

# [Star river electronics ltd assignment](https://assignbuster.com/star-river-electronics-ltd-assignment/)

It shows that the company had ability to recover its ROE and operating margin. If ROAR is sound and debt levels are reasonable, a strong ROE is a solid signal that managers are doing a good Job of generating returns from shareholders’ investments. Increasing sales and assets may also increase the debt of the company. Therefore, Star River needs more concern about the growth of profitability without taking too much debt. We analysis the financial leverage of the company, it shows that the debt to capital ratio and debt to equity ratio had an upward trend between 1998 and 2001.

The higher the debt-to- capital ratio, the more debt the company has. It shows that Star River is more prone to using debt financing. It may also show weak financial strength because the cost of these debts may weigh on the company and increase its default risk. The debt to equity ratio increased from 1. 13 in 1998 to 2. 20 in 2001. A high debt/equity ratio generally means that a company has been aggressive growth with debt financing. Iris can result in volatile earnings as a result of the additional interest expense. However, the interest coverage ratio of the company looks in good condition.

When a company’s interest coverage ratio is no more than 1. 5, its ability to meet interest expenses may be questionable. Star River’s interest coverage ratio is always higher than 2, so it had the ability to meet the interest expenses. In terms of assets utilization, the company’s asset turnover ratio is decreasing constantly from 65. 2% in 1998 to 57. 4% in 2001 and days in receivables ratios increased from 112 in 1998 to 122. 1 in 2001. Assets turnover is a ratio that shows the efficiency of a company’s use of its assets in generating sales revenue or sales income to the company.

Therefore, Star River has become less efficient to generate revenue by using its assets. The longer days in receivables indicates that company need longer time to collect on its sales to customers on credit. Moreover, the assets growth rate fluctuated wildly during the period, 8%, 13. 5%, 29. 3% and 14. 2% over the 4 years. From 1998 to 2001, there was a stable increase in Inventories to COGS ratio. It may be caused by a study predicted the market share of CD-ROOM will fall in the future because of the introduction of DVD. Therefore, Star River needs to consider the market change in order to avoid stock obsolescence.

The company needs to sell CD-ROOM inventories at discount price. However, the revenue of the company will be reduced or even make significant loss. In terms of liquidity ratio, current ratio is an indication of a firm’s market liquidity and ability to meet creditor’s demands. The analysis shows that the current ratios to the company are O 0 77, 0 8 and 0 88 during this period Moreover, the quick ratios of Star River are 0. 41, 0. 41, 0. 31 and 0. 34 from 1998 to 2001. Low values for the current and quick ratios indicate that company may have faculty in meeting current obligations.

Additionally, the sustainable growth rates are the most important figure for the company. The sustainable growth rate is a measure of how much a firm can grow without borrowing more money. As it shown in the table, we found that the sales growth rate of the company is higher than the sustainable growth rates between 1998 and 2001. It means that Star River must use other funds to facilitate growth, which will increase the financial risk. In summary, the company had a good financial performance between 1998 and 2001. However, the many needs to pay more attention on the increasing debt ratios and lethargic assets utilization. . Forecast the firm’s financial statements for 2002 and 2003. What Nil be the external financing requirements of the firm in those years? Can the firm repay its loan within a reasonable period? In order to forecast the financial statements of 2002 and 2003, the following assumptions need to be made. The growth of sales is 15%, same as 2001, which is estimated by managers. The rate of production costs and expenses per sales is constant to 50%. Administration and ailing expenses is the average of last 4 years. The depreciation is $7. Million per {ear, which is calculated by $54. 6 million divided by 7 years. Tax rate is 24. 5%, which IS provided. The dividend is $2 million per year only when the company makes profits. Therefore, we assume that there will be no dividend in 2003. Gross PEP will be $27. 3 million (54. 6/2) per year. We also assume there is no more long term debt, because any funds need in the case are short term debt, it keeps at $18. 2 million. According to the forecast, Star River needs external financing approximately $94 lion and $107 million in 2002 and 2003, respectively.

In order to analysis if the company can repay the debt, we need to know the interest coverage ratio, current ratio and DIE ratio. The interest coverage ratios through the forecast were 1. 23 and 3. 87 respectively, which is the danger signal to the managers, because in 2003, the profits even not enough to repay the interests. Moreover, the current ratios were 0. 84 and 0. 85 in 2002 and 2003. Considering the recent 6 years current ratio, even though t was increased, it was always less than 1, which means the current assets were not enough to pay back the current liabilities.

According to the forecast and analysis, it seems Star River cannot repay its loan within a reasonable period. We advise managers to find other ways to raise funds, such as increase equity. 3. What are the key driver assumptions of the firm’s future financial performance? What are the managerial implications of those key drivers? That is, what aspects of the firm’s activities should Koch focus on especially? The first key driver of this assumption is sales growth rate. Sales growth rate is treated as the most important components hat states in the balance sheet and income statement.

From the first sensitivity chart Nee can see, sales growth rate and short term borrowing has the positive relationship. Nee the sales growth rate rises up, the requirement of short term borrowing also increased. Otherwise, the increasing of sales growth can bring more revenue and pay more debt. Interest rate would be the second key driver of the assumption; company Nil pay the interest expense that has the strong relationship with variation of interest rate. When interest rate has 1% increased the short term borrowing has million extra raised.

From the data to assumption, we can analysis that interest rate is more sensitive than sales growth. The third one of this assumption is production cost of the firm which affects the short term borrowing much more than previous two. When production cost ratio increased 2%, the short term borrowing added about $2 million at the same time. The more cost we spend the more external financing we need. The next driver of this assumption is inventories. When Inventories decline, cash flow of company will increase. Some of cash flow will offset the chance of short term borrowing.

With the inventory ratio increasing, short term borrowing will increase. The last two drivers are Gross PEP and account receivable, Nee Gross PEP has constantly growing, short term borrowing will be higher than before. When account receivable is increasing, short term borrowing shows a rising trend because of the increasing non-receivable capital. From chart sensitivity 7 we can see that short term borrowing is more sensitive to Gross PEP than sales growth rate. From the last chart we can find that account receivable has more influence than sales growth rate when we focus on short term borrowing.

Account receivable directly effects the movement of capital. As a result, from the forecasting analysis it shows that higher working capital and increasing expenditure of company will need much more capital to balance the income and expense. The main implications are production cost and inventories. To control production cost and inventories reasonably can get more profit and efficiently decreased the short term debt. Thus, Ms. Koch should pay more attention on cost controlling and reasonably arranged the amount of inventories that can decrease the external financing. Also, it will save the tersest expense.