

## **Case 1: Analysis of Competitors**

### **Facts**

You are an analyst, following NatureWear and you are currently preparing your forecast for NatureWear. During your analysis, you find an interesting competitor of NatureWear, namely OutdoorWear. You are provided with the following information about OutdoorWear.

### **Company History and Operations**

OutdoorWear was founded in Hamburg in 2005. It produces outdoor clothing and accessories for camping. OutdoorWear mainly distributes their products via low-price discounters such as Declithon and via OutdoorWear's own online shop. The online shop operates globally, while the stores are mainly focused on the German-speaking region. OutdoorWear mainly uses online advertisement and posters to advertise their products.

OutdoorWear went public on the Frankfurter Wertpapierbörse in 2015.

### **Company Growth Strategy**

OutdoorWear's growth strategy has mainly one element: OutdoorWear holds an equity stake of 40% in an associated company, namely SustainableCamping Ltd. OutdoorWear expects that its business significantly profits from the investment, especially with the extension of the products.

### **Product Development**

Currently, OutdoorWear is highly depended on their suppliers and the goods are produced by independent manufacturers. In the future, OutdoorWear plans to build own factory buildings to become independent.

### **Financial Reporting**

The consolidated financial statements are reported in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) as applicable within in European Union. You are provided with OutdoorWear's balance sheet and income statement (s. Excel).

OutdoorWear provides you with the following notes concerning their joint venture.

#### *Notes*

*Significant companies where OutdoorWear is able, directly or indirectly, to significantly influence financial and operating policy decisions (associates), or that are directly or indirectly jointly controlled (joint ventures), are accounted for using the equity method. Joint ventures also include companies in which the OutdoorWear holds the majority of voting rights, but whose articles of association or partnership agreements stipulate that important decisions may only be resolved unanimously. Insignificant associates and joint ventures are carried at cost net of any impairment losses and reversals of impairment losses required to be recognized.*

*From a Group perspective, the joint venture SustainableCamping Ltd. was material at the reporting date.*

*SustainableCamping Company*

*SustainableCamping Company develops, produces and sells camping busses. There is an agreement in place between Group companies and the joint venture partner ChinaCamping Corporation Limited regarding a long- term strategic partnership. The principal place of business is in Changchun/China.*

## Tasks

1. Please describe OutdoorWear's business model and plans. How would you expect these plans to affect the company's future financial statements and key ratios?
  
2. Please explain how to account for joint ventures and associates under IFRS. Please develop a numerical example illustrating the accounting treatment.
  
3. Please decompose OutdoorWear's ROE using the Advanced DuPont model. Doing so, please:
  - a) Discuss different approaches to classifying the investment in associates (financing versus operating) and which approach is preferable in the present case. (How) do different classifications matter for ROE and why?
  
  - b) Please explain the problems that arise from the equity method in the context of the Advanced DuPont decomposition. Which additional information would you need to acquire from SustainableCamping Company to address these problems?