Executive Summary:

In the UK retail fashion industry, this investment research contrasts Palmer plc with Gallaher plc, assessing important financial parameters over a three-year period. Palmer plc has great financial health with consistently high gross profit margins, healthy current and acid test ratios, and outstanding profitability and liquidity. Palmer's dependence on large debt levels, however, increases danger in erratic economic times. Gallaher plc, on the other hand, maintains reduced debt levels, shows signs of growing profit margins, and offers risk-averse investors a solid investment alternative. The investment choice made by Sampdoria plc should be in line with its view for the market and risk tolerance. While Gallaher plc offers stability and steady progress, making it suited for more investors, Palmer plc offers the possibility of bigger profits but at a higher risk.

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Investment Advice to Sampdoria plc:

1: Gross Profit Margin Analysis

The Gross Profit Margin is a crucial financial metric that helps in assessing a company's financial health by indicating the percentage of sales revenue that exceeds the cost of goods sold (COGS). It essentially measures how effectively a company uses its labor and supplies in producing goods, and how efficiently it manages its production costs relative to its sales1. Here's a more detailed elaboration and analysis of the Gross Profit Margins for both Palmer plc and Gallaher plc over the past three years:

Calculation of Gross Profit Margin:

The formula for calculating the Gross Profit Margin is:

Gross Profit Margin = (Gross Profit/ Sales) ×100

This formula gives us the percentage of each pound of sales that remains after the company has paid for its goods.

Palmer plc

Steven Lindner and Barbara A Chernow, *Retail Accountability : Advanced Retail Profitability Analysis* (Fairchild Publications 2004).

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For Palmer plc, the Gross Profit Margin calculations over the three years are as follows:

- **2023**: The sales are £600 million and the cost of sales is £410 million. The gross profit (Sales - Cost of Sales) is £190 million.

$$\text{Gross Profit Margin} = \left(\frac{190}{600}\right) \times 100 = 31.67\%$$

- **2022**: The sales are £650 million and the cost of sales is £420 million. The gross profit is £230 million.

$$\text{Gross Profit Margin} = \left(\frac{230}{650}\right) \times 100 = 35.38\%$$

- **2021**: The sales are £700 million and the cost of sales is £420 million. The gross profit is £280 million.

$$\text{Gross Profit Margin} = \left(\frac{280}{700}\right) \times 100 = 40.00\%$$

Gallaher plc:

For Gallaher plc, the Gross Profit Margin has been pre-calculated for the same years: 2023: 30.0%

2022: 27.1%

2021: 25.0%

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Analysis

Trend Analysis:

Palmer plc shows a decreasing trend in the Gross Profit Margin from 40.00% in 2021 to 31.67% in 2023. This decline suggests that Palmer might be facing increasing production costs or potentially reducing selling prices to maintain or grow market share, which could be a concern for profitability in the long run.

Gallaher plc, on the other hand, shows an increasing trend in the Gross Profit Margin from 25.0% in 2021 to 30.0% in 2023. This improvement indicates better cost management or

possibly enhanced product pricing strategies which are succeeding in generating higher margins from their sales.

Comparative Analysis:

Palmer plc consistently achieves a higher Gross Profit Margin compared to Gallaher plc in each of the years analyzed. This implies that Palmer plc is more efficient in converting sales into actual profit, reflecting potentially higher quality products, stronger brand pricing power, or more effective cost control measures in its production process.

The higher margins at Palmer plc might attract investors looking for companies that can sustain higher profitability levels. However, the declining trend needs to be investigated to ensure it does not continue to erode these margins.

Gallaher plc's improving margin profile suggests it could be a rising contender, becoming more efficient and possibly positioning itself for sustainable growth by optimizing costs and maximizing sales revenue.

In conclusion, while Palmer plc shows higher efficiency in terms of current profitability metrics, the contrasting trends between the two companies could influence investment decisions based on long-term strategic goals. Gallaher plc's improving efficiency might appeal to investors focused on growth and improvement, whereas Palmer's existing higher margin might interest those looking for established profit capabilities with a need to understand and possibly curb the declining margin trend.

2: Current ratio analysis:

The Current Ratio is a key liquidity ratio that helps in assessing a company's ability to pay off its short-term liabilities (debts and payables) with its short-term assets (cash, inventory, receivables). The formula for calculating the Current Ratio is:

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Current Ratio = Current Assets/ Current Liabilities

A higher current ratio indicates a stronger liquidity position, suggesting that the company is more capable of paying off its obligations. A ratio under 1 suggests that the company might struggle to meet its short-term obligations without raising additional capital2.

