

The aim of this assignment is to compare business performance, liquidity and efficiency between two Finnish forest companies, ENSO-GROUP Oyj (Plc) and UPM-Kymmene Oyj (Plc).

Those two companies are leading forest companies in Finland

I compare their results, key ratios and financial positions in years 1992-1996.

This is done by use of different profitability ratios, efficiency ratios, liquidity ratios, investment ratios and gearing.

Calculations are made according to Finnish accounting law. Main differences between Finnish and IAS (International Accounting Standards) accountings are:

- Leasing contracts are not included in "Tangible assets" and in "Long-Term Liabilities".
- In Finland profit for the period is shown after increase or decrease in accumulated depreciation and untaxed reserves..

My interest for this is that forest industry is one of the most important client group to our company, and it is important to know trend of forest industry. It relates direct to our sales.

Changes in forest industry have also major impacts to whole Finnish economy.

It contributes about 8% of Finland's gross national product.

Forest industry's share of total export is 34 %. Because main raw material, wood, comes from Finnish forests and energy (another "raw material" to forest industry) is mostly generated in Finland, the forest industry yields 50% from Finland's net foreign currency earnings. (Source: Statistics Finland)

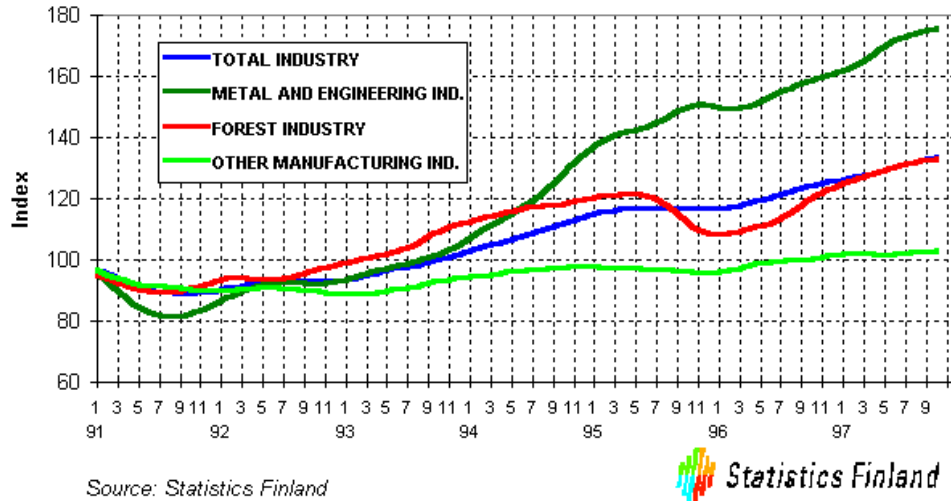
Economic factors affecting sector

Since crash of Finnish economy 1991 and followed devaluation of Finnish markka 1992, Finnish forest industry had three years of continuous growth. 1995 was record-breaking year. But 1996 industry faced biggest drop in production since 1975 recession, nearly 7% (pic1). Prices fell 8% (pic2) and export earnings FIM 6 billions. Biggest drop was in price of bleached long-fibre pulp, almost 35 % (Pic3).

