

Business review for Potential Joint Venture – Aston Martin Lagonda PLC

BUSINESS REPORT



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Executive Summary

The present report shows the findings obtained from the analysis of the financial statements of Aston Martin Lagonda PLC, with the aim of evaluate the possibility of a joint venture between said firm and our organisation. The due diligence and performance of financial analysis here presented, provide key information that will aid the strategic business decision for a joint venture. Market conditions and trends examined. The findings presented in this report advice against pursuing a joint venture with Aston Martin due to recurrent net losses over the past 2 years (Q3 2022 reports also show losses). The ratios here calculated show concerning financials that could lead to bankruptcy if fundamental changes are not taken place within the core of the business.

Introduction

Aston Martin Lagonda PLC, an English luxury car manufacturer with a global geographical footprint, corresponds to one of the most recognised luxury vehicle brands. Their global wholesale volumes are of 1,984 in the Americas, 1,109 in the UK, 1,270 in Europe and 1,815 in Asia Pacific (Aston Martin Lagonda, 2021). This car manufacturer has been operational since 1913 and are regarded as a icon in the British automotive industry (gov.uk, 2016). The company is part of the FTSE 250 Index and hence is traded in the London Stock Market. Despite the strength and history of their brand, Aston Martin Lagonda has been closed to bankruptcy in seven different occasions (Korn, 2018).

The financial statements of Aston Martin Lagonda PLC used here were obtained from the annual report publicly available at: <https://www.astonmartinlagonda.com/investors/annual-report>. These statements correspond to 2021 as, at the time of this report, no financial statements for 2022 were available.

This financial overview delves into the profitability, liquidity, gearing, efficiency and investor ratios of Aston Martin Lagonda over the past three years and discusses the trends and evaluate risks associated to their finances in line of a potential joint venture.

Non-Financial Considerations

Aston Martin Lagonda PLC is well known for their luxury cars and aim to follow geographical locations where wealth is increasing. An example of this is their focus on strengthening their market share in China since 2018 (The Business Desk, 2018). The results of this focus are reflected in the reported growth in sales in China of more than 206% in 2021 (Aston Martin Lagonda, 2021). This includes the launch of their DBX derivative, model Straight-Six, exclusively designed for the Chinese market. This also reflects their growth in the luxury SUV market.

In addition to this, Aston Martin Lagonda PLC has entered the wave of “electrification” of cars with the introduction of the Valhalla supercar, Straight Six and Valkyrie with hybrid technology. Their aim is to launch plug-in, fully electric vehicles by 2025.

The return of Aston Martin to the Formula 1 after 60 years and their continuous presence in the documentary Drive to Survive on Netflix represents an important milestone for the brand and key marketing stunt.

Financial Information

The following corresponds analysis and discussion of main aspects covered in the Aston Martin financial statements (2021):

Revenue:

According to the information provided in the annual report, Aston Martin saw an increase in wholesale volume of 82% in 2021. Something to consider is that this percentage reflects

the post-Covid market trend, as the figures from 2020 show the poor health of the business (all business in general) due to the global pandemic and lockdowns. Hence, the ease of lockdowns and therefore the return to more regular trading market pushed revenue to £1,095m, corresponding to an increase of 79% over the year before which was sitting at £611.8m. However, it's important to highlight that 2020 is not the best year for comparative purposes due to the reasons mentioned above.

Cost of sales:

Actions taken in 2021 to reduce cost of manufacturing have translated into a reduction of 20% in manufacturing each vehicle (Project Horizon). Year 2020 showed that costs of sales were of £500.7m with a revenue of £611.8m. The costs of sales in 2021 were £751.6m but higher revenue (£1,095m). The lower cost of sales in 2020 compared to 2021 could potentially reflect the lower demand and also the number of dealerships having to be closed down due to the pandemic.

Gross profit:

The combination of the actions taken to reduce costs, together with the increase in revenues due to businesses coming out of the pandemic to some extent, pushed the gross margin in 2021 to £343.7m compared to £111.1m in 2020. The selling and distribution expenses have gone up from 2020 (at £79.6m) to £84.8m in 2021, corresponding to an increase of 6.5%. However, similar to the discussion above, this increase could potentially be the response of the reactivation of all businesses after the global lockdowns. On the other hand, the administrative and other operating expenses have decreased from £354.4m in 2020 to £335.4m in 2021, opposite to the expected trend post lockdowns. This being likely associated to the actions taken in the company's transformation programme (Project Horizon) that took place in all areas of the business.