Palmer plc

For Palmer plc, the Current Ratios over the three years are as follows:

- **2023**: The total current assets are £195 million, and the total current liabilities are £47 million.

$$\text{Current Ratio} = \frac{195}{47} = 4.15$$

- **2022**: The total current assets are £210 million, and the total current liabilities are £54 million.

$$\text{Current Ratio} = \frac{210}{54} = 3.89$$

- **2021**: The total current assets are £230 million, and the total current liabilities are £62 million.

$$\text{Current Ratio} = \frac{230}{62} = 3.71$$

Gallaher plc

For Gallaher plc, the Current Ratios are pre-calculated for the same

years: 2023: 1.35

2022: 1.13

2021: 0.97

Analysis

Steven Lindner and Barbara A Chernow, *Retail Accountability : Advanced Retail Profitability Analysis* (Fairchild Publications 2004).

Trend Analysis:

Palmer plc shows a very strong liquidity position with current ratios significantly above 1 across all three years. This indicates that Palmer has more than enough current assets to cover its current liabilities, which is a positive sign for investors and creditors looking for security in financial health. The slight decrease in the ratio over the years could be due to either a slight increase in liabilities or a reduction in current assets, but the ratios remain comfortably high. Moreover, Gallaher plc, while maintaining ratios above 1, shows relatively lower current ratios compared to Palmer plc. However, there is an improving trend from 0.97 in 2021 to 1.35 in 2023, which suggests that Gallaher is improving its ability to cover short-term liabilities with its short-term assets.

Comparative Analysis:

Palmer plc's current ratios are much higher than those of Gallaher plc, which might indicate that Palmer is managing its working capital more efficiently than Gallaher. High current ratios can be indicative of good liquidity health, meaning Palmer is potentially less risky for short-term creditors and investors.

However, extremely high current ratios as seen in Palmer plc might also suggest an over-accumulation of assets or under-utilization of resources which could be invested back into the business for potentially higher returns. Thus, while Palmer's high liquidity is reassuring, it could also signal a need for better asset management to optimize financial returns.

Gallaher plc's improving current ratios are a good sign for the business, reflecting better management of assets or reduction in liabilities. This upward trend, if continued, could enhance Gallaher's attractiveness to investors who prefer companies with improving financial health indicators.

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In summary, both companies demonstrate good liquidity positions, but Palmer plc appears more robust in this area. However, the ideal current ratio should balance between excessive liquidity and the efficient use of resources to maximize business growth and profitability. Both companies might benefit from optimizing their asset management strategies to align with their overall business goals and market conditions.

3. Acid Test Ratio ((Current Assets - Inventory) / Current Liabilities)

Acid Test Ratio (Quick Ratio) Analysis

The Acid Test Ratio, also known as the Quick Ratio, is an important financial metric used to evaluate a company's short-term liquidity position, specifically its ability to meet its current liabilities without relying on the sale of inventory. This ratio is more stringent than the Current Ratio as it excludes inventory from current assets, providing a clearer view of the company's ability to cover short-term obligations with its most liquid assets3.

Formula:

The Acid Test Ratio is calculated using the formula:

Acid Test Ratio= Current Assets- Inventory/ Current Liabilities

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[3] Axel Tracy, *Ratio Analysis Fundamentals* (RatioAnalysisnet 2012).

Palmer plc

For Palmer plc, the Acid Test Ratios over the three years are calculated as follows:

- **2023**:

$$\text{Current Assets} = 195, \text{Inventory} = 170, \text{Current Liabilities} = 47$$

$$\text{Acid Test Ratio} = \frac{195 - 170}{47} = 0.53$$

- **2022**:

$$\text{Current Assets} = 210, \text{Inventory} = 190, \text{Current Liabilities} = 54$$

$$\text{Acid Test Ratio} = \frac{210 - 190}{54} = 0.37$$

- **2021**:

$$\text{Current Assets} = 230, \text{Inventory} = 205, \text{Current Liabilities} = 62$$

$$\text{Acid Test Ratio} = \frac{230 - 205}{62} = 0.40$$

Gallaher plc

The Acid Test Ratios for Gallaher plc are pre-calculated for the same

years: 2023: 0.09

2022: 0.12

2021: 0.15

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Analysis

Trend Analysis:

Palmer plc exhibits acid test ratios that, while decreasing from 2021 to 2023, still remain significantly higher than those of Gallaher plc. These ratios indicate that Palmer plc has a reasonable level of the most liquid assets compared to its liabilities, though there's a slight deterioration in this capacity over time. On the other hand, Gallaher plc shows very low acid

test ratios, increasing marginally over the years but still under 0.15. This suggests a minimal level of the most liquid assets relative to current liabilities, indicating potential liquidity risks if the company needed to settle liabilities quickly without relying on inventory sales.