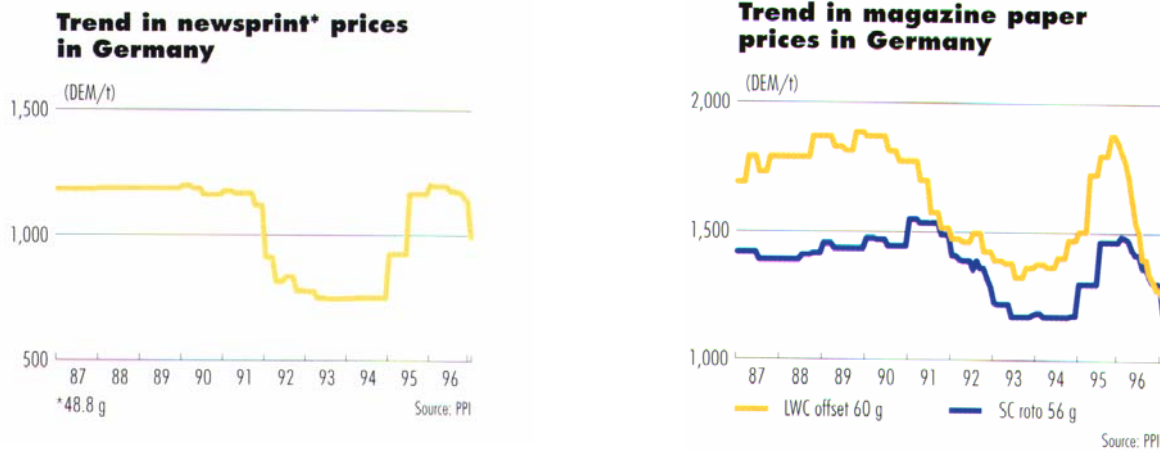
1996 was also year of reorganization in Finnish forest industry.

Merger of United Paper Mills and Kymi-Kymmene (UPM-Kymmene), merge of Enso-Gutzeit and Veitsiluoto (Enso Group) and joint-venture between Myllykoski Oy and merged Metsä-Serla & Metsä-Botnia.

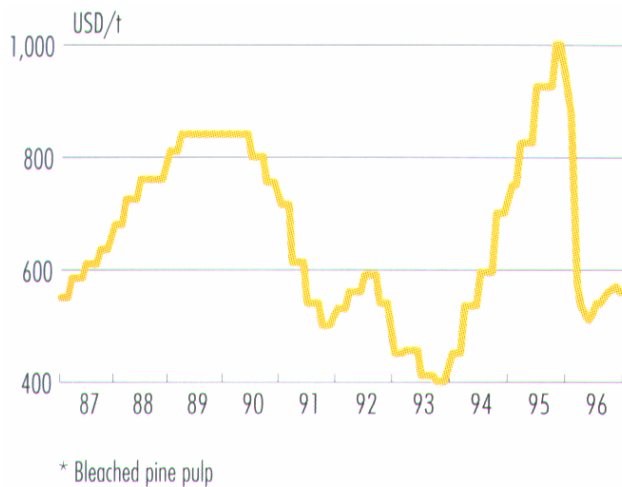
INDUSTRIAL PRODUCTION
Volume index 1990=100 (trend)



Pic.1 Industrial production 1991-97



Pic 2. Papers market prices 1987-96



Pic3. Pulps market price 1987-96

Analysis of UPM-Kymmene (UPM) and Enso-Group (EG)

Turnover and profit for the period MFIM

	1992	-93	-94	-95	-96
UPM					
turnover	35718	43963	47966	54738	51757
profit	na	na	898	1883	994
EG					
	14360	20433	23773	28026	25660
	-18	117	1153	1737	1033

If just look turnover and profit for the period , Enso-Group seems to be more attractive company to investors. Smaller turnover generates bigger profit. But this is not a entire truth. It needs more profound research to see how well company utilizes all resources available. What are movements, trends. Is one year business performance just a lucky stroke or a long term, noteworthy (or worrying) trend. And how well company is doing against competitors.

