Leverage analysis of ogawa

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Leverage Analysis of Ogawa World Berhad Our analysis is based on the comprehensive income statement of Ogawa World Berhad for the year ended 30 June 2010 as the base year. Analysis is done for increase in revenue by 50% and decrease in revenue by 40%. Operating leverage is good for the company because it magnifies EBIT. In Ogawa World Berhad, assuming there is 50% increase in revenue, the increase in EBIT, given that fixed cost is RM41, 547, 331, is 297%. If there is 40% decrease in operating leverage, then the EBIT being magnified to loss by 238%.

There is 5. 94 times in degree of operating leverage. Degree of operating leverage is the percentage change in operating cash flow relative to the percentage change in quantity sold. As for financial leverage, assuming that debt equity ratio does not change, interest is fixed to the amount of RM37, 735. Interest magnifies EAT, thus the financial leverage for Ogawa World Berhad is 298%. If there is 40% decrease in financial leverage, then the EAT being magnified to loss by 239%. The degree of financial leverage is 1. 0 time which is the percentage change in operating and financing cash flow relative to the percentage change in operating cash flow. Total leverage is a combination between operating leverage and financial leverage. Therefore, degree of total leverage for Ogawa World Berhad is 5. 96 times. DTL shows the percentage change in operating and financing cash flow relative to the percentage change in quantity sold. When the quantity sold decrease by 40%, the effect is decrease of 239% in EAT. On the other hand, there is increase of 289% in EAT when quantity sold increase by 50% of Ogawa total revenue.

Given the nature of Ogawa World Berhad and the analysis above, we would suggest Ogawa World Berhad to maintain an optimal combination of capital structure that focus more on common stock rather than debt. This is because Ogawa World Berhad is a high-technology company. So, the investor of common stock of this company will expect high capital gain. Debt is cheaper due to the tax effect, but, investor will be more interested to invest in common stocks compared to debt because of the expected capital gain through common stock.