Comparative Analysis:

Palmer plc's higher acid test ratios compared to Gallaher plc suggest that Palmer is in a better position to cover unexpected short-term liabilities without selling inventory. This could be particularly important in industries where inventory is not quickly convertible into cash.

The low ratios for Gallaher plc highlight a potential vulnerability in liquidity that could be problematic in case of sudden financial downturns or if cash inflows from sales are disrupted.

In conclusion, while Palmer plc demonstrates better short-term liquidity (excluding inventory) than Gallaher plc, both companies show a trend of decreasing liquidity over the past three years. This could indicate a need for both companies to perhaps reassess their strategies for managing liquid assets and liabilities. For Sampdoria plc, investing in a company with stronger liquid asset management like Palmer might be safer if concerns about market volatility or liquidity are paramount.

4. Gearing Ratio (%) (Non-Current Liabilities / Total Equity):

Gearing Ratio Analysis

The Gearing Ratio, also known as the leverage ratio, is a financial metric used to assess the extent to which a company's operations are funded by debt as opposed to equity. It provides an indication of the financial stability of a company by showing the proportion of its capital structure that is financed through debt4.

[4] Vivien Barth, *Gearing Ratios* (GRIN Verlag 2020).

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Formula:

The Gearing Ratio is calculated using the formula:

Gearing Ratio (%) = (Non-Current Liabilities/ Total Equity) × 100

Palmer plc

For Palmer plc, the Gearing Ratios over the three years are calculated as follows:

- **2023**:

$$\text{Non-Current Liabilities} = 300, \text{Total Equity} = 648$$

$$\text{Gearing Ratio} = \left(\frac{300}{648}\right) \times 100 = 46.30\%$$

- **2022**:

$$\text{Non-Current Liabilities} = 300, \text{Total Equity} = 640$$

$$\text{Gearing Ratio} = \left(\frac{300}{640}\right) \times 100 = 46.88\%$$

- **2021**:

$$\text{Non-Current Liabilities} = 300, \text{Total Equity} = 614$$

$$\text{Gearing Ratio} = \left(\frac{300}{614}\right) \times 100 = 48.86\%$$

Gallaher plc

The Gearing Ratios for Gallaher plc are pre-calculated for the same years:

2023: 11.6%

2022: 11.8%

2021: 12.0%

Analysis

Trend Analysis:

Palmer plc shows a slight decrease in the gearing ratio from 48.86% in 2021 to 46.30% in 2023. This indicates a marginal reduction in risk associated with high leverage as the company either increases its equity base or reduces its reliance on debt.

Gallaher plc maintains a consistently lower gearing ratio, fluctuating around 12%, which indicates a conservative debt position. This lower leverage suggests that Gallaher is less vulnerable to financial stress caused by debt, which is beneficial during economic downturns.

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Comparative Analysis:

Palmer plc's higher gearing ratios compared to Gallaher plc indicate that Palmer is more heavily leveraged. This could mean higher risk, as the company is more dependent on debt financing. High gearing ratios can lead to significant interest expenses which might reduce net income and dividends available to shareholders.

Gallaher plc's lower gearing ratios suggest a more stable financial structure with lower financial risk. Investors might view Gallaher as a safer investment, particularly in unstable economic conditions, due to its lower reliance on debt.

In conclusion, the gearing ratio analysis reveals distinct financial strategies between the two companies. Palmer plc operates with higher financial leverage, which could offer higher returns on equity during periods of positive economic growth but poses greater risks during downturns. Gallaher plc's conservative approach to leverage might appeal to investors looking for lower risk profiles, especially those concerned about market volatility or

economic recessions. For Sampdoria plc, choosing between these two companies should involve consideration of the company's risk tolerance and the economic outlook.

