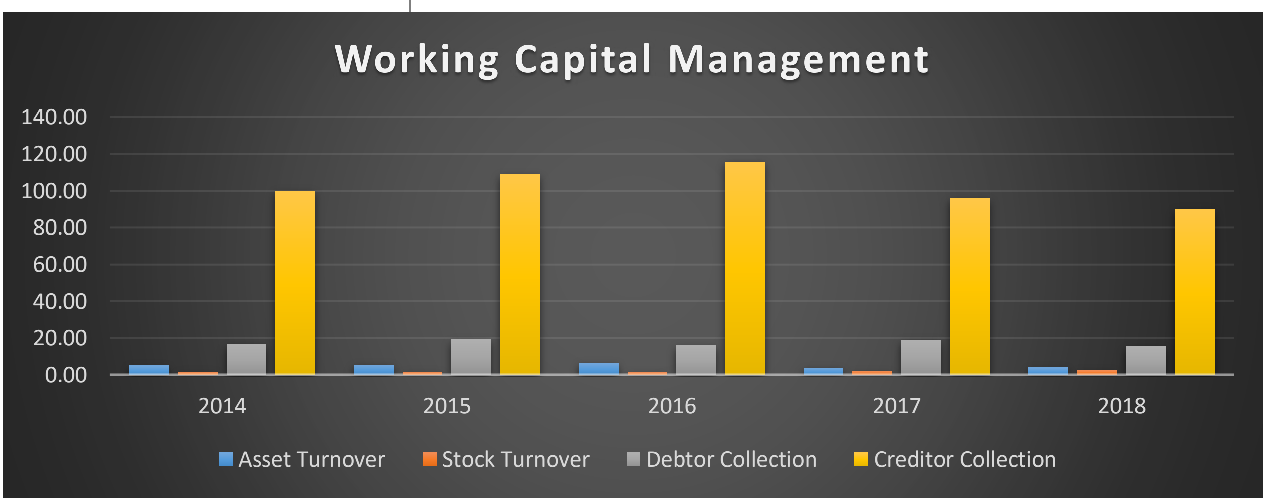


The net profit margin shown above indicates that the company's net profit deteriorated throughout the trend. It was highest in 2014 i.e. 4.91%, but it started falling down till 2016 when it was 3.49%. However, there were slight improvement in the NPM in 2017 and 2018, but it still couldn't make it back to what it was in 2014. The ROE indicates the return generated by the company out of every 100 RM of its total equity. The overall trend shows that 7 eleven improved its performance in terms of return on equity. GPM represents the gross profit earned out of every 100 RM spent in sales. Gross profit margin represented in the above inclines that there were insignificant fluctuations in the GP of the company from 2014 to 2017. Whereas, a significant improvement was discovered in the GPM for the year 2018. ROCE is basically representation of total profit generated out of each 100 RM invested in the capital employed of the company. A fluctuating ROCE has been discovered for 7 eleven for the 5 years. It can be said that the overall profitability for 7-eleven did not change much, even though it improved very well in 2016, but the company failed to maintain it (Le, & Ngo, 2020).

The overall profitability of 7-eleven as compared to the industry is good, the company has successfully used technology and innovation to stay ahead of its competition in terms of profitability (Zax, 2018). The profitability of 7-eleven rose significantly in the year 2016 due to the raise in demand of its food sector. The company was able to sustain high revenues and profits despite using less equity and capital employed compared to other years, this was one of the reasons it generated high return on equity and return on capital employed. Finally, based on the data from the annual report, the main reason why 7-eleven did not improve throughout the five year time is that its revenue has been quite the same throughout the time period, the company did not improve its sales.

