

INTELLECTUAL OUTPUT 4

Case Study IO4- Microeconomic

Tuhami, S.L: wholesale trade company in Melilla

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Key words: Tuhami S.L., financial analysis, economic analysis, solvency
and profitability

1. Summary

One of the economic determinants of Melilla, a Spanish city located in North Africa, is its historical tradition of supplying goods to the surrounding border area of Morocco. So, the companies dedicated to the wholesale trade have always been very important in the economy of the city.

Tuhami, S.L. is a small company located in Melilla, that has become one of the most important companies in the area. Why a company with relatively few workers can become the company with the highest turnover in Melilla?

The answer to this question is mainly due to two reasons. First, because of the exclusivity in the distribution licenses of products of great consumption that this company has, what favours to obtain good financial and economic results, as we can analyse in this case study.

At the same time, the company has changed its strategy by diversifying economic activities by changing the company's corporate purpose to real estate activities.

2. Introduction

This case study has been elaborated within the context of the 3economy+ project, being its main objective to analyse the economic and financial

situation of three different companies, one for each area involved into the project: Melilla (Spain), Alentejo (Portugal) and Malta (Malta). In addition, each company belongs to a different economic sector which favours the analysis of the differences that can arise in the financial and economic analysis.

In the case of Melilla, the firm selected is *Tuhami, S.L.*, dedicated to wholesale trade of electronic and telecommunications equipment and its components, and it is a small business with 10 employees. It was founded on 2006.

Recently, as a strategic policy, the company has diversified its wholesale activities, extending its corporate purpose to the real estate activities, comprising the acquisition and sale of land, buildings and urban properties in general, as well as the administration, holding, operation and rental or lease of real estate.

3. Aims

Businesses must base their activity on goals and objectives. To specify these goals and objectives, companies should analyse their finance and economic situation, in order to make the best decision considering the different policies and strategies.

In this sense, the financial and economic analysis is intended to study whether an entity is stable, solvent and profitable enough to warrant a monetary investment and it is mainly focused on the analysis of information coming from financial statements. So that, it allows to identify the key issues of one firm to facilitate decision-making.

The main objective of this case study is to analyse the key financial and economic indicators of *Tuhami, S.L.* the first company in turnover in Melilla.

4. Method

Whole aspects of a company are related to each other; however, in the microeconomic analysis, it is usual to distinguish between financial and economic analysis (Rodríguez-Ariza et al., 2016).

The first one examines mainly investments and disinvestments, both long-term and short-term, and the magnitudes derived from the financial area with the aim of diagnosing whether there is an adequate correlation between investments and financing sources, evaluating fundamentally the capacity of payment by the company.

On the other hand, the economic analysis refers mainly to the analysis of the firm' results with the objective of diagnosing if the company is carrying out its activity efficiently and efficiently, being able to generate adequate profitability.

The methodology of the financial and economic analysis consists on the analysis fundamentally of the firm data coming from the balance sheet and the income statement. So, after obtaining the financial statements of the selected company, it has been elaborated the common-sized balance sheet and income statement through the application of the vertical and horizontal analysis and calculated a series of ratios to identify the main strengths and weakness of the firm, following the methodology presented by Rodríguez Ariza et al. (2016).

So, first it is presented a brief summary of the company's characteristics. Then it is presented the financial analysis, for which we present the common-sized balance sheet and a list of financial ratios that are analysed according to the context of *Tuhami, S.L.* Finally, the economic analysis is performed through the study of the common-sized income statement and a series of economic ratios.

5. Results

Financial analysis

The common-sized balance sheet is presented in Table 1, for years 2015 and 2016. As it can be observed by the vertical analysis, the current assets present a higher weight than non-current assets, being the inventories the highest account element from the current assets.

This structure is common for companies operating in the wholesale sector and it is maintained both years, although there are some changes as the non-current assets has increased over 69,29% and the current assets has decreased a 45.23%.

Within this group of elements, inventories, accounts receivables and cash has decreased. The most significant drop is the suffered by the account receivables. The decrease of these elements can be originated by a decrease in the sales of the company and/or a change in the collection policy.

Considering the equity and liabilities, we can observe that *Tuhami, S.L.* has changed the structure of financing, as in 2015 it was mainly financed by external fund (74.74%) however in 2016 the main financing resource is equity (50.66%). Liabilities have decreased over 53.20% while equity has increased a

42.12%. There has been clearly a change in the financing policy of the company.

Within liabilities, the company is financed with short-term funds, coming from by its suppliers (29.98% in 2016 and 37.27% in 2015) and short-term loans (19.36% and 37.46%, respectively in 2016 and 2015).

