Student 6: High Not Achieved

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Executive Summary

This report is prepared for the union representing workers at Pumpkin Patch Ltd to investigate and interpret the annual report, to get an understanding of whether PPL is in a position to pay workers a 4% pay increase. I have prepared this report for the purpose of analysing and interpreting the financial position, stability and employment outlook for our workers, market confidence, and performance of Pumpkin Patch Ltd 1

Background: Pumpkin Patch Ltd is a specialist clothing and accessories company who specialise in toddlers, babies, maternity, and children clothes. Australia and New Zealand are Pumpkin Patch's major markets with "wholesale and direct" markets in Asia and other countries around the world. Pumpkin Patch Ltd has just recently closed their USA stores and is in the process of closing their UK stores.

Profitability

While the trading conditions have remained very difficult throughout the year, Pumpkin Patch Ltd has developed strategies that will bring long term benefits to shareholders. Initiatives being developed and employed in the US and the UK will help ease the effect underachieving stores have on the overall group earnings.

In Australia Pumpkin Patch's EBIT has decreased by 25.8% to $28.708m in 2011. This is a result of the increase in fixed overheads (e.g. wages and salaries) and sales dropping by 9%.

The Queensland floods would have made a big impact on this as well as a subdued economic environment. As people were being careful with their cash, they spent less in higher-end stores like Pumpkin Patch Ltd. As sales have brought in $12.955 million in the first half of 2012 (which is $1.916m less than the six months ended 31 January 2011), Pumpkin Patch Ltd is expecting trading conditions to stay difficult even though 13 new stores were opened during the year and three more are expected to open in 2012.

In New Zealand Pumpkin Patch Ltd has experienced a decrease in turnover of $4.741m with a decrease in EBIT of $2.798m.

Sales would have been impacted by the subdued economic environment and the Christchurch earthquakes which affected the EBIT. Seven new stores were opened so some of the losses could be attributable to the capital cost of this. Even though trading conditions stabilised towards the end of the year they are expected to remain subdued.

Although the US retail sector was very challenging, total USD sales were up on last year by 4.9%. All owned and operated stores in US will be closing in the 2012 financial year due to years of not making profits. Although the stores are closing the brand will continue to be sold through wholesale partners and the growing online operation and Pumpkin Patch Ltd is exploring new opportunities for the distribution of the brand throughout the US.

The United Kingdom has suffered challenging retail conditions throughout the year and especially in the last part of the year when the financial situation rapidly deteriorated across the whole of Europe. Although the GBP turnover has increased by 2.7%, the EBIT loss has nearly doubled. This is due to the higher exchange rate and softer sales performance. General retail conditions in the UK are expected to remain challenging so Pumpkin Patch Ltd is planning to close their UK stores in 2012. This should increase the overall 2013 profit dramatically as the other stores wouldn't have to carry UK's continual losses. Pumpkin Patch Ltd will continue to wholesale its products to other retailers and market their online Charlie and Me and Pumpkin Patch Ltd brands.

Wholesale sales continued to be impacted by high NZD exchange rates which caused wholesale partners to manage challenging retail conditions and, translated to NZDs. Direct business went a lot better than wholesale sales in 2010 and 2011 with significant increases, and with Pumpkin Patch's website being amongst the most visited children's product related websites in Australia. The company is anticipating continued growth of the Pumpkin Patch Ltd and Charlie and Me online businesses in 2012.

Liquidity and Cash Management

In 2010 Pumpkin Patch Ltd had a current ratio of 1.42:1 which decreased to 1.28:1 in 2011. This was largely due to the current liabilities increasing by $18.655 million due to a significant increase in Derivative Financial Instruments (DFI). DFIs are a result of Pumpkin Patch Ltd entering into a Foreign Currency Exchange contract. DFIs do not affect cash flows as they are a non-cash book entry but as a result, DFIs limit the accuracy of the current ratio by making it look a lot worse than it actually is as it is implied that it is in an acceptable cash position when it actually isn't.
Inventory represents a substantial proportion of Pumpkin Patch Ltd.'s current assets and unless they can turn this into cash they are in trouble because even though the current ratio implies that Pumpkin Patch Ltd is in a tolerable cash situation we know that this is far from the truth as in the 2011 cash flow statement we see that there was $20.929 million decrease in cash from customers while there is a $4.574m outflow from operating activities. This inadequate cash flow means that Pumpkin Patch Ltd could not qualify for the solvency test. As a result of this, Pumpkin Patch Ltd was unable to pay as much for directors' fees or for an increase in pay for all its workers. 2

Financial Stability and Employment Issues

The Equity ratio has fallen from 0.45:1 in 2010 to 0.16:1 in 2011 which means that the Pumpkin Patch Ltd shareholders have financed less than half of the total assets compared to external finance from outsiders e.g. creditors and finance lenders. This is bad as it is now far below the acceptable amount of 50% of total assets and it means that Pumpkin Patch Ltd is financing a significant amount of its funds on paying interest. This means they have five times as much debt as what they have equity. This means that they do have very little funding to pay for any pay rises. 2

Conclusion

We should complete further interpretation and analysis to decide on a 4% wage claim as PPL is not making any money and it isn't paying out dividends and even though Pumpkin Patch Ltd has closed its US and UK stores to bolster up the performing stores' profits the worldwide financial situation is very much at risk of collapse and if Europe went under the whole world would go under and people who are investing would lose it all.

All sources cited and a bibliography provided.