2.4 Working Capital Management

	2014	2015	2016	2017	2018
ASSET TURNOVER	4.93	5.42	6.29	3.81	3.90
STOCK TURNOVER	9.06	7.68	5.52	6.74	6.23
DEBTOR COLLECTION	16.49	19.25	15.97	18.95	15.39
CREDITOR COLLECTION	99.93	108.08	115.63	95.81	90.12

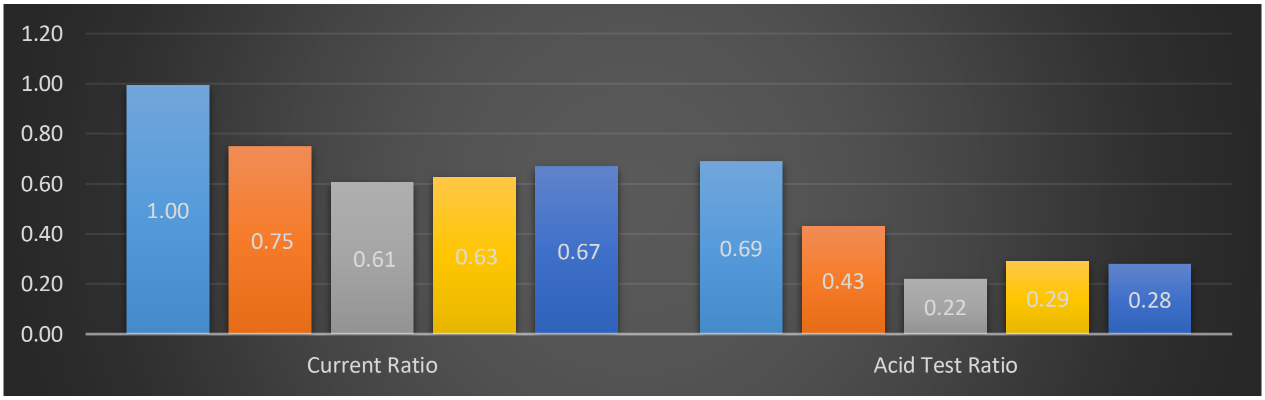


Asset turnover ratio indicates how capable 7 eleven is to convert its total assets into total sales. Hence, the company should always aim for a high asset turnover. In this case, the asset turnover ratio of 73 was 4.93% in 2014 and it kept improving with fluctuations till 2016, when it was the highest i.e. 6.29%. However, there was a significant fall in 2017 with a slight improvement in 2018, where the trend ended at 3.90%. The purpose of stock turnover ratio is to determine how efficient a business is in managing its stock or inventory. It can be said that the best stock turnover recorded for 7e was in 2014 i.e. 9.06%. Followed by fluctuating downfalls till 2016, then a slight improvement in 2017 and then finally again a downfall in 2018. The final stock turnover for the year 2018 was 6.23%. The purpose of debtor collection period ratio is to determine the number of days taken by a company to receive all its credits from clients. A lower debtor collection period inclines that the company is able to recover its credits quickly, which is considered more efficient. The overall trend of debtor collection period shows fluctuations from 2014 to 2018. This ratio indicates the number of days a company need to pay off its debts. The company was able to improve its creditor collection period from 2014 to 2016, but it started getting worse in 2017 and 2018. The highest number of days for which 7e was able to hold off its debt payment was 116 days in 2016 and the lowest one was 90 days in 2018 (Chalmers, Sensini, & Shan, 2020).

The main reason why the assets turnover ratio started deteriorating after 2016 was that the company increased its expenditure its assets in 2017 and 2018, but however, the revenue did not increase much. In terms of stock turnover, 7 eleven improved its performance as compared to the year 2015, the company was able to do so by improving its demand and availability to the customers. The debtor collection period of 7-eleven was low and remain almost the same throughout the years because it operates in retail sector and most of the customers pay upon the purchase. The company had high creditor collection period throughout the 5 years, this indicates that it had built good relationship with its suppliers.