Table 1. Common-sized balance sheet from Tuhami, S.L., 2015 and 2016

| ASSET | 2016 | % | 2015 | % | Variation |
|-------------------------------------|---------------------|--------------|---------------------|--------------|------------------|
| Non-current Assets | 8,963,129.3 | 33.6% | 5,294,482.7 | 14.1% | 69.3% |
| Current Assets | 1,771,5228.1 | 66.4% | 3,234,6028.3 | 85.9% | -45.2% |
| Inventories | 1,447,1825.1 | 54.3% | 1,794,4565.3 | 47.7% | -19.4% |
| Account Receivables | 3,105,072.5 | 11.6% | 1,379,5440.6 | 36.6% | -77.5% |
| Cash | 138,330.5 | 0.5% | 606,022.3 | 1.6% | -77.2% |
| TOTAL ASSET | 2,6678,357.4 | | 37,640,511.1 | | -29.1% |
| EQUITY AND LIABILITIES | 2016 | % | 2015 | % | Variation |
| EQUITY | 13,514,134.8 | 50.7% | 9,509,277.6 | 25.3% | 42.1% |
| LIABILITIES | 13,164,222.6 | 49.3% | 28,131,233.4 | 74.7% | -53.2% |
| Long-term Liabilities | | | | | |
| Current asset | 13,164,222.6 | 49.3% | 28,131,233.4 | 74.7% | -53.2% |
| Accounts Payables | 7,998,726.8 | 30.0% | 14,029,237.6 | 37.3% | -43.0% |
| Short-term financial liabilities | 5,165,495.8 | 19.7% | 14,101,995.8 | 37.5% | -63.4% |
| TOTAL EQUITY AND LIABILITIES | 2,6678,357.4 | | 37,640,511.1 | | -29.1% |

Source: Own elaboration derived from data from financial statements for Tuhami, S.L.

Going in depth, the financial ratios for *Tuhami, S.L.* are presented in Table 2. First, we present a series of ratios related with the financial position of the firm. Then the short-term and the long-term financial equilibrium are analysed.

Table 2. Financial ratios for Tuhami, S.L., 2015 and 2016

| FINANCIAL ANALYSIS | 2016 | 2015 | Variation |
|--|---------|---------|-----------|
| Financial position and Corporate indebtedness | | | |
| Solvency | 134.57% | 114.98% | 17.04% |
| Liquidity (acid test ratio) | 24.64% | 51.19% | -51.87% |
| Quick ratio | 1.05% | 2.15% | -51.22% |
| Debt to equity or Indebtedness | 97.41% | 295.83% | -67.07% |
| Debt composition | | | |

| | | | |
|---|---------------|----------------|---------|
| Long-term debt | | | |
| Short-term debt | 97.41% | 295.83% | -67.07% |
| Short-term financial equilibrium | | | |
| Working Capital | 4,551,005.49 | 4,214,794.86 | 7.98% |
| Operational Financing Needs | 9,578,170.8 | 17,710,768.34 | -45.92% |
| Net Liquid Resources | -5,027,165.31 | -13,495,973.48 | -62.75% |
| Cash Conversion Cycle | 54.51 | 52.77 | 3.30% |
| Days inventory | 145.07 | 133.69 | 8.51% |
| Days receivables | 8.02 | 7.07 | 13.40% |
| Days payables | 98.58 | 87.99 | 12.03% |
| Long-term financial equilibrium | | | |
| Equity guarantee | 202.66% | 133.80% | 51.46% |
| Short-term debt repayment capacity | 7.09% | 2.72% | 160.58% |
| Long-term debt repayment capacity | | | |
| Time to return financial credits | 14.11 | 36.76 | -61.62% |

Source: Own elaboration derived from data from financial statements for Tuhami, S.L.

From the analysis of the results presented in Table 2, *Tuhami, S.L.* is a solvent firm when it is compared current assets with current liabilities, but this advantage is decreasing if we analyse the liquidity and quick ratios that compare the most available assets with the current liabilities. Indeed, although solvency has increased, both, liquidity and quick ratios have decreased.

As it has been previously observed, *Tuhami's* indebtedness has decreased over a 67.07% so that in 2016 equity and liabilities are almost the same (97.41%). There is no long-term financing.

When analysing short-term financial equilibrium, *Tuhami, S.L.* present a positive working capital during 2016 and 2015 (so, part of current assets are financed by stable resources -equity and/or long-term liabilities-), with positive operational financing needs and negative net liquid resources. This result indicates that operational financing needs are higher than working capital, so part of operational financing needs are financed by basic financing (working capital) and short-term financing (net liquid resources). This situation can indicate certain financial tension.

Indeed, the cash conversion cycle during 2015 and 2016 is positive (54.51 and 52.77 days, respectively), which indicate that *Tuhami, S.L.* needs external financing to cover the exploitation cycle, related with its main activity. *Tuhami, S.L.* last on average 145 days in 2016 in selling its products, 8 days in collecting from its customers and it has 98.58 days of funding from its suppliers.

When the long-term financial equilibrium is studied, *Tuhami, S.L.* present a good position on guarantee as total assets can cover total liabilities (202.66% and 133.80% in 2016 and 2015, respectively), having capacity to repay the short-term liabilities so that, if *Tuhami, S.L.* would have to pay short-term liabilities, it would last 14 days. In summary, the financial position of the firm is good, although it must to control better the collection and payment politics.

