

Business Review of Another Business Utilising their Published Financial Statements

McLaren Holdings Limited

Jordan Wright 2011714

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Lecturer: Howard Davies

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<i>Abbreviation</i>	<i>Explanation</i>
Q1	First Quarter
Group	McLaren Group
F1	Formula One
MCLA	McLaren Carbon Light Architecture
EU	European Union
FTA	Free Trade Agreement
FY	Fiscal Year
RoA	Return on Assets
RoE	Return on Equity
DSO	Days Sales Outstanding
DPO	Days Payable Outstanding
D/E	Debt Equity Ratio
EBITDA	Earnings Before Interest, Taxes, Depreciation, and Amortisation
H1	First Half
CTO	Chief Technology Officer
CAGR	Compound Annual Growth Rate

Executive Summary

The purpose of this review is to utilise the financial statements of the British car manufacturers McLaren, presenting the proposition on a potential joint venture in producing an electric vehicle with McLaren Holdings company. Providing an analysis and evaluation of current and prospective profitability, liquidity and financial stability of the company will support the decision. Calculated financial ratios of the company performance will be presented alongside their importance and reasoning.

The review has found that the prospect of the joint venture with the company is currently favourable. Although there are weaknesses in the figures, through further investigation it has shown the time bound limitations are:

- The associated costs and time for the development of new innovative technology.
- Revenue impacted by the phase out of the Legacy Sports series in preparation for the UK Government announcement of net-zero end of sale for petrol and diesel vehicles by 2030.
- McLaren receive huge exposure during the Formula One (F1), which is currently on going and should reflect positively in the upcoming months.
- Restrictions due to COVID-19 effected the company's profit thus the operating margin increased due to rent saving on the global headquarters and the UK Government's Coronavirus Job Retention Scheme.
- Following the UK Government announcement to end all sales of petrol and diesel vehicles, allowed McLaren to invest in their new fleet of hybrid vehicles.

Introduction

This business review is presenting the recommendations of a potential joint venture with McLaren Holdings Limited to produce an electric vehicle for our company. By demonstrating a comprehensive understanding of McLaren's most current financial statement from 2020 until 2022 first quarter (Q1), the interpretation of the complex data will inform results that will influence our final decision. Consideration of possible changes in ratios and any limitations will be analysed.

Founded in 1963, McLaren Group Limited (Group) is a British based organisation that is divided into three divisions Automotive, Racing and Applied Technologies. The organisation manufactures luxury high performance supercars and innovative technology, as well as owning and operating one of the most successful teams in motorsport history (McLaren Group Limited, 2017 pg3). McLaren Holdings Limited is the financial instrument operating as a holding company for Group, controlling stock or investor interest in McLaren's other companies. This global leading company are pioneering the future of vehicle technology, for example in 2013 the company had already produced the world's first plug-in hybrid supercar.

Business, people and environment are the three main areas of the company. Sustainable fundamentals are ingrained into each facet of the process and operations within the company are aligned with the United Nations 17 Sustainable Development Goals (McLaren, 2021). For example by supporting decarbonisation the company pledge that by 2026 its road car fleet will be completely hybrid (McLaren Group Limited, n.d.).

Use and Limitation of Ratios

Financial Statements:

These provide a summary of the company's financial health and highlight any issues that financial ratios are unable to identify, in addition to presenting points that might support with interpreting the ratios. Gaining insight into how the company is performing, its financial position and the efficiency of operations and cash flow is essential when administering details about the company's debt, expenses, profitability and revenue. Although there are several types of statements the income statement and balance sheet are the most important, subsequent to the cash flow statement and notes to the accounts (MaRs, n.d.).

Financial statements are useful but should not always be depended upon as there are limitations. An understanding of these components will help make the company be aware of forthcoming problems before becoming reliant on them (Accounting Tools, 2022).

Financial Statement Limitations:

- The results on a financial statement might not be comparable to another company due to the difference in accounting practices.
- Without sufficient adjustment to inflation it will not reflect accordingly to the financial position and performance of the company (Goldschmidt & Yaron, 1991).
- Historical costs can be misrepresented on the balance sheet for assets and liabilities, due to the initial cost recorded at the time.
- Impact of non-financial factors such as economic changes that are not addressed can give false interpretation for the success or failure of a business (Accounting Tools, 2022).
- Interim reporting does not consider explicit time periods such as a surge in sales, seasonal effects and economic challenges. Future predictions can not be made.

