FACULTY OF BUSINESS, ECONOMICS AND ACCOUNTANCY

UNIVERSITY MALAYSIA SABAH

ADVANCE FINANCIAL MANAGEMENT

BD20303

SEMESTER 2

2023/2024

SECTION 2

GROUP ASSIGNMENT

TOPIC : FINANCIAL ANALYSIS AND FORECASTING

CASE STUDY : THERE'S MORE TO US THAN MEETS THE EYE

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DATE OF SUBMISSION:
29.06.2024

INTRODUCTION

Paramount Paper Inc.'s new CFO,Warren Badges, instructed his assistant,Greg Chapman, to analyze the company's financial performance over the previous three years and provide a scenario-based 12-month prediction.The idea was to persuade rating agencies to improve the company's credit rating,which remained low as a result of previous CFO Robert Malnight's account manipulation.Warren has made efforts to enhance the company's standing and guarantee adherence to the Sarbanes-Oxley Act.Greg,who just left Holland Paper due to an alluring offer from Warren, is motivated to disprove the opinions of market analysts regarding the company's standing. The case relates to the efforts of the new CFO, Warren Badges,of Paramount Paper Inc,to improve the company’s credit rating and restore its tarnished reputation due to account manipulation by the former CFO, Robert Malnight.

To begin, a thorough examination of the company's cash position is essential. This involves analyzing the cash flow statements from the past three years to identify trends in operating, investing, and financing activities. Following the cash position analysis, we will delve into liquidity ratios. These ratios, including the current ratio, quick ratio, and cash ratio, will provide insights into the company's ability to cover its short-term liabilities with its short-term assets. A higher liquidity ratio suggests a stronger financial health, which is a positive indicator for credit rating agencies. Additionally, we will perform a comprehensive performance analysis by examining profitability ratios such as the net profit margin, return on assets (ROA), and return on equity (ROE). These ratios will help us understand how efficiently the company is generating profit from its resources.

By integrating these analyses, we aim to provide a holistic view of Paramount Paper Inc.'s financial health. This comprehensive analysis will serve as a solid foundation for Warren Badges to make a compelling case to rating agencies for improving the company’s credit rating. Ultimately, the goal is to restore confidence among stakeholders and reposition Paramount Paper Inc. as a reputable and financially sound company in the market.

1. Using a cash flow statement for the most recent year, explain how Greg would sum up the company's cash position.

The Paramount Paper Inc.
Statement of Cash Flows
For the Years Ended

Cash Flows from Operating Activities:	**2014**	**2015**
Net Income	943 860	1611160
Add: Depreciation	2915000	3513000
Increase in account payable	53000	40000
Increase in accruals	72000	127000
Increase in marketable securities	(80000)	(98000)
Increase in account receivable	(300000)	(1233000)
Increase in inventories	(1100000)	(1063000)
Cash flow from operating activities:	**2503860**	**2897160**
Investing activities:		
Increase in net fixed assets	2214000	521000
Cash flow from investing activities	**2214000**	**521000**
Financing activities:		
Notes payable	30000	(5000)
Long term debt	1464140	2271840
Preferred stock	(400000)	(500000)
Common stock	750000	(1000000)
Preferred dividend paid	136500	171500
Cash flow from financing activities	1980640	938340
Net cash flow	6698500	4356500
Change in cash	32000	159000

The above cash flow statement tells Greg that net cash of the company increased greatly from 2014 to 2015. The long term debts are the major financing cash flow of the company. It indicates that the company's accounts payable generate the operating cash flows. It also states that for consecutive 2 years, the company was able to pay dividends to its preferred stocks investors. Overall, the company's cash from its operating and financial activities increased, while it was also doing a quite significant amount of investing to benefit the company. In terms of operations, there is quite a significant increase in accounts receivables as much as it is in inventories, which could reflect an increase in sales. It is proper to note, however, that accounts payables and other current liabilities have increased in the last two years, indicating ongoing expansion and hence increased sales. The increase in fixed assets acquired by Paramount Paper is quite large, and it has resulted in an outflow of cash in the investing activities. This also emphasizes the increase in net operating profit in 2015 compared to the last few years, and it may mean that the process of operation has been leaner and leaner in nature and the process of converting assets, inventories, to income improved.

