

Hampton machine tool company

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Hampton Machine Tool Company is facing problems in paying its \$1 million loan, which will mature two weeks from September 14, 1979. The loan was used to buy back the stock of a group of dissident shareholders. This loan was based largely upon forecast sales that Hampton gave to the bank. But from January through August 1979 Hampton sold completed only 72.89% of their projected sales. This failure to meet forecast sales can be attributed to three factors, albeit temporary.

First, a major component supplier failed to deliver their part on time. Second, the company bought \$420,000 worth of components over its normal levels of inventory. Third, the company's machines have given Hampton problems with maintaining capacity production. It also wants to pay a dividend of \$150,000 in December 1979. For these reasons, Hampton would like an extension on the original loan until the end of 1979, along with an additional loan of \$350,000 at 1.5% per month, also due at the end of the year.

The internal and external conditions for Hampton seem favorable. About half of Hampton's assets are owned by stockholders. Hampton's President has a good reputation, has complied with bank requirements, and his character is seemingly worthy to be extended credit. Its current assets are composed mostly of specialized goods in its inventory, while its receivables could only cover about half of the debt requested.

But collaterals are unnecessary when there is no doubt about capacity to pay. Hampton has become more liquid and profitable, based on a time series ratio analysis. But the increased liquidity is mainly due to an increase of its specialized inventories. And its increased profitability has not translated into

more efficient asset utilization and a better cash management, as the its activity ratios worsened and its free cash flow significantly decreased, due to excessive investments in its inventories.

But seemingly favorable conditions would probably improve its financial position and performance, as shown by Pro-forma statements, implying an increased capacity to pay, and cash budgets based on 2 scenarios, which show that Hampton could pay both its debts on December, if granted by the bank. The decision tree shows that among alternatives available, extending payment period would be the most feasible, as it would lead to higher interest income, and less risk, since sales is expected to increase tremendously in December, and thus, more cash on January if collected.

However, there is uncertainty as to whether actual sales will continue to deviate from forecast sales in the same way it deviated from January to August 1978 or not. Furthermore, insufficient data constrained analysis. Based on the available data, the bank should grant both the extension of \$1, 000, 000 loan until December 31, 1979, and the additional \$350, 000 loan that Hampton wants to borrow, payable on January 31, 1980, both at 1. 5% interest per month. However, the bank should undertake further studies and collect more data, to permit a better decision.