De La Salle University-Manila
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Case 2: Ratio Analysis
Holly Fashions

In Partial Fulfillment of the Course Requirements in
FNC 535M - Financial Management
Master of Business Administration

Submitted by:

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I. Synthesis

Fourteen years ago in Cherry Hill, New Jersey, William Hamilton and John White, two seasoned marketing and merchandising professionals with over twenty-five years of qualifying experience in the clothing industry, decided to start their own venture that specializes in making apparel, Holly Fashions. Each of their personalities and professional qualities blended splendidly in running the firm. Hamilton, reserved and is extremely creative with a knack for merchandising. Holly Fashions level has become synonymous with quality as a result of his genius. White, outgoing and assertive, has made significant contributions that aided the company's merchandising and marketing strategies, and he assumed the role of the Chief Operating Officer. Suffice it to say, Hamilton's work has a more creative and artistic element to it, while John White's is more operational.

Hamilton had little interest in the financial aspects of the company as he prefers to work on new fashion designs and marketing strategies. He concluded, however, that he needed to become more involved with the company's finances. His motivation is twofold. First, Hamilton is considering selling half of his interest in Holly Fashions. Despite his enjoyment of the firm's creative side, he had grown tired of the cash crunches that occurred in the past. Periodically, the retailers with whom the firm deals with have run into financial difficulties and have delayed payments, often causing a mad scramble for cash at the firm. Furthermore, if he decides to sell half of his interest, he recognizes that he will likely be engaged in some tense negotiations over the company's value, and while he would hire a consultant to assist him in any negotiations, he believes that it is a good idea to educate himself about the firm's financials. Another reason that Hamilton is interested in the firm's financials is so he can better assess the managerial competence of White. Hamilton thought White did a good job when HF was small, but now he wonders whether White is capable of running a large business like that of Holly Fashions. However, Hamilton believes that the apparel industry will face even tougher times in the coming years, and wonders if White is competent enough to successfully overcome these challenges. White, on the other hand, was dealing with practically all operational and financial matters at the time, and he decided three years ago to retire all long-term debt as the company's risk increased. He is also concerned about the firm's size and the difficulty of maintaining a stable bank relationship as a result of increasingly stringent federal regulations of banks.

Holly Fashion's inventory, according to Hamilton, is excessive, while White believes that a large inventory is necessary to meet customer demands for quick delivery. Furthermore, Hamilton is willing to offer trade discounts, while White rarely takes these discount decisions because he wants to hold onto their cash as long as possible. Despite all of this, the relationship between the two partners has remained relatively smooth over the years. Hamilton acknowledges that he may be unduly critical of White's management decisions. Furthermore, Hamilton had discussed the possibility of selling his half of the company with two consultants and arrived at an estimated market value for Holly Fashions' stock, figures which the consultants believe is reasonable for Hamilton.

Where:
- Sales = 1305
- Average AR = 224.8

Solution:
Average Collection Period = 365 / Accounts Receivable Ratio (Net Sales/Average AR)
Average Collection Period = 365 / (1305/224.8)
Average Collection Period = 62 days

Formula: Days Purchase Outstanding = (Accounts Payable * Number of Days)/COGS

Where:
- Accounts Payable = 84.2
- Cost of Goods Sold = 978.8

Solution:
Days Purchase Outstanding = (Accounts Payable * Number of Days)/COGS
Days Purchase Outstanding = (84.2*365)/978.8
Days Purchase Outstanding = 31.40

Profitability Ratios

Formula: Gross Margin (%) = ((Revenue - Cost of Goods Sold)/Revenue))*100

Where:
- Revenue = $1305
- Cost of Goods Sold = 978.8

Solution:
Gross Margin (%) = ((Revenue - Cost of Goods Sold)/Revenue))*100
Gross Margin (%) = ((1305-978.8)/1305)*100
Gross Margin (%) = 25%

Formula: Net Profit Margin (%) = Net Income/Sales

Where:
- Net Income = 35
- Sales = 1305

Solution:
Net Profit Margin (%) = Net Income/Sales
Net Profit Margin (%) = 35/1305
Net Profit Margin (%) = 2.68%