2. Analyze the firm's liquidity, leverage, turnover, and profitability using ratio analysis.

The Paramount Paper Inc.
Financial Ratios
For the Years Ended

	Industry	2013	2014	2015
Liquidity Ratios				
Current Ratio	9.40	6.48	6.89	7.93
Quick Ratio	3.84	2.88	4.07	3.59
Debt Ratios				
Debt to Total Assets	36.70%	30.38%	34.49%	36.31%
Times Interest Earned	7.00	9.72	4.52	5.77
Turnover Ratios				
Total Asset Turnover	2.61	1.36	1.62	1.91
Fixed Assets Turnover	4.49	2.04	2.56	3.11
Accounts Receivable Turnover	18.41	2.04	2.56	3.11
Average Collection Period	19.55	176.78	140.53	115.68
Inventory Turnover (using Sales since COGS not given)	9.04	5.80	6.49	7.91
Days in Inventory	39.82	62.09	55.49	45.51
Profitability Ratios				
Net Profit Margin	4.68%	6.02%	2.89%	3.26%
Return on Assets	12.22%	8.17%	4.69%	6.24%
Return on Equity	21.03%	13.14%	8.23%	11.32%

Liquidity Ratios

The current ratio or the measurement of the firm's ability to meet it short term obligations are high but it still falls behind it's industry competitors. However, observing the trend along the years, it continues to increase and may pose a promising improvement in the future. On the other hand, quick ratio which excludes inventory is higher in association to the industry competitor has an irregular trend since from 2013, it was lower than the competitor's average then it became higher when it came to 2014 and became lower again by 2015. The ratios do not pose a threat since the company is still able to meet long-term obligations and the variances along the years are not that different from each other.

Debt Ratios

The company's debt to total assets is not far from that of the industry average so they may pose a similarity in their leverage. Also, since a higher degree of leverage may be putting a company at a risk of default on its loans if interest rates were to rise suddenly, the Paramount Paper Inc. is still at a conservative rate since their debt to total assets ratio is still below 50%. The company's ability contractual payments were the highest during 2013. It even surpassed the industry average. However, due to the decrease in the Operating Income on 2014 and a large increase in Interest expense, it caused their TIE to fall short. In 2015, the company was able to increase their TIE due to their increase in Operating Income. However, the TIE was not able to skyrocket back to its high TIE on 2013 since their Interest Expense was also the highest in this year.

Turnover Ratios

When it comes to turnover, the Paramount Paper Inc. is falling behind the industry average. Almost all the basis for determining the Turnover Ratio of the company is losing behind the industry. Though in some ratios the company is improving year by year, it is still undeniable that the industry average beats them in this area. The days in inventory is alarmingly long compared to the industry. In 2013, the Paramount Paper Inc. up to 62.09 days in inventory while the industry was only 39.82. The difference is drastic but good thing the company was able to improve and by 2015, it was only running up to 45.51 days.

Profitability Ratios

The profitability ratio in general is not doing bad. It can still provide a comprehensive and decent return on sales, assets and equity. It's just that the industry average is higher when it comes to ROA and ROE. The ROS, even if fluctuating from year to year is still not bad since it was way ahead in 2013 and the most recent year, even if lower is not running far. Perhaps one of the goals of the company in the near future is to focus on how to maximize their ROE since the industry average is able to show that an ROE could reach up to 21.03%.

3. Using common size statements, help Greg present an appraisal of the company's performance and financial condition vis-à-vis its key competitors.