2.5 Liquidity

	2014	2015	2016	2017	2018
CURRENT RATIO	1.00	0.75	0.61	0.63	0.67
ACID TEST RATIO	0.69	0.43	0.22	0.29	0.28



Current ratio represented above indicates the capability of a company to pay off its short term liabilities by selling off its current assets (Mohammad, Asutay, Dixon, & Platonova, 2020). A benchmark ratio of 2:1 is considered as an effective liquidity. The results of current ratio show that 7 eleven failed to score an efficient enough liquidity throughout five years. Acid Test ratio is also quite similar to current ratio, despite the fact that acid test ratio indicates the capability of a company to pay off its liabilities on urgent basis using its liquid assets. Thus, due to the nature of urgency, inventory is removed from the current assets to calculate liquid assets. The benchmark for this ratio is 1:1 and the companies having less than that are believed to have poor liquidity. Hence, comparing both the ratios with their benchmark, it can be said that the company had poor liquidity performance throughout the 5 years.

One of the main reasons behind 7-eleven's poor liquidity is that the company had lesser current assets than its current liabilities. Secondly, the company kept on increasing its current liabilities throughout the five years, but failed to increase its assets by the similar value. However, the company declares that poor liquidity is not a critical problem for them as the industry they operate in, usually the liabilities are higher than the assets because all of the purchasing is done on credit basis.

2.6 Solvency

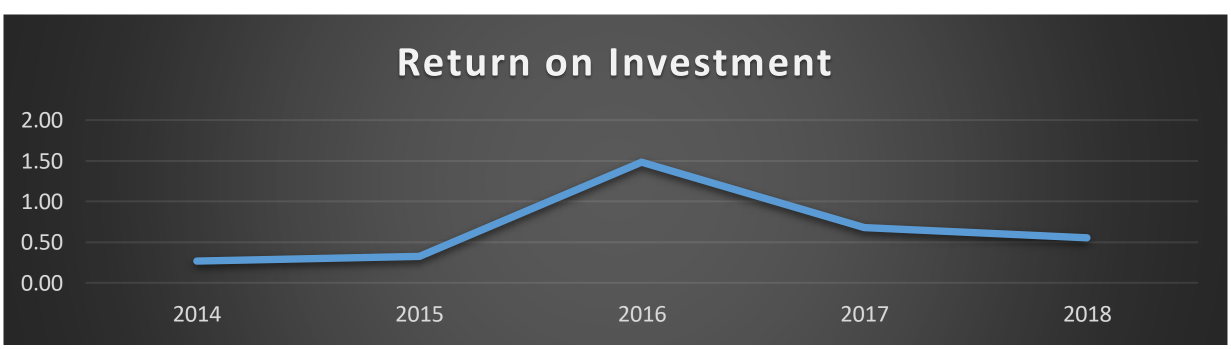
	2014	2015	2016	2017	2018
GEARING RATIO	6.21	7.93	57.70	48.33	24.68

Gearing ratio indicates if a company can meet its long term obligations. Gearing ratio above 50% indicates high risk of bankruptcy, whereas below 50% indicates low risk of bankruptcy Phi, Taghizadeh-Hesary, Yoshino, & Kim, 2020). 7e had very low gearing ratio in 2014 and 2015, but it increased significantly in 2016 and went to 57.70%, which was very risky for the company. However, it maintained to bring the gearing ratio down slightly in 2017 and 2018. The final gearing recorded was 24.68%.

One of the reasons for such a risky gearing ratio in 2016 and onwards is that the company lost its treasury shares in 2016 which lead to a decrease in total equity. Thus, the equity was too low as compared to company's debt.

2.7 Stock Market Performance

	2014	2015	2016	2017	2018
RETURN ON INVESTMENT	0.27	0.33	1.48	0.68	0.56



ROI ratio indicates what the shareholders earn out of every 100 RM invested by them in the company. The return on investment of 7 eleven was extremely low in 2014 i.e. 0.27. The company was able to improve it significantly till 2016, but still it was at 1.48. In the years after that, ROI experienced a significant downfall and ended at 0.56 in 2018. Based on the findings, it can be said that the stock market performance of 7 eleven has not been good enough.

Again, the significant rise in 2016's return on investment was due to the decrease in equity. The overall performance of the ROI has improved throughout the 5 years as the company's equity kept on falling. However, the net income also fell down with the equity.