Financial Ratios:

These act as objectives for future execution and the financial health of a company. These mathematical calculations can be used by the company to assess its performance, and can help recognise patterns in trends for either improvement or deterioration of the company by comparing two numbers. These numbers are best utilised when comparing the most current years ratios with the earlier year, and furthermore with the ratios of different company's in a comparable business (Fields, 2011 pg113). This is great help to management when studying the company's execution during a period of time. Ratios are divided into five categories:

1. Profitability
2. Liquidity
3. Activity
4. Financial Leverage/Gearing
5. Investment

These categories summarise the overall financial health of the company. A good understanding of the ratios will help when analysing the performance of a company against the financial environment, and within context of a progressive climate. Having an awareness of legal and administrative issues, a good recognition of the behaviours of ratios in a similar industry and having a better understanding of the company and its products can help make financial decisions.

Financial Ratio Limitations:

- Similar data is fundamental for any significant ratio analysis, for example missing data of industry averages or earlier years' performance will restrict the investigation (ACCA Global, 2007).
- Documented data is released periodically and therefore will always be historical and out dated, ultimately not guaranteeing a true representation of the company's future performance. Consideration also needs to be made for inflation.
- Structuring of the data needs to be correct otherwise will supply poor results.

Analysing ratios is established from data reported in the company's financial statements.

- Changes within accounting policies and procedures or operational structure will effect the company performance and conclusions.
- Economic changes could possibly limit ratio analysis, adjustments must be made to support any results.

Ratios are there to analysis the information and present how a business is performing. When everyone is using similar information it is easier to manage and understand between competitors, as well as gaining a better overview of a variety of different financial statements and their results. A sporadic transaction or exchange can alter the honest representation of a company. Highlighting the risks and trends of a company must be considered, for example the cost of materials in comparison with a similar company will give a better understanding of potential spikes in figures.

The McLaren ratios are valuable when recognised as part of a trend and reflecting changes in performance. The non-financial risks, trends and uncertainties for McLaren are not addressed in the financial statements, although are declared in the 2021 annual report.

McLaren's time bound limitations and trends are:

- The associated costs in developing future vehicles to leverage a competitive and technology advantage. McLaren Automotive want to economically position the brand into a key market similar to the cars being sold (McLaren Group Limited, 2020 pg10).
- F1 is a global motorsport entertainment giving McLaren huge exposure, prize money compensation and procurement of sponsorship. The World Championship is being held from Sunday 20th March until Sunday 20th November 2022 (F1, 2022). A change in car sales during the race should be considered, especially during the summer months and the final races (McLaren Group Limited, 2020 pg10).
- Since the COVID-19 pandemic the company took a momentous hit with both retailers and factories being made to close because of restrictions heightening. Shareholders supported the company by injecting 300 million GBP into G1 2020 through subscription to convertible preference shares (McLaren Group Limited, 2020 pg3). Car wholesale and factory operations are being managed despite international restrictions still in place.
- The UK Government have announced a net-zero with end of sale for petrol and diesel cars and vans by 2030 (GOV UK, 2021). As a result, McLaren have been innovating a new technology called McLaren Carbon Lightweight Architecture (MCLA), a fleet of hybrid vehicles with the goal to become completely electric in the next eight years (McLaren Group Limited, 2020 pg21).
- As of 31st January 2020 the UK have officially left the European Union (EU). The company planned for Brexit immediately putting the company in a strong position when moving forward, and making light of certain actions that might reduce any possible impact. A Free Trade Agreement (FTA) has settled, which will have an overall benefit for supporting the company (McLaren Group Limited, 2020 pg11).

Understanding that the financial statements help to thoroughly investigate the method of figuring out the risk and profitability of the company, and the ratio analysis is the infrastructure when estimating credit risk prices and the overall value of the company will give better results supporting the decision for a joint venture.

Ratio Analysis

Using McLaren Holdings Limited financial statements to analysis the income statement, balance sheet, cashflow and notes to accounts the outcome of the calculations will show that overall the company is in a healthy position. Comparing years Q1 2022, 2021 and 2020 the results are presenting a steady positive growth. Consideration for Q1 2022 is difficult to compare as the statements do not indicate what is profitable, for example if McLaren experience higher sales in the summer months this will not be reflected in Q1.