Paramount Paper Inc.
Income Statements
For the Years Ended December 31

	2013		2014		2015		2015 Industry	
Sales Revenues	28,255,000	100%	37,340,000	100.00%	54,670,000	100.00%	590,000,00	100.00%
Cash Operating Costs	22,321,450	79.00%	32,112,400	86.00%	47,562,900	87.00%	505,040,000	85.60%
Depreciation	2,775,000	9.82%	2,915,000	7.81%	3,513,000	6.43%	31,270,000	5.30%
Total Operating Costs	25,096,450	88.82%	35,027,400	93.81%	51,075,900	93.43%	536,310,000	90.90%
Operating Income (EBIT)	3,158,550	11.18	2,312,600	6.19%	3,594,100	6.57%	53,690,000	9.10%
Interest Expenses	325,000	1.15%	512,000	1.37%	623,000	1.14%	7,670,000	1.30%
Taxable Income	2,833,550	10.03%	1,800,600	4.82%	2,971,100	5.43%	46,020,000	7.80%
Taxes	1,133,420	4.01%	720,240	1.93%	1,188,440	2.17%	18,408,000	3.12%
Net Income	1,700,130	6.02%	1,080,360	2.89%	1,782,660	3.26%	27,612,000	4.68%
Preferred Dividends	108,500	0.38%	136,500	0.37%	171,500	0.31%	590,000	0.10%
Earnings Available to CS	**159,160,630**	**5.63%**	**943,860**	**2.53%**	**1,611,160**	**2.95%**	**27,022,000**	**4.58%**

Paramount Paper Inc. *Balance Sheet* *For the Years Ended December 31*								
	2013		**2014**		**2015**		**2015 Industry**	
Cash	396,000	1.90%	428,000	1.86%	587,000	2.06%	6,554,000	2.90%
Marketable Securities	460,000	2.21%	540,000	2.35%	638,000	2.23%	45,200	0.02%
Accounts Receivables	2,225,000	10.69%	2,525,000	10.97%	3,758,000	13.16%	32,046,800	14.18%
Inventories	3,850,000	18.50%	4,950,000	21.50%	6,013,000	21.05%	55,867,200	24.72%
Current Assets	6,931,000	33.31%	8,443,000	36.68%	10,996,000	38.50%	94,513,200	41.82%
Net Fixed Assets	13,875,000	66.69%	14,576,000	63.32%	17,568,000	61.50%	131,486,800	58.18%
Total Assets	20,806,000	100.00%	23,019,000	100.00%	28,564,000	100.00%	226,000,000	100.00%
Accounts Payables	425,000	2.04%	478,000	2.08%	518,000	1.81%	5,085,000	2.25%
Accruals	495,000	2.38%	567,000	2.46%	694,000	2.43%	3,073,600	1.36%
Notes Payables	150,000	0.72%	180,000	0.78	175,000	0.61%	1,898,400	0.84
Current Liabilities	1,070,000	5.14%	1,225,000	5.32	1,387,000	4.86%	10,057,000	4.45%

Long Term Debt	5,250,000	25.23%	6,714,140	29.17%	8,985,980	31.46%	72,885,000	32.25%
Total Liabilities	6,320,000	30.38%	7,939,140	34.49%	10,372,980	36.31%	82,942,000	36.70%
Preferred Stock	1,550,000	7.45%	1,950,000	8.47%	2,450,000	8.58%	11,752,000	5.20%
Common Stock	10,250,000	49.26%	9,500,000	41.27%	10,500,000	36.76%	30,510,000	13.50%
Retained Earnings	2,686,000	12.91%	3,629,860	15.77%	5,241,020	18.35%	100,796,000	44.60%
Total Common Equity	12,936,000	62.17%	13,129,860	57.04%	15,741,020	55.11%	131,306,000	58.10%
Total Liabilities and Owner's Equity	**20,806,000**	**100.00%**	**23,019,000**	**100.00%**	**28,564,000**	**100.00%**	**226,000,000**	**100.00%**

Paramount paper's financial conditions indicate a use of more of the cash. Compared to their competitors, they have higher costs with lower income and available earnings.

