

# Mulberry

## Balance sheets and Alexa Chung

The luxury handbag company Mulberry has come out of the recession stronger than ever. **Michael Mison** considers how and why, and incorporates balance sheet analysis to help with your exam practice

For many companies, the recent recession meant going to hell and back. Some, though, didn't come back. What then were the survival prospects for a 40-year-old producer of not-very-fashionable, expensive handbags? Bags costing between £500–£1,500 each?

In the 3 years leading up to the 2008/09 recession, Mulberry had been going nowhere (see Table 1), even though this was a boom time for luxury products. The collapse in consumer confidence in autumn 2008 caused immediate and dramatic effects. Although Mulberry's factory in Somerset is its flagship, 70% of its bags (the more labour-intensive, fiddly ones) are made in China, Spain and Turkey. This forces the company to place orders for the autumn/pre-Christmas season early in the year. Therefore, when demand slumped in October–December 2008, supplies kept coming. The company's stocks (inventories) doubled between March 2008 and March 2009. The effect of this on the balance sheet can be seen in Table 2.

### Financial background

Fortunately for Mulberry plc, its chief executive is a former finance director, who describes his financial management as 'conservative'. In years when bankers were encouraging businesses to borrow to expand, Mulberry kept a very safe, cautious balance sheet. This provided a cushion for the business when the tough times came. The nearly £7 million collapse in the cash total would have caused a liquidity crisis in many businesses. For Mulberry, however, March 2008's generous acid test ratio meant the business could cope with the tricky autumn.

The acid test ratio figures for 2008 and 2009 (calculated from Table 2) are as follows:

$$\text{acid test ratio} = \frac{\text{current assets} - \text{stock}}{\text{current liabilities}}$$

$$2008 = \frac{\pounds 15,785,000}{\pounds 11,821,000} = 1.34$$

(comfortably above accountants' recommendation of around 1.0)

$$2009 = \frac{\pounds 9,742,000}{\pounds 11,750,000} = 0.83$$

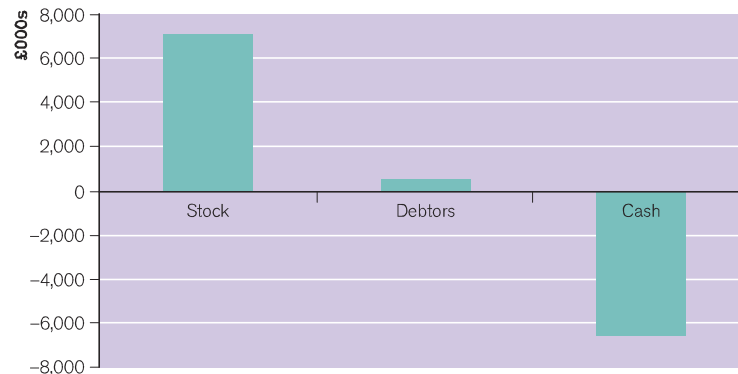
(just under 1.0; not a worry)

Figure 1 gives a clear idea of how the increase in stock stripped the balance sheet of its cash in 2009. For Mulberry, as with every other business, stock management is critical to working capital management — and therefore both to cash flow and to liquidity.

Even though the recession was still in full flow, the period April–September 2009 saw a remarkable recovery by Mulberry. At the end of 2009, the company chairman reflected that 'sales for the 6 months to 30 September 2009 were significantly ahead of our expectations'. Remarkably, UK sales

**Table 1** Financial data for Mulberry plc, 2006–2008

	Year end 31/3/2006	Year end 31/3/2007	Year end 31/3/2008
Revenue	£43,406,000	£45,078,000	£51,174,000
Operating profit	£6,157,000	£6,672,000	£4,774,000
Operating margin	14.2%	—	9.3%
Capital employed	£13,452,000	£16,869,000	£22,519,000
Return on capital employed (ROCE)	45.8%	—	21.2%



**Figure 1** Mulberry plc: change in current assets 2009

**Table 2** Mulberry plc balance sheets  
2008 and 2009 (year to 31 March)

	2009 (£000s)	2008 (£000s)
Non-current (fixed) assets	11,694	10,791
Inventories (stock)	14,830	7,785
Receivables (debtors)	6,032	5,548
<b>Cash</b>	<b>3,710</b>	<b>10,237</b>
Current liabilities	(11,750)	(11,821)
Non-current liabilities	(132)	(21)
<b>Net assets</b>	<b>24,384</b>	<b>22,519</b>
Share capital	9,878	9,878
Reserves	14,506	12,641
<b>Total equity</b>	<b>24,384</b>	<b>22,519</b>

at Mulberry shops were 41% ahead of the previous year. This enabled the excessive stock level to be brought under control.

### New strategy

The explanation for the surge in sales was simple: Mulberry had become fashionable. It-girl Alexa Chung had been seen carrying a classic Mulberry bag and this had created media interest. Mulberry's creative director, Emma Hill, had cashed in by launching a wave of new, younger-looking bags. This repositioning of the brand (from middle-aged to young and stylish) was complemented by a redesign of the online store. Accordingly, sales through the website rose by 80%.

In January 2010, Emma Hill made an even bolder attempt at capturing the young, fashion-conscious market with the 'Alexa' bag. This was an updated version of the classic Mulberry bag, but named after Chung herself. A wave of public relations-based articles appeared in magazines from *Vogue* to *OK*. The £800 price tag proved no barrier to sales, as the first batch sold out in 3 weeks.

### Turning point

At the time of writing, the 2010 annual results are not yet out, but the company says that UK sales will be 47% higher than in the previous year. In the midst of the biggest recession for several generations, Mulberry has turned an important corner. In the past, it thought that only middle-aged women could afford posh handbags. Now it believes that young women will find a way to get the bags they want — even if it takes them 6 months.



Alexa Chung with the Mulberry 'Alexa' bag she inspired