The company's Fiscal Year (FY) 2021 and Q1 2022 results show the company has faced unfavourable hurdles over the past 12 months, for example supply chain problems globally and delays of the new high performance hybrid supercar Artura has detrimentally impacted cash flow (McLaren, 2022 pg2).

Profitability Ratios:

	2022 Q1	2021	2020
Profitability Ratios			
Gross Profit Margin	27.46%	27.31%	26%
Operating Profit Margin	-3.89%	2.1%	1.1%
Net Profit Margin	-31.83%	-22.3%	-33.8%
Return on Assets (RoA)	-2.92%	-9.3%	-13.4%
Return on Equity (RoE)	-7.17%	-22.1%	-54.4%

These five ratios help determine the profitability of the vehicle manufacturing thus improving decision making to grow the company. The factors determining the profitability are product price, unit volume sold, cost (fixed and variable) and profitability (Fields, 2011 pg167-170). The identification of fixed and variable costs will help with efficient decision making.

Comparing performance figures for each year shows the company has had a steady growth with profits rising. Although in comparison with competitors Ferrari have had a gross profit margin for Q1 2022 of 50.4% (Ferrari N.V, 2022) and 50.95% for FY 2021 (Ferrari N.V, 2021) giving an adverse effect on McLaren's figures.

In 2021 McLaren's revenue was impacted by the phase out of their Legacy Sports Series, resulting in a slightly increased gross profit margin and lower margin revenue stream. The operating margin has increased significantly as a result of rent saving on the global

headquarters during COVID-19, resulting in a gain of 67.7 million GBP in 2020. Other operating reduced costs in 2020 was the UK Government's Coronavirus Job Retention Scheme that decreased costs and acquired the company 8.5 million GBP (McLaren Holdings Limited, 2021b pg6). The RoA shows to be less efficient at generating profits in 2021, although consistent with net profit results. As stated previously, McLaren have faced limitations in their supply chain and delays of Artura, which is reflecting on the loss of the net profit margin per sale and might result in profit gains during 2022. Although the McLaren's 2021 annual results show that the company sold more units but less money was made (McLaren Holdings Limited, 2021b pg4).

Liquidity Ratios:

	2022 Q1	2021	2020
Liquidity Ratios			
Current Ratio	1.58	1.6	1.1
Quick Ratio (Acid Test)	1.01	1.06	0.87

Liquidity ratios shows the company's ability to meet its short-term (<12 months) financial liability. These two ratios are the most commonly used to help evaluate this and examine the exchange between liquid resources and future payments owed. The success of a company are the ample liquid resources available to meet maturing obligations (Atrill & McLaney, 2019 pg196-7), for example the McLaren's 2021 annual results show that the bank loans and overdrafts in 2020 were paid off during the year (McLaren Holdings Limited, 2021b pg17) demonstrating good financial management.

When analysing the balance sheet this helps to evaluate the asset management performance of the company, for example inventory can take time to be attained into cash, which is why quick ratios are important when inspecting why stock has been removed because decisions about how the short-term assets can pay off short-term liabilities can be made (Fields, 2011 pg19-20). Currently healthy ratio figures for the automotive industry are 1.58 for current ratio and 1.33 for quick ratio once stock has been removed (Investing, 2022).

Activity Ratios:

	2022 Q1	2021	2020
Activity Ratios			
Days Sales Outstanding (DSO)	24	30	84
Inventory Turnover	1.92	8	14.2
Days Payable Outstanding (DPO)	32.74	52.62	46.92

Also referred to as Working Capital Management, these three ratios support the company when assessing its performance with reference to how credit function is managed. This is reflected in account receivable and inventory management (Fields, 2011 pg119-126).

The company's DSO payment terms when collecting money from their customers are very good, and high DPOs are favourable when paying suppliers because by slowing down cash flow demonstrating good financial management. Consideration for reasons to why the payment term may not have been met could be quality related, a supplier being in the company's debt, the system not being efficient or working, or credit control might not be managed.

Getting the working capital cycle right is important, although the time period of stock being turned-over has differed in 2021 as cash flow saw an increase of production stock for the company, and as a result cars were complete but not yet ready for wholesale (McLaren Holdings Limited, 2021b pg13). Some of this activity outflow continued into Q1 2022 because of the ongoing investment into Artura prior to customer launch, this should reflect positively in revenue over the forthcoming months. When calculating the inventory turnover raw materials were not included for turnover only finished goods, although due to the decrease of production volumes and industry shortages there was a decrease in raw materials thus lowering inventory being held (McLaren Holdings Limited, 2021b pg15).