A. Business performance

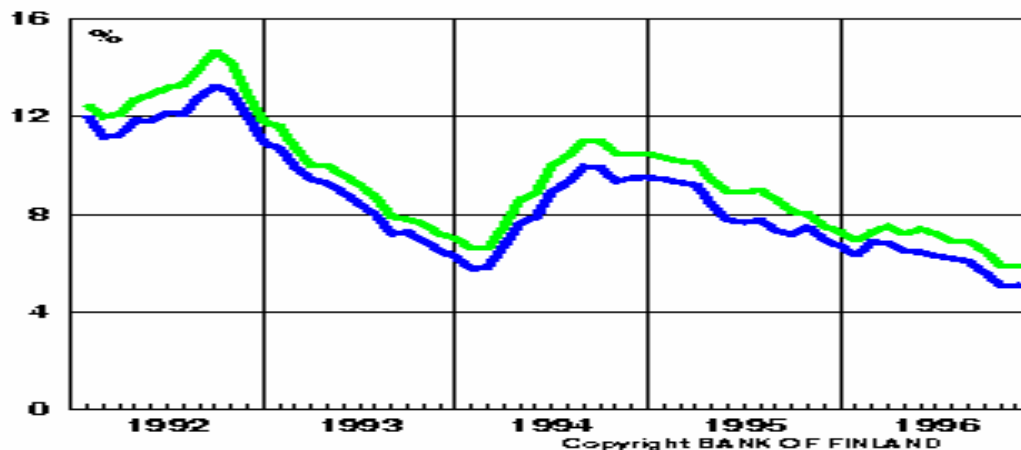
1. Return on capital employed

	1992	-93	-94	-95	-96
UPM	3%	6,8%	10,7%	16,2%	10,1%
Change %	+127%	+57%	+51%	-38%	
EG	4,3%	8,4%	12,2%	13,9%	8,2%
Change	+95	+45%	+14	-41%	

LONG-TERM INTEREST RATES

■ MARKET RATE, 5 YRS

■ TAXABLE GOVERNMENT BONDS, 4-7 YRS



Pic4 Government bonds

(Pic 4) Risk-free governments bonds had yielded better than investments in UPM-Kymmene. 1995 was first year when UPM-Kymmene gave better return than bonds. In 1996 gap was ~ +4%.

”The management has set a long-term profitability target of 15% for the return on capital employed ...which exceeds risk-free returns by a clear margin” (Yrjö Niskanen Chairman of the Board of Directors : UPM-Kymmene Annual Report 1996).

Enso-Group’s annual report 1996 do not put any emphasis on ROCE

In trend of ROCE since last five years, UPM has managed better.

1. Return On Sales

	1992	-93	-94	-95	-96
UPM	5,7%	9,3%	11,5%	15,5%	10,8%
Change		+63%	+24%	+35%	-31%
EG	5,4%	11,2%	13,5%	17,6%	10,5%
Change		+107%	+21%	+30%	-41%

Enso-Group’s ROS has been better 1992-95, but UPM’s trend is better.

Costs and expenses MFIM

UPM	na	na	39858	44005	43760
				+10%	-1%
EG	na	na	na	22176	21629
					-2%

When a sale has dropped, overhead costs and expenses have not followed.

From 1994 to -96 overheads have risen 9,8 %, and sales 7,9%.

When a sale goes up, expenses easily follow. When sales drop, how to cut expenses?

Do not let expenses rise in god times, so you do not have to cut those in bad times.

2. Sales/person MFIM

	1992	-93	-94	-95	-96
UPM	0,85	1,03	1,09	1,23	1,19
EG	0,76	1,09	1,23	1,45	1,34

EG can generate more sales/ person. EG's value of machinery and equipment per turnover is 0,58 and UPM's 0,48. EG seems to have more modern and productive machines.

4. Operating profit MFIM

	1992	-93	-94	-95	-96
UPM	na	na	5477	8504	5591
EG	777	2292	3206	4933	2706

Profit on disposal of fixed assets MFIM

	1992	-93	-94	-95	-96
UPM	na	na	361	361	677
EG	na	na	-	-	173

PBIT from basic business (Operating profit – disposal of fixed assets) MFIM

UPM	--	--	5116	8143	4914
				+59%	-40%
EG	-	-	3206	4933	2533
				+54%	-49%

UPM-Kymmene's performance on basic business -96 has been 4% lower than -94, and 40% lower than -95.

Enso-Group: -96/-94 7,9 and -96/-95 49% lower

UPM's trend seems to be better.

