

Adom's Year 4 Plan

Student brief

The credit committee renewed Adom's facility, with conditions. One of them is that the company must deliver a credible Year 4 plan within thirty days, showing how it intends either to grow into its current working-capital structure or to bring that structure into line with its industry.

The bank wants both scenarios modelled. Ama and Kwesi have asked Mountain River to build them.

Scenario A — status quo. Growth continues at twenty-five percent. Working-capital practices are unchanged: sixty days to collect, fifty days of inventory, forty days to pay suppliers. Capital expenditure of GH¢4.3 million.

Scenario B — tightened. Growth slows to fifteen percent. Collections come back to forty days, inventory to thirty-five days, and payables stretch to fifty days. Capital expenditure of GH¢2.1 million.

Scenario A has been built for you. Your job is Scenario B.

Exhibit 1 • Shared assumptions

OPERATING ASSUMPTIONS • BOTH SCENARIOS

ITEM	BASIS	VALUE
Year 3 revenue	Actual	GH¢80.0m
Cost of goods sold	% of revenue	85%
Operating overhead (SG&A)	% of revenue	8.1%
Operating cash	% of revenue	1.0%
Interest	7% × Year 3 closing debt of 16.5	1.16
Tax rate	On pretax income	25%
Dividends	—	none

YEAR 3 CLOSING BALANCES • GH¢ MILLIONS

ITEM	VALUE
Net property and equipment	11.0
Short-term debt (held flat in Year 4)	5.0
Long-term debt (the plug)	11.5
Owners' equity	10.0

Exhibit 2 • Scenario A, completed

SCENARIO A • 25% GROWTH, CURRENT TERMS

GH¢ millions

LINE	AMOUNT
INCOME STATEMENT	
Revenue	100.00
Cost of goods sold (85%)	(85.00)
Gross profit	15.00
SG&A (8.1%)	(8.10)
Depreciation	(1.80)
Operating income	5.10
Interest	(1.16)
Pretax income	3.95
Tax at 25%	(0.99)
Net income	2.96
ASSETS	
Cash (1.0% of sales)	1.00
Receivables (60 days)	16.44
Inventory (50 days of COGS)	11.64
Net PP&E (11.00 + 4.30 – 1.80)	13.50
TOTAL ASSETS	42.58
CLAIMS	
Payables (40 days of COGS)	9.32
Short-term debt	5.00
Equity (10.00 + 2.96)	12.96
Subtotal	27.28
LONG-TERM DEBT (the plug)	15.30
THE ANSWER	
FINANCING GAP = 15.30 – 11.50	+3.81

Exhibit 3 • Scenario B — six blanks to complete

SCENARIO B • 15% GROWTH, TIGHTENED TERMS

GH¢ millions. Six cells are yours to complete.

LINE	AMOUNT
INCOME STATEMENT	
Revenue (80.00×1.15)	92.00
Cost of goods sold (85%)	(78.20)
Gross profit	13.80
SG&A (8.1%)	(7.45)
Depreciation	(1.60)
Operating income	4.75
Interest	(1.16)
Pretax income	3.59
Tax at 25%	(0.90)
Net income	2.69
ASSETS	
Cash (1.0% of sales)	0.92
Receivables (40 days)	----- (1)
Inventory (35 days of COGS)	----- (2)
Net PP&E ($11.00 + 2.10 - 1.60$)	----- (3)
TOTAL ASSETS	----- (4)
CLAIMS	
Payables (50 days of COGS)	----- (5)
Short-term debt	5.00
Equity ($10.00 + 2.69$)	12.69
Subtotal	-----
LONG-TERM DEBT (the plug)	----- (6)
THE ANSWER	
FINANCING GAP = (6) – 11.50	?

Question 1 • 15 minutes

Complete the six blanks and compute Scenario B's financing gap.

A negative gap is not an error. Think about what it means before you assume you have made a mistake.

Question 2 · 13 minutes

Compare the two scenarios line by line. Where does the difference come from?

Then quantify the trade: **how many cedis of financing does each cedi of forgone profit buy?**

Question 3 · 9 minutes

What do you recommend Ama and Kwesi commit to?

Name one real cost of your recommendation that does not appear anywhere in this model, and one thing you would want to know before locking it in.