Financial Gearing / Leverage Ratios:

	2022 Q1	2021	2020
Financial Gearing Ratios			
Debt / Equity Ratio	0.83	0.75	1.57

The gearing/leveraging ratios are the exchange between the finance contribution made by the company and the lenders contribution, this link is important when understanding how the level of risk will effect the company. The results of these ratios are used to support the decision about which financial loan would be best for the level of risk at stake (Atrill & McLaney, 2019 pg196). The use of borrowed funds demonstrates good financial management and can increase profitability.

The calculations have shown that for this report the Interest Coverage within the finance costs hasn't been split so is not calculable, so in this instance only D/E will be calculated. For D/E level the creditors greater than one year have been used. Due to the delay of the Artura launch this has had an opposing impact on the company's cash flow resulting in lower earnings before interest, taxes, depreciation, and amortization (EBITDA) and some of the working capital being absorbed. The stock for Artura was built in advance of customer deliveries, which resulted in the second half (H2) of 2021 constituting to the counterbalance of the cash retention in H1 (McLaren, 2022 pg3).

Investment Ratios:

	2022 Q1	2022 Q1 x 4	2021	2020
Investor/Investment Ratios				
Earnings per Ordinary Share	-£377.29	-£1509.18	-£1259.44	-£2020.98
*Price per Earnings Ratio	-0.00008879	-0.0000222	-0.00002144	-0.00001979

*(yahoo!finance, 2020) (yahoo!finance, 2021) (yahoo!finance, 2022)

These ratios are calculated to help shareholders who are not involved with managing the company to assess the profits and dividend from their shares. The results show that the company isn't making a profit meaning that the investors and shareholders are not receiving a dividend, so dividend cover and yield ratios cannot be determined.

New investors from both private equity and credit groups have invested 400 million GBP into the company, which has allowed for financial and strategic experts to support McLaren. The company's current shareholders, alongside a number of private investors have provided 150 million GBP of convertible preference shares. Consecutive to this value rise McLaren Group Ltd have bought investment in McLaren Racing as well as specific legacy resources, commissioning for ordinary share capital in the company bringing about cash inflow of 371.0 million GBP in the Group (McLaren Holdings Limited, 2021b pg5).

Summary of Findings

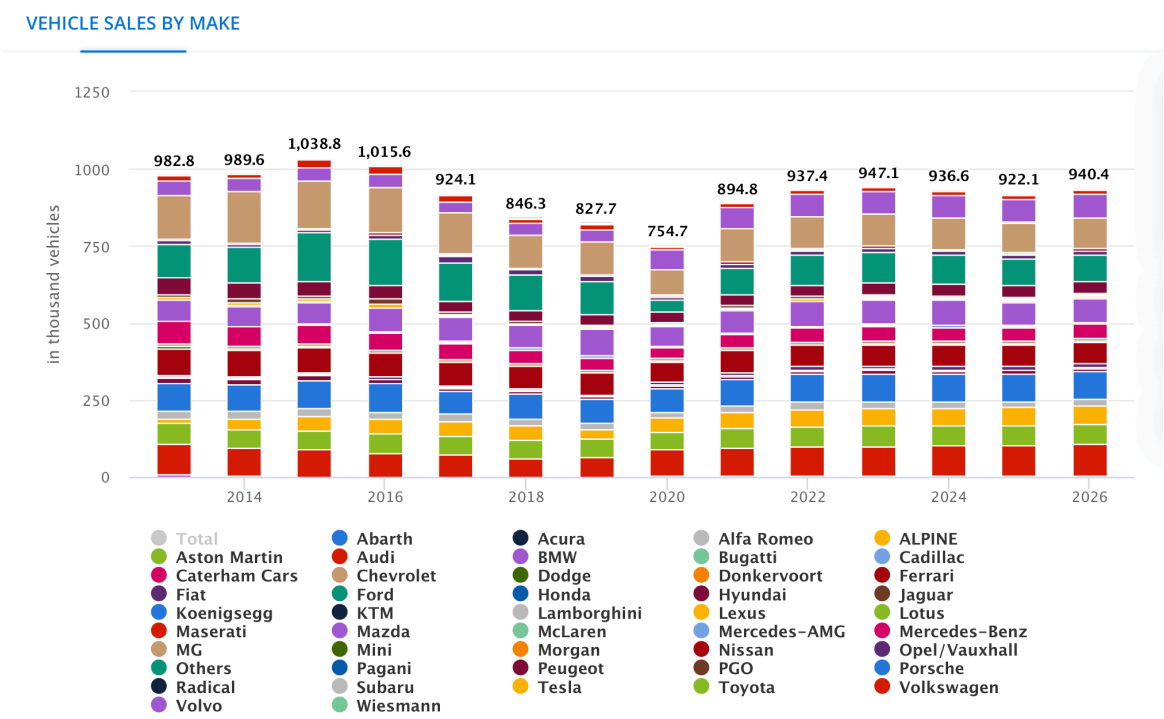
Over a 27 month period these findings have shown that year on year the company is making positive healthy progression in light of multiple limitations faced. With margins getting stronger and linking all the ratios together, these calculations provide direction for focus and consolidate inquiry giving a wider understanding into the future projection of the company. Data has shown that the company demonstrates good cash flow management and efficient debt return, which puts trust in an investor or investment.

