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SOUTHERN AFRICA

SME DUE DILIGENCE AND VALUATION TRAINING MATERIAL

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FINANCIAL SECTOR PROGRAM

SME DUE DILIGENCE AND VALUATION TRAINING MATERIAL

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CONTENTS

1. THE CENTRE ROAD CHILD CARE CENTRE CASE – ATTACHED AS SEPARATE FILE.....	1
2. ASSET CONVERSION CYCLE EXERCISE – ATTACHED AS SEPARATE FILE	2
3. STATEMENT RECOGNITION EXERCISE.....	3
4. STATEMENT RECOGNITION EXERCISE - ANSWER.....	5
5. BREAKEVEN CALCULATION EXERCISE.....	6
6. BREAKEVEN CALCULATION EXERCISE - ANSWER.....	7
7. BUSINESS RISKS/MITIGANTS EXERCISE.....	8
8. THE MAIN LINE MARKET CASE – ATTACHED AS SEPARATE FILE.....	11
9. CASH BUDGET EXERCISE	12
10. MONTHLY CASH BUDGET EXERCISE – ATTACHED AS SEPARATE FILE.....	14
11. MONTHLY CASH BUDGET EXERCISE – ANSWER – ATTACHED AS SEPARATE FILE	15
12. MONTHLY CASH BUDGET FORM – ATTACHED AS SEPARATE FILE	16
13. MONTHLY CASH BUDGET FORM – ANSWER – ATTACHED AS SEPARATE FILE.....	17
14. TEST FOR SME DUE DILIGENCE AND VALUATION TRAINING – ATTACHED AS SEPARATE FILE	18

**1. THE CENTRE ROAD CHILD CARE CENTRE CASE –
ATTACHED AS SEPARATE FILE**

2. ASSET CONVERSION CYCLE EXERCISE – ATTACHED AS SEPARATE FILE

3. STATEMENT RECOGNITION EXERCISE

The attached information reflects the balance sheets and key financial ratios of seven companies operating in distinct industries or sectors.

Based on your understanding of the asset conversion cycle and statement logic, review the attached information and identify the companies listed below.

Place the letter identifying the company next to your selection.

Please note that the balance sheet information is presented in terms of percentages; that is, X percent of total assets or Y percent of total liabilities and owner's equity.

Be prepared to discuss your decision.

YOU WILL HAVE 15 MINUTES TO COMPLETE THIS EXERCISE.

Companies	Letter
Commodity Dealer	_____
Automobile Manufacturer	_____
Hotel Chain	_____
Supermarket Chain	_____
Finance Company	_____
Utility Company	_____
Holding Company	_____

Companies:	A	B	C	D	E	F	G
BALANCE SHEET (%)							
Cash & Mkt. Sec.							
Notes Payable	42.0%	29.6%	4.4%	0.0%	0.8%	3.2%	0.0%
A/P & A/E	24.5%	1.9%	28.2%	0.4%	10.8%	33.5%	3.3%
Accrued Taxes	1.6%	1.8%	1.0%	6.5%	0.8%	4.0%	2.2%
Other Current Liabilities	1.2%	2.1%	1.3%	0.2%	2.5%	0.3%	1.5%
Long Term Debt	4.0%	48.0%	30.8%	0.0%	25.4%	7.1%	41.2%
Other Liabilities	1.6%	0.0%	1.7%	0.3%	3.9%	8.0%	4.4%

Capital Stock & PIC	9.4%	4.0%	3.4%	36.3%	46.5%	3.5%	30.4%
Retained Earning	15.7%	12.6%	29.2%	56.9%	9.3%	40.4%	17.0%
Total Liabilities & Equity	100%	100%	100%	100%	100%	100%	100%

FINANCIAL RATIOS

Return on Equity	18.7%	15.0%	14.2%	1.1%	5.3%	19.8%	10.1%
Return on Sales	0.8%	14.7%	1.0%	NA	4.3%	4.4%	10.7%
Asset Turnover	5.6	0.2	4.4	0.0	0.7	2.0	0.4

4. STATEMENT RECOGNITION EXERCISE - ANSWER

Statement Recognition Exercise

The attached information reflects the balance sheets and key financial ratios of seven companies operating in distinct industries or sectors.

