

# [Hampton machine tool company](https://assignbuster.com/hampton-machine-tool-company-2/)

Hampton Machine Tool Company 1. Why can’t a profitable firm like Hampton repay its loan on time and why does it need more bank financing? What major developments between November 1978 and August 1979 contributed to this situation? A/ Hampton Machine Tool Company was unable to repay its loan on time due to several factors. One of such factors is the fact that the stock repurchase, for which the loan was initially requested, was a major cash disbursement of $3 million.

In the period between November 1978 and August 1979, stock repurchase represented 58% of total expenditures for that period, while inventory purchases represented 42% of total expenditures. There were some developments that also contributed to this situation. For instance: The shipment has been upset by the suppliers’ delay of sending the electronic control mechanisms to Hampton. This has influenced the decrease of cash from past months as for example the accumulated orders have not been filled. Raw materials were acquired before immediate need. The company has spent $420, 000 for the purchase of this type of inventory.

Since December 1978, Hampton has spent $3 million on repurchasing stocks of several dissident shareholders. The $181, 000. 00 tax payment in December. The $150, 000. 00 dividend payment in December. We consider that this dividend payment must not be made. 2. Based on the information in the case, prepare a projected cash budget for the four months September through December 1979, a projected income statement for the same period, and a pro forma balance sheet as of December 31, 1979. Pro Forma Income Statement, Balance Sheet, and Cash Budget for the period from September to December 1979 are found in attachment. . Review the results of your forecast. Doe the cash budgets and the pro forma financial statements yield the same results? Why? Hampton Machinery Tool Company’s income statement shows a balance in retained earnings for December of $435, 570. 00. At the same time, the company’s cash budget for the same period shows that they are short $331, 500. 00 to be able to pay the debt in December as they have stated. One of the main reasons for this negative cash balance may be that Hampton is experiencing liquidity problems, that is, they are not generating enough cash to pay for their current expenses.

Another factor that may contribute to such phenomenon is the delays in production that Hampton has had because suppliers have not delivered the raw materials. The inventory conversion period is greater than what Hampton can finance because the cash conversion cycle is even greater than collections from customers. 4. Critically evaluate the assumptions on which your forecasts are based. What developments could alter your results? Is Mr. Cowins correct in his belief that Hampton can repay the loan in December? Some of the assumptions include:

One assumption that should be clearly analyzed is that the collection period is of 30 days net. Not always customers have the ability and willingness to pay off their debts in 30 days, some may take more time, and some could incur in bad debt. Another assumption Hampton is making is that the company will be able to pay off debts in 30 days. There is no 100% certainty this will happen. The assumption that accruals and prepaid expenses will remain fairly stable and constant should be analyzed more clearly, because this is not always the case. Another assumption is that the shipments are going to be made exactly as they forecasted.

It is important to note that in the previous periods the actual shipments have been deviated from the forecasted shipments. Thus, it is a strong and somewhat ridiculous assumption to believe that the shipments will be as forecasted. Another assumption is that operating expenses will remain constant at $400, 000. Again, there are many factors that may alter this amount, such as training of employees, inflation, etc. A final assumption is that there will be no allowance for any customer advance payment. As shown by the ending cash balance of December, Mr. Cowins is wrong in his belief that the company will be able to repay its loan.

At the time, the company would have a negative cash balance of $331, 500. An option would be for Mr. Cowins to repay the initial $1 million loan, and ask the bank for an extension on the date of payment of the additional $350, 000. 5. What action should Mr. Eckwood take on Mr. Cowin’s loan request? What are the major risks associated with the proposed loan? What other alternatives does Mr. Eckwood have, and what are their pros and cons? What would you do? Hampton should present a stable capital before the bank grants the new loan. It is recommended to decline the petition if the loan made is capital investment for the company.

That is because the potential for return on the investment is limited strictly to the interest on the loan, and the potential loan would exceed the reward. He should evaluate also the capacity of the firm to meet its regular financial obligations and to repay the loan. The company could be presenting profits, but what about the cash. In the last months it has decreased by a approximately 19%. Besides that, Mr. Eckwood should ask for collaterals in case that Hampton defaults on the loan. Moreover, what about Hampton’s character. Is it Hampton recognized for its honest behavior? Finally, what are the conditions that surround the loan request.

The company is not trying to increase the market share or use the money to implement strategies for long-survival. The major risks would be that Hampton is not only not able the new loan, but also that the repayment of the 1million will not take place. The other options for Eckwood would be to ask for collaterals, and higher interest payments. Moreover, he could provide this loan to other industries, or even other companies, those posses higher rates of return. Or he could even reject the petition. 6. Why did Hampton repurchase a substantial fraction of its outstanding common stock?

What is the impact of this repurchase on Hampton’s financial performance? Critically assess Hampton’s dividend policy. Do you agree with Mr. Cowin’s proposal to pay a substantial dividend in December? Hampton decided to buy back their stock because they were confronting many dissident stockholders at the moment. Besides, the company had always maintained a conservative financial policy. Having to spend 3 million on the repurchase affected their cash balance, as well as their payable accounts, that in turn it increases creditors and suppliers claims against the company.

When a company decides to pay dividends, it has to be careful on how much it will be given to the shareholders. It is of no use to pay shareholders dividends if it will affect negatively the financial position of the company in the following months. If the company is not meeting with the required cash balances, it makes no sense for it to pay dividends. Therefore, we would say that Mr. Cowin’s idea of paying dividends in December is not a good idea if he wants to be able to pay back the loan as he has intended to.