4. What would Greg discover after performing a DuPont Analysis on the company's key probfitability ratios?

The Paramount Paper Inc.
DuPont Analysis

Profitability Ratio	Industry Average	2013	2014	2015
Net Income	27,612,000	1,700,130	1,080,360	1,782,660
Sales	590,000,000	28,255,000	37,340,000	54,670,000
Total Asset	226,000,000	20,806,000	23,019,000	28,564,000
Total Equity	131,306,000	129,936,000	13,129,860	15,741,020
ROA	**12.22%**	**8.17%**	**4.69%**	**6.24%**
ROE	**21.03%**	**13.14%**	**8.23%**	**11.32%**

Based on the DuPont Analysis above, Greg would find out that the industry is performing better than Paramount Paper Inc. both in terms of ROA and ROE.

5. How much additional sales can the company support without having to add fixed assets?

Current Sales (2005)	54,670,000
÷ Current Level of Fixed Asset Utilization	90%
Full Capacity Sales	**60,744,444.00**
Less: Current Sales	54,670,000
Maximum additional sales that can be achieved given current level of fixed assets	**6,074,444**

The company can support an additional sales of $ 6,074,444, without adding fixed assets.

The Paramount Paper Inc.
Balance Sheet Percentages of Sales
December 31

	2013		2014		2015		AVG % OF SALES
Cash	396,000	1.40%	428,000	1.15%	587,000	1.07%	1.21%
Marketable Securities	460,000	1.63%	540,000	1.45%	638,000	1.17%	1.41%
Accounts Receivables	2,225,000	7.87%	2,525,000	6.76%	3,758,000	6.87%	7.17%
Inventories	3,850,000	13.63%	4,950,000	13.26%	6,013,000	11.00%	12.63%
Current Assets	6,931,000	24.53%	8,443,000	22.61%	10,996,000	20.11%	22.42%
Net Fixed Assets	13,875,000	49.11%	14,576,000	39.04%	17,568,000	32.13%	40.09%
Total Assets	**20,806,000**	**73.64%**	**23,019,000**	**61.65%**	**28,564,000**	**52.25%**	**62.51%**
Accounts Payables	425,000	1.50%	478,000	1.28%	518,000	0.95%	1.24%
Accruals	495,000	1.75%	567,000	1.52%	694,000	1.27%	1.51%
Notes Payables	150,000	0.53%	180,000	0.48%	175,000	0.32%	0.44%
Current Liabilities	1,070,000	3.79%	1,225,000	3.28%	1,387,000	2.54%	3.20%
Long Term Debt	5,250,000	18.58%	6,714,140	17.98%	8,985,980	16.44%	17.67%
Total Liabilities	6,320,000	22.37%	7,939,140	21.26%	10,372,980	18.97%	20.87%
Preferred Stock	1,550,000	5.49%	1,950,000	5.22%	2,450,000	4.48%	5.06%
Common Stock	10,250,000	36.28%	9,500,000	25.44%	10,500,000	19.21%	26.97%
Retained Earnings	2,686,000	9.51%	3,629,860	9.72%	5,241,020	9.59%	9.60%
Total Common Equity	12,936,000	45.78%	13,129,860	35.16%	15,741,020	28.79%	36.58%
Total Liabilities and Owner's Equity	**20,806,000**	**73.64%**	**23,019,000**	**61.65%**	**28,564,000**	**52.25%**	**62.51%**

