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Wool questions remain unanswered

Alan Robb\*

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In October 2010 the directors of Wool Partners Co-operative Ltd were confident that they could attract subscriptions for at least \$65 million of shares by 30 November.

They did not and the closing date was twice extended.

Criticisms of the prospectus were that although it complied with securities requirements it did not include a comprehensive summary of expected revenues and expenses, there was no balance sheet nor was there any detail of the assets and liabilities being acquired from Wool Partners International (*The New Zealand Farmers Weekly* November 1). An amended prospectus has now been issued.

While it does contain 30 pages of the additional financial information which was absent from the October prospectus not all of the questions have been answered.

The summary prospective income statements show the co-operative is likely to lose \$1.774m on three months trading to 30 June 2011 and make a profit of \$1.418m for the 12 months to 30 June 2012, both figures being after tax.

No rebates are expected to be paid to members in either period.

The prospective cash flow statements show a negative operating cash flow of \$1.161m for 2011 and a surplus of \$2.192m for the year to June 2012.

A net inflow of just \$1.031m on turnover of \$117.4m is hardly a sign of strength.

The notes to these statements disclose the following points and raise some questions.

There are no provisions for doubtful debts and neither is any bad debts forecast.

It is noted that the majority of receivables relate to trade finance receivables of the sales division are "are insured by the Group to reduce the risk of non-collection."

I note that the insurance will "reduce" the risk rather than "eliminate" it.

The prospectus is presenting an over-optimistic picture by making the assumption that there will be no losses on revenue of over \$100m.

A second questionable assumption concerns the value of intangible assets.

The balance sheet shows that intangible assets "including goodwill" amount to \$14.799m.

A footnote discloses that \$500,000 comprises Brands. ‘

No details are provided as to the nature of the remaining \$14.299m of intangibles.

The notes refer to intangibles as comprising "computer software, goodwill, research and development, and brands".

It is also shown, for the first time, that the projected results do not include any writing down of these intangibles.

It used to be the standard practice to write goodwill and other intangibles off, “normally over 10 years and in any case over not more than 20 years.” This was a conservative practice which had much to commend it.

Today’s accounting standards require intangibles with an indefinite life to be tested at least annually for “impairment” and any decrease in value to be written off.

By declaring that “no impairment is forecast during the period to 30 June 2011 and the year to 30 June 2012” the directors are implying that they are confident that the value of intangibles will be not less than \$14.799m.

In the light of the earlier unconfirmed report that the business made losses of \$3.9m and \$1.8m in 2009 and 2010 under PGG Wrightson and will barely break even in 2011 and 2012 it is impossible to see how goodwill and other intangibles can justify a value of nearly \$15m.

The intangibles will amount to 32% of the total assets at 30 June 2011.

The settlement of the acquisition price, \$17.069m is confusing.

The notes state that it will be paid by two instalments. \$8.534m will be paid on 31 May 2011 and the remaining balance in 2012. The unpaid balance will bear interest at 9.75%.

The prospective statement of cash flows shows the full amount being paid in the period ending 30 June 2011. It also shows a “Drawdown of Deferred Settlement” of \$8.325m in 2011 with a “Repayment of Deferred Settlement \$8.583m” in 2012.

This suggests that the co-operative will be borrowing half the acquisition money in 2011 in order to complete the transaction.

The debt to members’ funds in 2011 will be 313% and in 2012 is expected to fall to 103%. Both ratios depend on farmers contributing at least \$13m in capital each period.

To date the board has been over-optimistic in assessing the extent of farmer support.

The board’s emphasis has been on marketing the concept of a co-operative without providing sufficient necessary financial information.

The revised prospectus will do little to dispel the view that the float would be financing “a loss-making wool business that has yet to prove itself” and that “PGG Wrightson will have made considerably more from financing the sale of their wool business than they ever made from trading.”

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- Alan Robb is an Adjunct Professor in the co-operatives programme at Saint Mary’s University, Canada, and an independent financial analyst and commentator based in New Zealand.