Based on your understanding of the asset conversion cycle and statement logic, review the attached information and identify the companies listed below.

Place the letter identifying the company next to your selection.

Please note that the balance sheet information is presented in terms of percentages; that is, X percent of total assets or Y percent of total liabilities and owner's equity.

Be prepared to discuss your decision.

YOU WILL HAVE 15 MINUTES TO COMPLETE THIS EXERCISE.

Companies	Letter
Commodity Dealer	A
Automobile Manufacturer	F
Hotel Chain	E
Supermarket Chain	C
Finance Company	B
Utility Company	G
Holding Company	D

5. BREAKEVEN CALCULATION EXERCISE

Using the income statement information provided below, calculate the following information for the companies listed:

- Rand Amount of Fixed Costs:
- Variable Costs ÷ Sales (VC ÷ Sales) %:
- Contribution Margin: CM %
- Breakeven Sales (BES): R

<u>Men & Boys Clothing Mfg.</u>	<u>Bakery</u>	<u>Computer Manufacturer</u>
Sales 100	Sales 100	Sales 100
Cost of Goods Sold (77)	Cost of Goods (53)	Costs of Goods Sold (52)
Depreciation (1)	Depreciation (3)	Depreciation (2)
Gross Profit 22	Gross Profit 44	Gross Profit 46
Operating Expenses (17)	Operating Expenses (39)	Operating Expenses (42)
Operating Profits 5	Operating Profits 5	Operating Profits (4)
Other Expenses (1)	Other Expenses (1)	Other Expenses (1)
Profit Before Tax 4	Profit Before Tax 4	Profit Before Tax 3

Breakeven Calculation	Breakeven Calculation	Breakeven Calculation
Fixed Costs(R) _____	Fixed Costs (R) _____	Fixed Costs (R) _____
VC ÷ Sales (%) _____	VC ÷ Sales (%) _____	VC ÷ Sales (%) _____
CM (%) _____	CM (%) _____	CM (%) _____
BES (R) _____	BES (R) _____	BES (R) _____

6. BREAKEVEN CALCULATION EXERCISE - ANSWER

Using the income statement information provided below, calculate the following information for the companies listed:

- Rand Amount of Fixed Costs:
- Variable Costs ÷ Sales (VC ÷ Sales) %:
- Contribution Margin CM %:
- Breakeven Sales (BES): R

<u>Men & Boys Clothing Mfg.</u>		<u>Bakery</u>		<u>Computer Manufacturer</u>	
Sales	100	Sales	100	Sales	100
Cost of Goods Sold	(77)	Cost of Goods	(53)	Costs of Goods Sold	(52)
Depreciation	(1)	Depreciation	(3)	Depreciation	(2)
Gross Profit	22	Gross Profit	44	Gross Profit	46
Operating Expenses	(17)	Operating Expenses	(39)	Operating Expenses	(42)
Operating Profits	5	Operating Profits	5	Operating Profits	(4)
Other Expenses	(1)	Other Expenses	(1)	Other Expenses	(1)
Profit Before Tax	4	Profit Before Tax	4	Profit Before Tax	3
Breakeven Calculation		Breakeven Calculation		Breakeven Calculation	
Fixed Costs(R)	19	Fixed Costs (R)	43	Fixed Costs (R)	45
VC ÷ Sales (%)	77%	VC ÷ Sales (%)	53%	VC ÷ Sales (%)	52%
CM (%)	23%	CM (%)	47%	CM (%)	48%
BES (R)	82.6	BES (R)	91.4	BES (R)	93.7

7. BUSINESS RISKS/MITIGANTS EXERCISE

You are a newly appointed lender. Two companies seeking financing have approached your institution. One company is a retailer of women's and children's clothing. The other is a manufacturer of gold jewelry.

Your assignment is to:

Identify the business risks that each company faces and the steps each company's management should take to mitigate the identified risks.

Use the attached pages to list the business risks identified and the steps that management should take to mitigate the risks.