3.0 Recommendations

Based on the profitability ratios, it can be said that investing in 7 eleven could be a good choice as its profit ratios are good as compared to its competitors. The working capital management ratios also support that 7 eleven could be a good company to invest in. However, the ratios that are important in determining such a decision are liquidity, solvency and stock market performance ratios. And certainly, the liquidity ratios of 7 eleven were not efficient at all. The gearing ratio trend indicates that 7 eleven suffered a huge risk of going bankrupt in 2016 and 2017, it just managed to do fine in 2018. Moreover, there was an extremely low return on investment recorded for all the five years. Hence, keeping all the findings in consideration, it can be said that even though 7 eleven is doing good in terms of profitability, it is still not a good idea to invest in the company.

a) Princetown plc Valuation

i. Price / Earnings Ratio

For the P/E valuation, we will benchmark the P/E ratio of Harvard plc and use the earnings of Princeton to arrive at an equity valuation.

Value Using P/E of Harvard plc		GBP millions
Princeton's Earnings	A	31.6
Harvard plc's P/E	B	16.2
Equity Valuation	**C = A x B**	**512.9**

Number of shares	D	110
Value per share	**E = C / E**	**4.76**

ii. Dividend Valuation Method (Gordon Growth Model)

For Dividend Valuation Method, we will use the Gordon Growth Model to calculate the value of Princeton plc. For this we need to calculate the cost of equity and perpetual dividend growth rate for Princeton plc.

CAPM		
T-Bill Yield	A	2%
Market Return	B	8%
Equity Market Premium	C = B - A	6%
Beta	D	1.89
Required Equity Return	**E = A + (C x D)**	**13%**

Now we will discount back the dividend at the required return on equity calculated through CAPM and use the stable growth to calculate the present value of the company. Following is the valuation using the DDM valuation approach. We have used the 4% as the perpetual growth of the company.

Value Using Dividend Valuation		
Dividend	A	0.3
Growth	B	4%
Next Year Dividend	C = A x (1 + B)	0.4
Cost of Equity	D = Refer to CAPM	13%
Value per share	**E = C / (D - B)**	**3.9**
Number of shares	F	110
Equity Valuation	**G = E x F**	**427.5**

iii. Discounted Cashflow Method

For the discounted cash flow method we have used a number of assumptions to calculate the forecasted balance sheet and income statement of Princeton plc, which has been subsequently used to calculate the free cash flows for our DCF method. Following is the pro forma balance sheet:

Balance Sheet	**Y0**	**Y1**	**Y2**	**Y3**	**Y4**	**Assumption**
Non Current Assets	184	144	129	116	105	In the first year, GBP 22m of savings assumed. 10% depreciation rate also applied.
Current Assets	31	104	153	201	250	The balancing figure is assumed to be cash
Total Assets	**215**	**248**	**282**	**318**	**355**	
Ordinary Shares	110	110	110	110	110	
Reserves	11	44	78	114	151	Increasing with the increase in earnings (4%)
Total Equity	**121**	**154**	**188**	**224**	**261**	
4% Bonds	66	66	66	66	66	
Current Liabilities	28	28	28	28	28	
Total Liabilities	**94**	**94**	**94**	**94**	**94**	

Hence using these assumptions, we have calculated the FCFF of the Princeton plc as follows:

FCFF	**Y1**	**Y2**	**Y3**	**Y4**
Distributable Earnings	33	34	36	37
Add: Depreciation	18	14	13	12
Less: CAPEX	22	(0)	0	0
Less: Change in WC	0	0	0	0
FCFF	73	49	48	49

These FCFFs are then discounted back at the required return on equity which was calculated via CAPM. The sum of the present value of these FCFFs along with the present value of the terminal value gives us the enterprise valuation. From this we need to deduct the net debt of the company (just used the debt since cash not given), to arrive at equity value of Princeton plc.