5. Gross profit %

	92	-93	-94	-95	-96
UPM	na	na	42,7	42,4	43,9
EG	na	na	na	44,8	44,2

B. Liquidity

1. Current ratio, short term liquidity

This ratio measures ability to pay current liabilities

	-92	-93	-94	-95	-96
UPM	1,01	0,95	0,95	1,03	0,92
Change %	-5,9%	0%	8,4%	-10,7%	
EG	na	na	na	1,42	1,00
Change %				-29,6%	

Forrest industries seem to operate on tight liquidity ratio. Manufactures normal safety level is 1,5 – 2.

Enso-Group current ratio has dropped sharply from –95 to –96.

2. Acid test.

This test ignores stock value, and gives real short term liquidity.

	-92	-93	-94	-95	-96
UPM	0,64	0,61	0,58	0,56	0,53
Change %	-4,7%	-4,9%	-3,4%	-5,4%	
EG	na	na	na	0,56	0,48
				-14,3%	

Forest industries stocks are saleable (normal paper, pulp and timber, no obsolescence stock), so current ratio gives more realistic picture.

3. Gearing ratio

This measures relationship between loans and funds

	-92	-93	-94	-95	-96
UPM	209%	184%	145%	102%	98%
Change %	-12%	-21,2%	-29,7%	-3,9%	
EG	236,2	205,2%	162,4	115,1	106,1
Change %	-13,1%	-35,5%	-29,1%	-7,8%	

UPM-Kymmene and Enso-Group have heavy burden of dept. But the trend is positive. As words of Yrjö Niskanen: ” The main goal (for UPM) in the immediate future is to reduce indebtedness” (UPM-Kymmene Annual Report 1996).

It seems to be so that EG has more ambitious plan to pay off debts, but recession in 1996 increased short time debts. Or is it so that EG has believed in continuous growth ?

C. Efficiency ratios

1. Stock turnover in days

	-92	-93	-94	-95	-96
UPM	na	na	na	59	56
EG	na	na	na	60	61

UPM's stock turnover has decreased, and EG's increased. Higher stock ties up working capital.

2. Debtors turnover in days

	-92	-93	-94	-95	-96
UPM	na	na	na	46	48
EG	na	na	na	43	52

An increase may show growth in bad debts. EG may have some problems in collecting money (or has changed policy in terms of payments, but increase in current ratio suggest that they have some problems). Longer payments tie up working capital

3. Creditors turnover in days

	-92	-93	-94	-95	-96
UPM	na	na	na	56	56
EG	na	na	na	49	49

UPM takes longer credit periods from its suppliers. Longer credit period release working capital.

Conclusions:

Both company's business performance is rather low.

Industry is capital-intensive (low ROCE, but ROS normal). And a bad investment yields bad results for decades (expected lifetime for paper machine is 20-30 years).

There is no "hat trick" to improve results in short run. All adjustments to improve results can be seen in long run.

Enso-Group's main shareholder is Finnish State, 53% of shares and 73,5% of votes, therefore sometimes Enso's decision can be driven by political, not a economical point of view.

In business performance: ROCE, ROS, profit from basic business, UPM-Kymmene's trend is a little bit better than Enso-Group's. EG generate more turnover/person, what may be a hint that UPM have to invest more to new machines.

Current ratio, acid test and gearing ratio pinpoints the biggest problem in Finnish forest industry, burden of dept.

For investors it is difficult to say, which company is better to invest.

My opinion is that the scale tips in favour of UPM-Kymmene Oy. Its trends are more consistently.

Evaluation (3/9-99)

In this assignment I learned to look behind figures. How to analyse firms reports and what those figures really mean. What information can be found and calculated in addition to "released information" (stock/debtors/creditors turnover ROCE etc).

Today I use similar methods to compare our performance to competitors performance.

The books I read for this:

Financial Management (R. Brockington)

Business Finance for Decision Makers (McLaney E J)