You have 20 minutes to complete the exercise.
Be prepared to discuss your response.

Retailer of Women's and Children's Clothing

Risks

Mitigants

Supply

Production

Demand

Collection

Manufacturer of Gold Jewelry

	Risks	Mitigants
Supply		
Production		
Demand		
Collection		

**8. THE MAIN LINE MARKET CASE – ATTACHED AS
SEPARATE FILE**

9. CASH BUDGET EXERCISE

Temba's Ground Services, Inc.

You are a recently hired lender of the Western Mountain Loan Fund (WMLF). One of the companies assigned to your portfolio in Temba's Ground Services, Inc. (TGS). TGS, which began operating three years ago, provides a range of ground maintenance services to local commercial and residential customers. To reduce the impact of seasonal demand on the company's business, last year the company entered into the snow removal business. Though this decision has helped lessen the impact of seasonal demand patterns, it has not eliminated the affects of seasonality.

The management of WMLF has become frustrated by the apparent lack of management's understanding of the company's financing needs. During your first meeting with Ellen Hogan (WMLF loan committee member) you received an earful. She stated, "We are beginning to lose confidence in the company's management. They seem to be clueless. During each of the last four months, the company has requested additional short-term financing. The company simply doesn't seem able to organize a financial plan. I'll be happy when someone, anyone determines the company's financing needs, and designs an appropriate facility that could address the company's needs.

At your first meeting with TGS, you were given a partially completed monthly cash budget prepared by the company management. The budget (attached) contained information on the following cash inflows and outflows:

- Cash collection from accounts receivable;
- Purchase of inventory and / or supplies;
- Principal and interest payments on existing loans;
- Advertising and promotion; and
- Travel.

By asking Ms. Temba appropriate questions you obtained the following valuable information regarding the company cash inflows and outflows:

Long-term contracts

The company was recently awarded a five-year contract with the Lower County Museum and Art Gallery to provide ground services. The contract provides TGS a minimum monthly payment of R 70,000.

Wages Paid

Wages, which exclude amounts received by the owner, vary from month to month, depending on seasonal demand. During the year, the company employs one or two work crews. A work crew consists of a supervisor and four workers. Each supervisor is paid R 20,000 per month, while each worker is paid R 15,000 per month. Based on historical patterns, Ms. Temba believes the company will engage the following number of work crew, during the next twelve months:

Months	Work Crew	Months	Work Crew
January	1	July	2
February	1	August	2
March	1	September	2
April	1	October	1
May	2	November	1
June	2	December	1

Management has emphasized that the above wages do not include payroll expenses that equal 32.0% of the wages paid.

Rent

The company pays R20, 000 a month in rent.

Insurance

The company’s annual insurance premium payment, amounting to R 54,000 is paid in January.

Owner’s Withdrawal

Ms. Temba withdraws R75, 000 per month from the company. This amount included related taxes.

Other Assumptions

Incorporate the following assumptions in preparing the monthly cash budget.

Interest charged on the short-term line of credit (new loans) is 9.0% per annum

The company needs to maintain approximately R 50, 000 in available balances to cover operating expenses.

Assignment

Using the additional information provided above, complete the attached monthly cash budget and be prepared to answer the following three questions:

1. On a cumulative basis, is the company’s cash flow sufficient to cover operating expenses?
2. How much short-term financing does TGS require to cover short-term needs, or how much (Rand amount) of the line of credit does the company need to operate?
3. In which month does the highpoint borrowing occur?

**10. MONTHLY CASH BUDGET EXERCISE – ATTACHED AS
SEPARATE FILE**

**11. MONTHLY CASH BUDGET EXERCISE – ANSWER –
ATTACHED AS SEPARATE FILE**

**12. MONTHLY CASH BUDGET FORM – ATTACHED AS
SEPARATE FILE**

**13. MONTHLY CASH BUDGET FORM – ANSWER – ATTACHED
AS SEPARATE FILE**

**14. TEST FOR SME DUE DILIGENCE AND VALUATION
TRAINING – ATTACHED AS SEPARATE FILE**