Economic analysis

To perform the economic analysis, the common-sized income statement is presented in Table 3. As it can be observed, *Tuhami, S.L.* present a positive net result during both years, 2016 and 2015.

When analysing the composition of the result and margins, gross margin has a weight over 4.45% and 4.52% in 2016 and 2015, respectively, indicating that the highest cost element is cost of sales, representing the 95.55% and 95.48%, respectively, over total revenues. If other operating income and costs (cost of personnel and other expenses) are considered, the margin, EBITDA, decreases (until a weight of 2.23% and 1.98%).

This margin is relatively the same that EBIT, implying that amortization and depreciation present a low percentage. The financial result is negative so it decreases the margin as well as taxes, until a 1.59% over revenues.

Table 3. Common-sized income statement from *Tuhami, S.L.*, 2015 and 2016

| | 2016 | % | 2015 | % | Variation |
|---------------------------|--------------------|--------------|--------------------|--------------|--------------|
| Revenues and other income | 42,680,883.4 | 100.0% | 39,446,546.9 | 100.0% | 8.2% |
| Cost of sales | -40,781,329.5 | 95.6% | -37,665,376.8 | 95.5% | 8.3% |
| GROSS MARGIN | 1,899,553.9 | 4.4% | 1,781,170.1 | 4.5% | 6.7% |
| Other Income operating | 42,499.3 | 0.1% | 17,306.9 | 0.1% | 145.6% |
| Cost of personnel | -217,770.4 | 0.5% | -197,646.5 | 0.5% | 10.2% |
| Other operating expenses | -774,191.5 | 1.8% | -81,9152.5 | 2.1% | -5.5% |
| E.B.I.T.D.A. | 950,091.3 | 2.2% | 781,677.9 | 2.0% | 21.6% |
| Amortization and deprec. | -16,869.8 | 0.1% | -16,357.5 | 0.1% | 3.1% |
| E.B.I.T. | 933,221.5 | 2.2% | 765,320.4 | 1.9% | 21.9% |
| Financial income | 153,430.0 | 0.4% | 102,990.6 | 0.3% | 49.0% |
| Financial cost | -307,524.0 | 0.7% | -198,550.8 | 0.5% | 54.9% |
| FINANCIAL results | -154,094.0 | -0.4% | -95,560.2 | -0.2% | 61.3% |
| GROSS results | 779,127.5 | 1.8% | 669,760.3 | 1.7% | 16.3% |
| NET INCOME | 677,273.9 | 1.6% | 544,647.5 | 1.4% | 24.4% |

Source: Own elaboration derived from data from financial statements for *Tuhami, S.L.*

Studying the economic ratios presented in Table 4, return on assets evaluates the efficiency of the company using its assets to generate earnings, that has increased in 2016, having a result of 2.54%; while return on equity, that evaluates a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested, has decreased although it presents a positive result. In summary, the firm present a good economic position, with a positive result and efficient return on investments.

Table 4. Economic ratios for Tuhami, S.L., 2015 and 2016

| ECONOMIC ANALYSIS | 2016 | 2015 | Variation |
|---------------------------|-------------|-------------|------------------|
| Gross Margin Ratio | 4.45% | 4.52% | -1.44% |
| Operating Profit Margin | 2.19% | 1.94% | 12.70% |
| Profit Margin (after tax) | 1.59% | 1.38% | 14.93% |
| Return on assets | 2.54% | 1.45% | 75.45% |
| Return on equity | 5.01% | 5.73% | -12.50% |

Source: Own elaboration derived from data from financial statements for Tuhami, S.L.

6. Discussion

Financial statement analysis is a key tool in order to have a picture of the situation of a specific company, favouring the decision making.

The financial (solvency) and economic (profitability) situation of a firm is important for a large number of users of accounting information. However, each one will emphasize different aspects and will require a specific focus on the information depending on the decision they want to make (Rodríguez-Ariza et al., 2016).

In this case, the main purpose of the case study is to understand why *Tuhami S.L.* is one of the main companies in Melilla. To do it, we have analysed the balance sheet and the income statement of the firm, and we have performed a ratio analyses with data coming from these two financial statements.

And how is it possible to link this analysis with factors determining its leadership position? Because the good financial and economic health of the firm is the consequence of the strategy implementation, which in accordance with the notes, is focused on the exclusive license of distribution and the diversification activities to the real estate sector.

7. Conclusions and Recommendations

From the analyses performed, several conclusions can be highlight. First, *Tuhami, S.L.* presents a good financial health, although it must revise the collection and payment policy. It has a good capacity to generate liquid resources from its assets and also to meet the cost of external financing.

The firm present a good economic position, with a positive result, healthy cash flow and efficient return on investments, what may ensure a sustainable growth of the firm.

8. References

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