

Star river electronics assignment



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In Partial Fulfillment Of the Course Requirement In Management Financial Planning Submitted to: Professor Raymond Queddeng Submitted by: Group 3 Alfabeto, Carmela Conos, Via Leal, Diva On: November 17, 2007 I. CASE BACKGROUND Star River Electronics (SRE) was a joint venture company between Starlight Electronics Ltd. , and an Asian venture-capital firm, New Era Partners. The company was based in Singapore, and was engaged into the manufacturing of CD-ROMs which it supplied to major software companies. The CD-ROM manufacturing industry grew rapidly in the mid-1990s due to the popularity of optical and multimedia products.

Because of the emergence of small, but aggressive players, CD-ROM prices were pushed down by as much as 40%. Corporate consolidations followed suit as less efficient producers were affected by the industry shakeout. Amidst this industry development, SRE headed by CEO Adeline Koh, was confronted by a number of management-related problems, which were mostly financial in nature. Questions concerning the company's growth potentials, as well as the need for additional investments in new technology (e. g. Digital Video Discs or DVDs) and more efficient equipment have been raised to the attention of Ms. Koh. II.

AREAS FOR CONSIDERATION 1. Developments in the CD-ROM manufacturing industry/environment ??? During the mid-1990s, there was an oversupply of CD-ROM products which pushed prices down by as much as 40%; ??? Less efficient producers consolidated for survival; ??? DVDs became increasingly popular because of their bigger storage capacity (14x more) than CD-ROMs. In fact, a study was done by Global Industry Analysts, Inc. , which predicted that by 2005, DVDs would comprise 59% of the total optical disc-drive

shipments while CD-ROMs would account for the remaining 41%. 2. Star River's capabilities SRE's sales posted double-digit growth from 1999 to 2001 amidst a strongly competitive environment; ??? The company had begun experimenting on DVD manufacturing, but DVD accounted for less than 5% of SRE's total sales by end of fiscal year 2001. 3. Other Concerns: ??? SRE's bank was of the opinion that the company is growing too fast beyond its financial capabilities. CAGR of the company's sales from 1998 to 2001 is at 13.8%; ??? The company was given a proposal to invest in a new packaging equipment which promised to provide labor cost savings (in terms of overtime) and better packaging efficiency.

Investment would be made by 2002. III. PROBLEM STATEMENT Given the situation, what would be the financial projections for Star River Electronics in 2002 and 2003? IV. OBJECTIVES 1. To compute for the Sustainable Growth Rate of SRE, and assess whether the company's projected sales growth is indeed beyond its financial capabilities or not; 2. To compute for the appropriate Weighted Average Cost of Capital (WACC) that SRE should use in its DCF analysis of the possible equipment purchase; 3. To ascertain whether SRE should invest in the new packaging equipment in 2001 or wait for 3 more years before making the purchase; . To prepare a simple financial forecast of SRE's performance for the next two years based on the initial assumptions as agreed by Adeline Koh and Andy Chin, and incorporating the decision on whether to purchase the new packaging equipment or not; 5. To determine the funding requirements (debt) of SRE during the said period; 6. To compute for the Return on Assets and Return on Equity of Star River in 2002 and 2003. V. CASE ANALYSIS 1. How is the company's financial health

and financial performance? [pic] 2. What are the key assumptions that should be used for SRE's financial forecast 2002 and 2003? Capital expenditures of SGD54.6 million for DVD manufacturing equipment which is equally spread out over the next two years and depreciated over a useful life of seven years. ??? Any external funding needed is in the form of debt. ??? Any other assumptions are based on the historical analysis of reports. ??? To find the rate of interest of New Era Loan, multiply the borrowings of bond issue and short term borrowings to their rates then deduct the total of the two interest amounts from the total interest expense in 2001 (SGD7,818). The given interest rates are: a) 6. % was computed as Prime Lending rate of 5.2% + 1.5% (City Bank); b) interest rate on bond issue was stated at 5.75% which is paid semi-annually. The interest expense attributed to the New Era loan of SGD10,000 is a balancing figure. The interest rate to be used for all short-term borrowings should be 7.58%. 3. What is the company's sustainable growth rate based on the projections for 2002 and 2003? Is the company growing beyond its financial capabilities? Based on the company's 2001 performance, the computed sustainable growth rate is at 10.95%.