Operating profit / loss:

During 2021, Aston Martin obtained operating losses of £76.5m, indicating that the cost of running the business seems to remain high for the gross profit obtained in 2021. Although this loss less compared to the one reported in 2020 (£322.9m), it can be argued that 2020 corresponds to a one-off year. The loss after tax for 2021 is £189.3m and £410.5m for 2019.

Information from previous annual report also show losses of £104.4m (after tax) for 2019 and £57.1m in 2018, indicating 4 consecutive years of reported losses that reflect an unhealthy business.

An alarming factor to consider and investigate further, is the high finance expense in 2021 (£173.7m), corresponding to the cost of the debt. An operating loss of £76.5m and interest on the debt of almost £174m could correspond to exacerbating financial problems with lenders for example, seeing this as a risk for lending to this firm.

According to the announcement of September 2022, Aston Martin Lagonda has raised £575.8m in a rights issue, with four new shares at 103 pence for every existing share (Reuters, 2022). This being an action to raise funds to help alleviating the current financial state of the company. However, this could also be interpreted as distressed measurements to keep the company in business.

Cashflow:

A positive cashflow of £178.9m was reported for 2021, with depreciation and impairment of plant, property and equipment; and amortisation and impairment of intangible assets and customer deposits being the main contributors. An unsustainable negative cashflow of -£198.6m was reported in 2020, but as mentioned previously, the unusual nature of 2020 has to be taken into account in this case.

Assets:

The total assets for 2021 totals £2,842.5m comprising of a combination of non-current and current assets as follows:

- Non-current assets:

The total non-current assets for 2021 is £1,974.6m. Amongst these, the item that shows the highest value is the intangible assets with £1,384.1m. According to the information presented in the annual report, this is a combination of goodwill (£85.4m), brand (£297.6m), technology (£153.6m), capitalised development cost (£833.3m), dealer network (£4.6m) and software and other (£9.6m). Further investigation is needed to

understand the details of what *capitalised development cost* refers to, and whether this is related to the production line to evaluate its liquidity.

- Current assets:

The inventories, which correspond to finished vehicles, work in progress, parts for resale, service parts and production stock are at £196.8m. Other current assets are trade and other receivables (£243.4m), income tax (£1.5m), other financial assets (£7.3m), and cash and cash equivalents (£418.9m) totalling at £867.9m for year 2021. It's important to highlight that the current cash and cash equivalent at £418.9m is quite significant. This can be used to help the company with the capital requirements and should be deployed as it is advisable to use it to boost the company's growth (Tuovila, 2022).

Liabilities:

As of 2021, Aston Martin had a total of £2,182.1m suggesting financial vulnerability. This should be of concern as banks can also see this as a risk for lending funds. Specifically, the total borrowings of £1,074.9m in the non-current liabilities is quite high and may be difficult to refinance. In current liabilities, the trade and other payables is the item with the highest value at £721.0m. These include trade payables (£134.1m) that are non-interest bearing, customer deposits and advances (£342.6m), accruals and other payables (£239.2m) and deferred income (£5.1m).

Capital and reserves:

The main stream of fundings in Aston Martin Lagonda come from shares (share premium) showing a total of £1,123.4m and with retained losses of £662.4m. In fact the share price YTD (as of December 2022), have been down 67.77% (Fig.1) and with a concerning fall of 95.91% of the past 5 years (Fig. 2), making the firm not appealing for investors. Factors such as a lawsuit for £150m in September 2022 from former dealers have exacerbate the decline in the share price (Hargreaves Lansdown, 2022).



Figure 1. Aston Martin Lagonda Global Holdings PLC, share price YTD



Figure 2. Aston Martin Lagonda Global Holdings PLC, share price 5 years

Analysis of ratios

The following table summarises the financial ratios calculated in this report:

	2021	2020	2019		2021	2019	2018
					(£m)	(£m)	(£m)
Liquidity ratios							
Current Liquidity Ratio	0.9588	1.1005	1.101	Revenue	1,095.30	611.8	980.5
Quick Liquidity Ratio	0.7414	0.8439	0.8453	Cost of sales	751.6	500.7	642.7
Cash ratio	0.4628	0.6055	0.6052	gross profit	343.7	111.1	337.8
Leverage ratios				Operating profit/loss	-76.5	-332.9	-52
gearing ratio	65.911	59.522	65.87	finance expense	173.7	183.1	83.9
debt/equity ratio	330.42	247.57	376.13	Net loss for the year	-189.3	-410.5	-117.6
long term debt / equity ratio	178.44	133.38	175.37	Non current assets	1,974.60	1905.3	1501.7
Interest coverage	-44.04	-176.4	-181.81	Current assets	867.9	889.5	550.9
Profitability & return				Current liabilities	905.2	808.3	789.5
Gross margin %	31.38	18.16	34.452	Non current liabilities	1,276.90	1182.4	832
Operating profit %	-6.984	-54.41	-5.3034	total shareholders equity	660.4	804.1	431.1
Net profit %	-17.28	-67.1	-11.994				
Return on assets %	-6.66	-14.69	-5.7293				
Return on shareholders equity %	-28.66	-51.05	-27.279	borrowings	1,074.90	971.3	604.7
Activity ratios				trade and other payables	9.8	7.5	49.8
days sales outstanding	81.133	106.53	89.379	lease liabilities	93.7	93.7	101.5
inventory turnover	3.8191	2.4142	3.8881	Interest charge	173.7	183.1	83.9
Days payable outstanding	351.71	422.55	372.1				
Investor ratios				trades and other receivables	243.4	177.9	240.1
Earnings per ordinary share	-1.639	-5.317	-2.7034	average revenue	3.000822	1.676164	2.686301
Dividend cover	N/A	N/A	N/A	inventories	196.8	207.4	165.3
Price per earnings ratio	N/A	N/A	N/A	trade and other payables	721	578.9	655.2
Dividend yield ratio	N/A	N/A	N/A	No of shares	115.5	77.2	43.5

Liquidity Ratios:

- Current ratio:

Current Assets / Current liabilities -> £867.9m/£905.2m = **0.95**

The current ratio for Aston Martin has decreased in 2021 compared to 2020 (1.1) which is of concern as it sits low compared to the current liquidity ratios of other firms in the automotive industry (1.00 – 1.50) (macrotrends, 2022). This ratio is used to evaluate the ability of the company for paying its short-term obligations (Corporate Finance Institute, 2022). Increased trades and other payables in 2021 seem to be the main driver for the low current liquidity ratio.

- Quick ratio:

$$(\text{Current Assets} - \text{inventories}) / \text{Current liabilities} = (£867.9\text{m} - £196.8\text{m}) / £905.2\text{m} = \mathbf{0.74}$$

The quick ratio is typically a more conservative ratio as it excludes assets that are not necessarily quick to convert into cash (Quick Books, 2019). Like the current liquidity ratio, a quick ratio also shows very low numbers for 2021. Both ratios show a decrease compared to year 2020 and therefore provide the message that Aston Martin Lagonda PLC has increasing problems with liquidity.

- Cash ratio:

$$\text{cash} + \text{cash equivalents} / \text{current liabilities} = £418.9\text{m} / £905.2\text{m} = \mathbf{0.46}$$

Potentially being one of the most reliable ratios for measuring liquidity as it indicates whether or not the company has enough cash to fulfil its current liabilities. Aston Martin shows that for 2021, the cash ratio is 0.46, indicating that less than 50% of the current liabilities could be covered with the available cash and cash equivalent.

Leverage ratios:

- Gearing ratio:

$$(\text{Non current liabilities} / (\text{equity} + \text{non current liabilities})) \times 100$$

$$£1,276.9\text{m} / (£660.4\text{m} + £1,276.9\text{m}) \times 100 = \mathbf{65.9}$$

The obtained gearing ratio shows that Aston Martin is highly levered and can potentially be heading into financial distress. The business shows an increase of capital coming from creditors, this is likely a key factor in pushing the organisation into a critical financial state as the payments to creditors are not controlled by the generated income of the firm (Boyte-White, 2021). The current increasing trend in interest rates could even make Aston Martin more vulnerable and push it into bankruptcy.

- Debt / equity ratio:

$(\text{Total liabilities} / \text{stockholders equity}) \times 100$

$(£2,182.1\text{m} / £660.4\text{m}) \times 100 = \mathbf{330.4\%}$

In other words, the debt / equity ratio shows that Aston Martin has £3.3 of liabilities for every £1 of equity.

- Long term debt / equity ratio:

$(\text{long term debt} / \text{stockholders equity}) \times 100$

$(£1,178.4\text{m} / £660.4\text{m}) \times 100 = \mathbf{178.4\%}$

The long term debt includes borrowings, trade and other payables, and lease liabilities. Similar to the previous ratio, this indicates that for every £1 of equity, Aston Martin has £1.78 of long term debt. The increase in the long term debt / equity ratio in 2021 compared to the one from 2020 (133.3%) is of concern.

- Interest coverage:

$(\text{Operating profit} / \text{interest charge}) \times 100$

$(-£76.5\text{m} / £173.7\text{m}) \times 100 = \mathbf{-44.04\%}$

Aston Martin reported operating losses of £76.5m in 2021 meaning that the interests charged are not being covered by the business. With 2020 also reporting losses of £322.9m, the business is on an alarming track of not being sustainable for covering interest charges.