DCF	**Value**	**Assumptions**
PV of FCFF	165	Using the required equity return calculated via CAPM
PV of Terminal CF	372	Using the GGM and then calculating the PV of the terminal value at Y0
Enterprise Value	**537**	
Less: Net Debt	66	Just used the debt since cash not given
Equity Value	**471**	
Number of Shares	110	
Price per share	**4.28**	

b)

Mergers and Acquisitions are an effective tool for companies which have limited internal growth opportunities. This can be due to many reasons including the fact that these companies have reached their maturity lifecycle stage, they have reached maximum capacity levels, and the industry is suffering a demand contraction leading to little growth opportunities. Hence, for these companies merger and acquisition is an attractive option to keep the growth trajectory alive. This arises a question of whether the mergers and acquisition actually benefit the shareholders of these companies or not i.e. whether the merger actually leads to a rise in shareholder value.

There are several benefits for acquiring companies' shareholders when it comes to mergers and acquisitions which can increase the company's value after merger (Sherman, 2010). Firstly, it provides the shareholders with a greater diversification benefit as the shareholders' risk is spread across varied markets and segments. This is even more effective if the acquired company is in a different industry or a different geographical market. Secondly, the acquiring company can also take advantage of its excess liquidity by making the most of idle cash and earning a sizable return. This is usually because the management of the acquiring company is under constant pressure to generate excessive returns (Gaughan, 2011). Other than that, the acquiring company can also take advantage of lower finance costs due to larger size of their balance sheet post-merger, which is likely to increase their net profitability going forward. Another benefit for the acquiring company post-merger is the economies of scale that potentially can be achieved due to higher production leading to lower unit costs and in turn higher profitability. There is also sometime a potential for the shareholders to create value by acquiring undervalued and / or distressed companies which are operationally inefficient due to various reasons and thus, accompany lower valuation multiples. The value can be created via increasing the operating profitability of the target company post-merger by eliminating prior inefficiencies, paying off debt from the balance sheet to increase the shareholder value, and also via re-rating of low valuation multiples. All these factors are some of the key considerations when the acquiring companies plan to take over another company. These benefits highlighted usually lead to increased shareholder value following the merger since these factors lead to a higher operating profitability and in turn greater distributable earnings.

However, various studies have shown that the shareholder value actually depletes following any merger and acquisition and two thirds of all the mergers and acquisition fail (McKinsey, 2018). The primary reason which has been cited is that the acquiring companies often end up paying a higher premium for the target company, overestimating the benefits of the merger (The European Inter-University Association on Society, Science and Technology, 2012). This is further exacerbated by the difficulties faced by the management to integrate the systems and processed which were previously followed along with the failure to sync the synergies into the conglomerate post-merger (Ncube, 2003). Hence, these lead to fall in returns and operating performance of the conglomerate. In addition, the most critical factor which often lead to a failed merger is the level of strategic fit in the company post-merger which often involves similarity in cultures, systems and structures which facilitate a successful merger (Peng, 2006)The other key factor is the have also suggested that in the short term after the merger the acquiring company usually experiences a spike in share performance, but this is rather short lived - the share price in the long term eventually fall down owing to the factors highlighted above. Hence, it can be implied from this that the share price performance in itself is not the reliable measure to determine the success of mergers and acquisitions, and in turn the shareholder value.

One particular example of a failed merger is the acquisition of Engro Foods, a Pakistan based food company by Friesland Campina, a dutch multinational dairy company. Engro Foods was a fairly successful company in the dairy sector when it was acquired in 2006. Although, the merger showed immense potential owing to the favorable factors of the industry, and Friesland Campina, being one of the renowned global dairy player, was set to gain market share, the opposite have been the case. If we see the operating performance of the company pre and post-merger leading to a decline in shareholder value.

Engro Foods Performance Post Merger	**2016**	**2019**
Revenue (PKR mn)	44,346	38,857
Net Profit (PKR mn)	2,386	(955)
Gross Profit Margin	23%	13%
Net Profit Margin	5%	2%

The studies have suggested that the failure of Friesland Campina to understand the local business and to incorporate the core organizational values i.e. culture, systems and processes was one of the key reasons for this dismal performance.

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