The strength in the McLaren's balance sheets shows the structure supporting the company's goals and how these can maximise its financial performance, for example the trend analysis demonstrates that McLaren are growing in a positive direction and getting better after the investment of 156 million GBP in 2021 for new products and services (McLaren Holdings Limited, 2021a). Supporting the development of its innovative range McLaren Automotive have partnered with some of the world leading specialist experts in technology such as AkzoNobel, Kenwood, Pirelli and Richard Mille (McLaren Group Limited, n.d.)

The data has demonstrated that the future growth of a company cannot be based only on the figures in the performance, consideration must be made for the non-financial limitations that the company has encountered. Alongside this summary of findings additional influential information is that McLaren have recently appointed Michael Leiters as Chief Executive Officer of McLaren Automotive, which is commencing 1st July 2022 (Golding, 2022). Leiters has a wealth of knowledge and experience working previously as Chief Technology Officer (CTO) at Ferrari for eight years, and before that was at Porche for thirteen year as Product Line Director (Leiters, n.d.). Another is that in the 2021 World Championship McLaren's Racing F1 team was awarded fourth place, the 2022 F1 race finishes in November and if performed well this might effect vehicle sales or sponsorship. Finally as already mentioned global test driving for Artura started on 6th June for press and media, with the customer launch at the end of Q2 2022. With 424 wholesales in Q1 2022 down by 18% compared with 520 in Q1 2020, figures should reflect the awaited Artura in Q2 (McLaren, 2022 pg4).

It is predicted that between 2022 and 2026 the supercar market will have a Compound Annual Growth Rate (CAGR) of 0.10% and projected market value of around 55194.25 million GBP. With the segment unit sales expecting to reach 940.4 thousand vehicles by 2026, McLaren are known to be one of the major players pioneering the high-performance sports

car industry (Supercar Market, 2022). The diagram below shows McLaren's unit sales alongside supercar competitors over a fourteen year period.



Most recent update: Jan 2022

Source: Statista

(Statista, 2022)

In conclusion importance of the governance shared values between us and McLaren for the joint venture of electric cars is vital, as is the aligned brand and company values. The brand represents the way the company differs from its competitors but also welcoming investors, potential employees and customers. The differentiation and benefits of feeling like someone belongs to a brand are the core of brand values (Hatch & Schultz, 2008), so aligning everything from company messaging to employee goals helps the relationship to work in harmony. McLaren have affirmed a huge value creation opportunity focusing on brand strength, order books, pricing and margins, not volumes (McLaren Holdings Limited, 2021b).

Conclusion and Recommendation

After analysing the financial information found, to conclude I believe that there is a risk of appetite for the joint venture with McLaren based on the financial performance review presented. Looking at the trend analysis and fully considering the economic change issues, we can see that although McLaren's figures are currently in the negative the company are in a strong position with growth on the up. The liquidity ratios within this report shows the company has a lean business model by improving processes, reducing waste and delivering defined value to the customer.

