Macadams case study

Education

This Increase was necessitated by the fact that Macadam's had embarked on an solution spree Ana required tons Tuning to secular Lavas Brothers In I-array 1996, as well as to fund the investment in new factories, land and distribution warehouses across the country. The short term debt had increased by 229%. This increase would have been necessary to fund their working capital obligations, as short term debt is significantly more expensive to service than long term debt. Despite the massive increase in debt, the interest cover ratio is still healthy.

This however, is not a cash based ratio and gives us no indication as to whether the many is able to make its cash payments to service the increased quantities of debt. The current ratio and quick ratio gives us an indication of the company's ability to repay its short term debt. Macadam's have a very high current ratio, which shows that on the accrual basis the company's short term assets are readily available to pay off its short term liabilities. The inventory on hand days have increased, together with the debtor's collection period.

This further exacerbates the cash flow problems as their cash is tied up in working capital. The longer collection period is probably indicative of more relaxed reedit terms - while this may boost sales and may well be a contributing factor to the increased turnover, it also presents a problem to the businesses scofflaws as well as an increased bad debt risk. Both the fixed asset turnover and total asset turnover have declined, due to an increased asset base resultant from large acquisitions in the current year, as well as the inability to use these assets as efficiently as possible.

This is supported by the increased profit margin discussed below. Profitability The business displayed healthy turnover, which increased by 58. 5% from the prior ear. The group is obviously doing well in terms of growth, but perhaps they were trying to grow too fast. A 58. 5% increase in turnover cannot be sustainable without a strong balance sheet to support it. The turnover growth in the current year (1996) was largely attributable to surging demand for their products, a favorable exchange rate for their exports and acquisitions of businesses which complement their existing operations.

Their operating margin was up from 10. 8% to 14. 9% showing that the company was operating more efficiently. Net profit margin increased from 7. 4% to 8. 5%. Not only were they boosting turnover, they were also managing to increase their margins. Total net profit attributable to shareholders was up 81% from the prior year. Cash flow From the ratio analysis above as well inspection of the face of the income statement, Macadam's appear to be making higher sales and larger profits off of these sales. Upon inspection of the cash flow statement, a different picture is seen.

The large increase in working capital of 595% from R 2, 7 million to R 19 million, resulted in Macadam's Delve unmade to Tuna tenet operating Ana Investing satellites. I Nils introduction between the two statements highlights the increased profitability, but negative (and worsening) cash flows. A further draw-down of increased working capital cost is explained in the balance sheet with an increase in inventory of 66% (R 12 million) to meet consumer demand which was funded out of cash resources as well as increased debtors of 129% (R 15 million) due to increased credit sales.

Furthermore, creditors increased by 87% (R 8 million), which only partially offset the increase in current assets. Conclusion Macadam's is earning high sales and profits, but has serious cash flow problems I. . The business is too successful, as they are trying to grow too quickly. Cash is seen to be the lifeblood of a business and the accrual of accounting profits are meaningless unless they are converted into cash flow.

There are certain options available to overcome this problem, being: ; Cutting back on growth (which is never popular) ; Increasing borrowings (which wouldn't be a wise choice, as the movement in the cash-flow statement shows an inability to service current interest payments) ; Improving working capital management (which would necessitate a cut back in Roth) ; Arrange alternative financing (a reasonable solution by means of sale and leasebacks), or ; Issue more shares (which is what was chosen) Macadam's nearly failed as a business despite the fact that they had a successful idea and product that was in high demand.

They resolved this by issuing more shares to institutions for cash, as well to fund the acquisition of Livings Pros and other fixed property acquired. They also recommended a capitalization issue in lieu of cash dividends to retain as much cash reserves as possible. If I owned shares in this company at this point I would (buy/sell)