

# Financial management case study samples

[Business](#), [Company](#)



**Part One:**

a) Calculate the Weighted Average Cost of Capital

WACC: Weight of Debt\* Cost of Debt(1-Tax rate) + Weight of Equity\* Cost of Equity

WACC:[( 200000/400000)\* 0. 09(1-. 22)] + [(200000/400000)\* . 15]

WACC: 0. 0351+ . 0300

**WACC: 6. 51%**

\*WACC that is also known as Cost of Capital will be used further to discount the cash flows of the company.

b)Calculation of Capital Allowance and Tax Payable on each project:

**Project A:**

Tax depreciation

Capital Allowance and tax liability

\*Assuming that business loss for Year 1 will not be carry-forward to be offset from Year 2 profit and also there is no minimum alternate tax even if the business occurs loss.

**NPV Calculation:**

Discounted Payback Period Calculation:

Project B:

Tax depreciation

Capital Allowance and tax liability

\*Assuming that business loss for Year 4 will not be carry-forward and also there is no minimum alternate tax even if the business occurs loss.

## **NPV Calculation:**

Discounted Payback Period:

Part 2:

c) Critical Evaluation of Ratio Analysis:

### **Advantages of Ratio Analysis:**

- i) Ratios turn raw financial data into meaningful quantitative numbers that allows the analysts and the shareholders to take their decisions relating to their investments
- ii) It facilitates comparison of the financial performance of the companies irrespective of their size or financial structure.
- iii) Since ratios indicate the ongoing trend in the financial performance of the company, they also allow the analysts to forecast the future trend.
- iv) They give a comprehensive overview relating to the liquidity, profitability and many other financial sections of the company.

### **Disadvantages of Ratio Analysis:**

- i) Ratios turn useless when used in isolation. They are only valid when compared with those of other firms or to the historical performance of the company.
- ii) It is difficult to find comparable industry ratios when analyzing the companies that operate in multiple industries.

## **Part 3:**

- a) Calculate and report on the number of products that should be made and sold in order to break even during the year and also the margin of safety if

the company produced and sold 30 units. Both elements should be calculated in units and revenue

### **Break-Even Points in Units: Fixed Cost/( Sales- Variable Cost)**

Here:

Fixed Cost= \$252000

Sales= \$25000/ unit

Variable Cost= \$16000/unit

So, Break-Even Point=  $252000/(25000-16000)$

= 28 Units

ii) Break-Even Point in Revenue: Price/ Units\* Break-Even Sales/ Unit

=  $25000*28$

= \$700000

iii) Margin of Safety: (Actual sales- Break Even Sales)/ Actual Sales

Actual Sales= 30 Units

Break Even Sales= 28 Units

So, MOS=  $(30-28)/30= 6.66\%$

b) Calculate the estimated annual profit or loss assuming 50 products could be sold during the year:

Estimated Profit= Sales Price- (Fixed Cost+ Variable Cost)

Here Sales Price for 50 Units=  $25000*52= \$1300000$

Fixed Cost= \$252000

Variable Cost=  $16000*50= \$800000$

Estimated Profit=  $1300000-(252000+ 800000)$

=\$248000

c) Critically analyse the advantages of undertaking break-even analysis and the key criticisms of the technique?

### **Advantages of Break-Even Analysis**

i) Easy to Conduct and Understand:

Break-Even analysis follows simple set of formulas that are easy to understand and also facilitates easy calculation for the user. Hence, the simplicity of the process is a big advantage for the user.

ii) Helps in studying relationship:

The process is also favoured as it helps in studying relationships between returns, variable cost and fixed costs. In other words, by using Break-Even Analysis, the user will be able to calculate the volume of goods to be sold so as to cover the cost related to the production. Hence, indirectly it also facilitates to prevent the business loss by determining the minimum amount of business activity required to prevent the losses. In addition, break even analysis can be used to indicate how the changes in variable cost/fixed cost relationships affect profit levels. However, it is best to use a break even analysis in relation to one product at a time.

iii) Estimated time for recovering investment:

Break-even analysis also facilitates the decision making process by estimating the time required to recoup the money invested in the production process.

### **Disadvantages of the Break-Even Analysis Process:**

- i) The process assumes that all output is sold at a given price
- ii) Regular changes in the circumstances reduces its usefulness as a forecasting tool.