Analysing the impact of COVID-19 on the automotive industry from a financial perspective, McLaren have taken the experience of the global pandemic positively coming out in a strong position. With key job roles in the company shifting, McLaren are gaining good work experience from new employers that can help the company in reaching its future goals. The company's objective can be defined in words other than on a certified balance sheet, but based on financially reviewing the company the figures have presented itself in a healthy financial state. The UK government outcome of ending all sales of new petrol, diesel and hybrid cars and vans from 2030 feels like this joint venture with a pioneering technology company is at the perfect time and could be the collaboration that we as a company need. The supplying of accurate information and innovative analysis helps to formulate the best possible business plan to choose for all involved members.

Appendix | Ratio Calculation

Performance:

	Q1 2022	2022 (ESTIMATE)	2021	2020
Profitability Ratios				
Gross Profit Margin	27.46%		27.31%	26%
Operating Profit Margin	-3.89%		2.1%	1.1%
Net Profit Margin	-31.83%		-22.3%	-33.8%
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Return on Equity (RoE)	-7.17%		-22.1%	-54.4%
Liquidity Ratios				
Current Ratio	1.58		1.6	1.1
Quick Ratio (Acid Test)	1.01		1.06	0.87
Activity Ratios				
Days Sales Outstanding (DSO)	24		30	84
Inventory Turnover	1.92	7.68	8	14.2
Days Payable Outstanding (DPO)	32.74		52.62	46.92
Financial Gearing Ratios				
Debt / Equity Ratio	0.83		0.75	1.57
Investor/Investment Ratios				
Earnings per Ordinary Share	-£377.29	-£1509.18	-£1259.44	-£2020.98
*Price per Earnings Ratio	-0.00008879	-0.0000222	-0.00002144	-0.00001979

*(yahoo!finance, 2020) (yahoo!finance, 2021) (yahoo!finance, 2022)

Calculations:

	2022 Q1	2022 Q1 x 4	2021	2020
Profitability Ratios				
Gross Profit Margin	$35161/128004 \times 100 = 27.46\%$		$166732/610387 \times 100 = 27.31\%$	$167826/645413 \times 100 = 26\%$
Operating Profit Margin	$(4985)/128004 \times 100 = (3.89\%)$		$12805/610387 \times 100 = 2.1\%$	$7219/645413 \times 100 = 1.1\%$
Net Profit Margin	$(40748)/128004 \times 100 = (31.83\%)$		$(136020)/610387 \times 100 = (22.3\%)$	$(218266)/645413 \times 100 = (33.8\%)$
Return on Assets (RoA)	$(40748)/908652 + 485077 \times 100 = (2.92\%)$		$(136020)/902771 + 556671 \times 100 = (9.3\%)$	$(218266)/1111624 + 515857 \times 100 = (13.4\%)$
Return on Equity (RoE)	$(40748)/568228 \times 100 = (7.17\%)$		$(136020)/615018 \times 100 = (22.1\%)$	$(218266)/400968 \times 100 = (54.4\%)$
Liquidity Ratios				
Current Ratio	$485077/(306669) = 1.58$		$556671/(339484) = 1.6$	$515857/(462336) = 1.1$
Quick Ratio (Acid Test)	$485077 - 174136/(306669) = 1.01$		$556671 - 195326/(339484) = 1.06$	$515857 - 112773/(462336) = 0.87$
Activity Ratios				
Days Sales Outstanding (DSO)	$34653/128004 \times 90 = 24$		$50043/610387 \times 365 = 30$	$149012/645413 \times 365 = 84$
Inventory Turnover	$92843/48145 = 1.92$	$1.92 \times 4 = 7.68$	$443655/55385 = 8$	$477587/33614 = 14.2$
Days Payable Outstanding (DPO)	$33775/92843 \times 90 = 32.74$		$63967/443655 \times 365 = 52.62$	$61398/477587 \times 365 = 46.92$
Financial Gearing Ratios				
Debt / Equity Ratio	$473385/568228 = 0.83$		$459877/615018 = 0.75$	$631011/400968 = 1.57$
Investor/Investment Ratios				
Earnings per Ordinary Share	$(40748)/108 = (377.29)$	$(40748)/108 \times 4 = (1509.18)$	$(136020)/108 = (1259.44)$	$(218266)/108 = (2020.98)$
*Price per Earnings Ratio	$0.0335/(377.29) = (0.00008879)$	$0.0335/(1509.18) = (0.0000222)$	$0.0270/(1259.44) = (0.00002144)$	$0.04/(2020.98) = (0.00001979)$

*(yahoo!finance, 2020) (yahoo!finance, 2021) (yahoo!finance, 2022)

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