Profitability and returns ratios:

- Gross margin:

Gross margin / revenue -> $£343.7\text{m} / £1,095.3\text{m} = \mathbf{0.313 \rightarrow 31.3\%}$

Improved margins are seen in 2021 with a 31.3% gross margin compared to 2020 when the business reported 18.1%. These values reflect a healthy gross margin compared to other companies in the automotive sector.

- Operating profit:

Operating profit / revenue $\rightarrow$ $-\text{£}76.5\text{m} / \text{£}1,095.3\text{m} = -0.0698 \rightarrow -6.98\%$

- Net profit:

Net income / revenue $\rightarrow$ $\text{£}-189.3\text{m} / \text{£}1,095.3\text{m} = -0.1728 \rightarrow -17.28\%$

Both operating profit and net profit show negative values and requires an investigation on exactly which items are the ones driving this (e.g. high overheads, higher interests). Substantial improvements in further reduce costs and increase sales are critical for the survival of the company.

- Return on assets:

Net income / assets $\rightarrow$ $-\text{£}189.3\text{m} / \text{£}2,842.5\text{m} = -0.0665 \rightarrow -6.65\%$

- Return on shareholders equity:

Net income / shareholders equity $\rightarrow$ $-\text{£}189.3\text{m} / \text{£}660.4\text{m} = -0.2866 \rightarrow -28.66\%$

The profitability and returns of Aston Martin show alarming negative ratios for the past 2 years (2021 & 2020). Q3 financial results available in the Aston Martin website show that losses are continuing to be reported together with increasing debt. This reinforces the message of Aston Martin not being a viable option for a joint venture.

Activity ratios:

- Days sales outstanding (DSO):

Trade and other receivables / average revenue per day $\rightarrow$

$\text{£}243.4\text{m} / \text{£}3.0\text{m} = 81.1 \text{ days}$

Although the automotive industry is a rather slow-paced industry compared to other ones, an improvement in the DSO should be pursued by Aston Martin.

- Inventory turnover:

Cost of goods sold / average inventory -> £751.6m / £196.8m = **3.8**

- Days payable outstanding (DPO):

Trade and other payables / average COGS per day -> £721.0m / £2.05m = **351.7 days**

The DPO of almost a year seems concerning and steps to substantially improve this are required. Investigations into how to improve the inventory turnover and also reduce the DSO should positively impact the DPO. Otherwise, the suppliers could withhold materials, for example, if invoices are not paid in acceptable timeframes.

Investor ratios:

- Earnings per ordinary share (EPS):

Net income / No of shares = -£189.3m / 115.5m = **-1.63**

- Dividend cover (EPS / dividend per share): Aston Martin has not paid any dividends for the past 3 years and is not expected to pay any dividends in the near future due to its financial situation.

- Price per earnings ratio:

Market value per share / EPS -> 501.52 / -1.63 = **-307.6 (=N/A)**

- Dividend yield ratio:

Dividend per share / market value per share -> N/A

For the benefit of the report, the price per earnings, dividend yield and dividend cover formulas are shown. However, no values are obtained due to Aston Martin not paying dividends for the past years. No dividends were paid in 2022 and also no dividends are

expected to be paid for 2023. This absence of dividend payments discourages investors' confidence in the company and aggravates the financial health of Aston Martin.

Limitations:

It's important to mention that the financial ratios are to be used as guidance to interpret the health of the company. However, the interpretations made from the ratios are dependent on the judgement made by the analyst (Atrill & McLaney, 2017) and the outcome can therefore vary from person to person. The financial ratios should be analysed as a whole and not only rely on specific ones, but also not only rely on them when analysing the finance of a company. In addition, context must be considered when it comes to evaluating the business. For instance, the pace of sectors such as supermarkets will have significantly different DSO and inventory turnover ratios to those of the automotive sector. Inflation can also skew the financial ratios and will portray a distorted view of the business (Atrill & McLaney, 2017). Lack of standardisation can also add inconsistencies to the ratios obtained.

Conclusions

The analysis of the financial statements show that the financial health of Aston Martin is concerning, and no joint venture should be pursued. Reported losses for the past 3 years, together with liquidity and profitability issues do not provide an appealing case. A drop of 69.98% in the share price value YTD and 96.19% in the past 5 years brings discouragement to investors which in turn will potentially worsen the financial resources available.

The gross margin seems to be healthy for the industry indicating that other aspects need to be looked at in detail to bring the company back to profit. For example, the operating losses may indicate that factors such as overheads are too high and need to be tackled. Also actions to improve the aspects controlling the activity ratios should assist the company's liquidity issues.

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