This means that the forecast 15% sales growth per year for 2002 and 2003 is above the maximum growth rate that SRE can maintain without resorting to additional borrowings. Given this, it can be surmised that if SRE is compelled to target this annual growth for the next two years, then it will have to be prepared to increase the level of its short-term borrowings. 4. Calculate the appropriate weighted average cost of capital for SRE given information about other companies within the same industry. Among the five comparable companies that were cited in Exhibit 5, only two were considered to be

comparable to SRE, and they are Wintronics, Inc. and STOR-Max Corp. These companies have, more or less, the same line of business as that of SRE given that Wintronics' CD-ROM sales account for 95% of its total production while STOR-Max's was recorded at 90%. In addition, STOR-MAX is considered as SRE's major competitor in the CD-ROM production. The other companies, namely Sing Studios, Inc. , Digital Media Corp. , and Wymax, Inc. either have declined CD-ROM sales, or have diversified into other businesses, e. g. MIDI manufacture and sale, film production and digital animation, and software programming.

For the computation of the Weighted Average Cost of Capital, the following assumptions have been made: ??? Cost of Debt is computed as follows*: *5. 2% represents the current prime lending rate in Singapore while the 1. 5% is the premium. These figures were lifted from Footnote 1 of Exhibit 2. ??? SRE's competitors are also subject to the same Cost of Debt since they belong to the same industry; ??? Levered Beta and WACC of SRE is the same as that of STOR-MAX since the latter is its major competitor; Appropriate WACC to be used in the DCF analysis should be 11. 44%. 5.

Compute for the NPV of the two options: a) defer purchase of new packaging equipment in 3 years (2004), and b) purchase new packaging equipment as early as 2001 using the DCF analysis. Refer to the attached exhibit for the DCF analysis of the two options. Based on the DCF Analysis, it would be a wise decision for SRE to defer purchase of the new packaging equipment in 2004. Deferring the purchase will yield a cost advantage of SGD195, 358 which the company can use in its operations. 6. Historical and Projected Income Statement and Balance Sheets based on assumptions and capital
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budgeting decision of deferring equipment purchase to 2004. pic] [pic] 7.

What is SRE's funding requirement in 2002 and 2003? SRE needs to raise short-term borrowings of SGD107.6-Mil in 2002, and SGD124.6-Mil in 2003.

8. What returns on book assets and book equity Star River will offer in the 2 years? Return on book assets and book equity of Star River in 2002 and 2003 are declining. ROA in 2002 is at 2.9% (-1.0% pts from 2001) and 2.5% in 2003; while ROE in 2002 is estimated to be at 11.9% (-3.3% pts from 2001) and 10.8% in 2003. 9. What are the "key-driver" assumptions of those returns?

The key driver assumptions of these returns are the sales growth, % of cost of goods sold to sales, % of inventories to cost of goods sold, and level of receivables. Manipulating these assumptions will have the following impact on the level of debt that the company has in its portfolio as well as its ability to meet the interest payments of its short- and long-term borrowings. The following sensitivities illustrate this: VI. CONCLUSION & RECOMMENDATION

CEO Adeline Koh and her assistant should propose the following to the owners of Star River Electronics Ltd: Purchase of the new packaging equipment should be deferred to 2004 because it will be a cheaper endeavor for the company than buying it in 2001. In addition, Star River should conduct further research to determine a more realistic demand for its CD-ROM products as well as industry trends within the next three years. By doing so, it will enable the company to be more prudent in its capital expenditures, and prioritize those which will take advantage of the opportunities that are available to the company. In that way, resources are better managed, and spending on potential white elephants is avoided. In

terms of projecting the company's sales growth, it would be more advisable for SRE to check the industry growth as well as the performance of its close competitors, STOR-Max and Wintronics. In this way, it can have some sensitivities on whether the company is capable of growing faster than the industry, or slower than its competitors. Moreover, as shown by the SGR computation, the 15% annual sales growth is above the maximum growth rate that the company can sustain without altering its equity structure. ??? SRE should look into its operating costs more closely.

The CAGR of the company's total operating expenses is estimated to be at 15.8% from 1998 to 2003, which is faster than the CAGR for sales. Despite the 15% increase in sales in 2002 and 2003, the company's margins are expected to be squeezed further as costs grow with sales. Perhaps, while Ms. Adeline Koh is at it, it would be better if she and her assistant discuss with their Production Line Managers on how to reduce operating costs through implementation of various cost-reduction, line-efficiency efforts. ??? SRE should also consider the Residual Dividend Theory when planning for declaration and payment of dividends to its stockholders.

This will enable the company to provide for capital expenditures using internally-available funds, rather than depend on external borrowing for any fund deficits. Of course, what is important is that Management is able to effectively communicate its plans and programs to its stockholders, and present to the latter the benefits of prioritizing certain investments now over the enjoyment of dividends. [pic][pic] ————— De La Salle Professional Schools, Inc. Ramon V. Del Rosario, Sr. The Graduate School of Business Case 24: STAR RIVER ELECTRONICS [pic] [pic] [pic] [pic] [pic] [pic] [pic] [pic] <https://assignbuster.com/star-river-electronics-assignment-essay-samples/>