Investment Analysis and Recommendation Report for Sampdoria plc

Executive Summary:

This report provides a comprehensive financial analysis of Palmer plc and Gallaher plc, aimed at guiding Sampdoria plc in making an informed investment decision. Both companies operate within the UK retail fashion sector but cater to different market segments. The analysis delves into several financial metrics including gross profit margins, liquidity ratios (current and acid test ratios), and gearing ratios over the past three years. Our goal is to identify the company that presents a more favorable investment opportunity based on financial stability, efficiency, and growth potential.

Company Overviews:

Palmer plc

Palmer plc positions itself in the luxury segment of the market, renowned for its high-quality and stylish offerings. The company's financial strength is highlighted by its robust gross profit margins and strong liquidity ratios, indicating efficient operations and a solid financial base. However, it also maintains a high gearing ratio, reflecting a substantial reliance on debt financing.

Gallaher plc:

Gallaher plc targets the mid-range market segment, focusing on cost efficiency and broad consumer appeal through competitive pricing. The company has shown a commendable improvement in its gross profit margins, suggesting enhancements in cost management and

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operational efficiency. Unlike Palmer, Gallaher adopts a conservative financial strategy with lower debt levels, as evidenced by its low gearing ratio.

Financial Performance Analysis

Profitability

Palmer plc has consistently reported higher gross profit margins compared to Gallaher plc, suggesting superior profitability from its sales. Specifically, Palmer's margins over the last three years have been 40%, 35.38%, and 31.67% respectively, despite a downward trend. In contrast, Gallaher has improved its margins from 25% in 2021 to 30% in 2023, indicating progressively better utilization of resources and perhaps an optimization of pricing strategies.

Liquidity

Liquidity analysis, encompassing current and acid test ratios, reveals that Palmer plc significantly outperforms Gallaher in terms of short-term financial health. Palmer's current ratios are exceptionally high (over 3.70 in all observed years), reflecting a strong buffer to cover unexpected financial difficulties. The acid test ratios, while lower, still comfortably exceed those of Gallaher, further underscoring Palmer's superior liquidity position. However, Gallaher's lower ratios, though improving, suggest tighter liquidity which could pose risks in adverse economic conditions. These metrics indicate Gallaher's more aggressive approach to asset management might not provide as much financial cushion as Palmer offers.

Gearing

The analysis of gearing ratios presents a contrasting picture. Palmer plc's high gearing levels (around 46-48%) could be a concern as they imply a higher risk of financial exposure to debt and associated costs. In comparison, Gallaher maintains a conservative leverage strategy with

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ratios just above 11%, potentially making it a safer bet during economic downturns when debt servicing could become challenging for highly leveraged companies.

Investment Recommendations:

Based on the detailed financial analysis, each company presents unique strengths and weaknesses:

Palmer plc offers strong profitability and liquidity, which are attractive in stable economic conditions. However, its high debt levels increase its risk profile, particularly if market conditions deteriorate. Potential investors should consider this if they have a lower risk tolerance or foresee economic uncertainty5.

Gallaher plc appears to be improving its operational efficiency and maintains a sound financial strategy characterized by low debt levels. This conservative approach may appeal to investors seeking stability and lower risk in volatile markets. 6

Strategic Considerations:

- For Sampdoria plc, the choice between Palmer and Gallaher should align with their risk appetite and market outlook:

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[5] Marc Bertonèche and Rory Knight, *Financial Performance* (Oxford [UA] Butterworth-Heinemann 2003).

[6] Marc Bertonèche and Rory Knight, *Financial Performance* (Oxford [UA] Butterworth-Heinemann 2003).

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- If aiming for higher returns and equipped to handle potential risks, Palmer plc could be the preferred choice. Its strong market position and ability to generate cash quickly are significant advantages7.
- Alternatively, if a more cautious strategy is preferred, Gallaher plc offers a compelling investment. Its improving profit margins and conservative capital structure provide a resilient investment option against economic volatility.

Final Thoughts:

In conclusion, while Palmer plc shows potential for high returns, its financial risk cannot be overlooked. Gallaher plc, meanwhile, offers stability and a gradual improvement in returns, making it an appealing option for conservative investors. Sampdoria plc should weigh these factors carefully to align their investment with their overall strategic financial goals. Further, in-depth analysis and possibly consultation with financial advisors are recommended to tailor the investment choice to Sampdoria plc's specific needs and market conditions.

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