The Paramount Paper Inc. Income Statement Percentages of Sales For the Years Ended December 31							
	2013		2014		2015		AVG % OF SALES
Sales Revenues	28,255,000	100.00%	37,340,000	100.00%	54,670,000	100.00%	100.00%
Cash Operating Costs	22,321,450	79.00%	32,112,400	86.00%	47,562,900	87.00%	84.00%
Depreciation	2,775,000	9.82%	2,915,000	7.81%	3,513,000	6.43%	8.02%
Total Operating Costs	25,096,450	88.82%	35,027,400	93.81%	51,075,900	93.43%	92.02%
Operating Income (EBIT)	3,158,550	11.18%	2,312,600	6.19%	3,594,100	6.57%	7.98%
Interest Expenses	325,000	1.15%	512,000	1.37%	623,000	1.14%	1.22%
Taxable Income	2,833,550	10.03%	1,800,600	4.82%	2,971,100	5.43%	6.76%
Taxes	1,133,420	4.01%	720,240	1.93%	1,188,440	2.17%	2.70%
Net Income	**1,700,130**	**6.02%**	**1,080,360**	**2.89%**	**1,782,660**	**3.26%**	**4.06%**
Preferred Dividends	108,500	0.38%	136,500	0.37%	171,500	0.31%	0.35%
Earnings Available to CS	1,591,630	5.63%	943,860	2.53%	1,611,160	2.95%	3.70%

6. Will Paramount Paper have to raise external capital over the next 12 months? If so how much? If not, why not?

Sales Level	**Current Sales**	**10%Expected GrowthRate (Pessimistic)**	**20%Expectd GrowthRate (Expected)**	**30% Expected Growth Rate (Optimistic)**
Sales	**54,670,000**	**60,137,000**	**65,604,000**	**71,071,000**
Change in Sales		**5,467,000**	**10,934,000**	**16,401,000**
Assets Needed:				
Spontaneous Current Assets: (CA/Sales) X Δ Sales		999,636	1,832,667	2,537,538
Fixed Assets*: (FA/Sales) X Δ Sales		1,261,363.64	2,312,500.00	3,201,923.08
Total Assets Needed to Support Sales:		2,261,000	4,145,167	5,739,462
Less Spontaneous Current Liabilities: ((CL - NP)/Sales) X Δ Sales		81,363.64	149,166.67	206,538.46
Less Δ Retained Earnings: ((ROS X Sales)- Preferred Stock Dividends*) X Retention Ratio**		1,789,426	1,967,692	2,145,958
Equals: Required External Funding (Surplus)		**390,210**	**2,028,308**	**3,386,965**

Based on the computations above, Paramount paper need to raise their external capital over the next 12 months to support its growth. They must increase it to 2,028,308. This amount is expected and realistic than the 10% and 30% growth rate additional external funding. But if the company would be able to optimize well their resources, the 30% growth rate is optimistic and the best. These funds are necessary to finance the increase in assets needed to support higher sales levels and ensure operational stability as the company expands.

7. Is Warren correct in saying “there’s more to us than meets the eye”? Explain.

In my opinion, Warren is correct when he states, "There's more to us than meets the eye?" It's because they have access to information beyond what they are aware of thanks to their analysis and financial statements. For example, despite having a positive net income, the amount that their equity and assets are transformed into net income is not operating efficiently. They don't measure up to the industry norm. However, if looking at the company's past record, they have come a long way in complying with Sarbanes-Oxley.

8. If you are Warren, explain how you would attempt to convince the rating agencies that the firm’s debt rating should be raised.

A borrower's credit rating indicates the likelihood that they would repay a loan within the agreed-upon terms, without defaulting. With Warren joining the team, they will feel more confident. Warren is thought of as a reliable, moral, and entertaining manager. Warren will advance the development of the company. Rating agencies may now trust him and his leadership since he is crucial to growing Paramount Paper's net worth. If I were him, I would tell the rating agencies that they are working hard to lower their accounts receivable and payables turnover ratios, and that the results are showing. They had raised their long-term debt in an attempt to help the business through investments. Their cash accounts have significantly increased, and this should enable the company's debt ratings to be raised.

CONCLUSION

Paramount Paper Inc. stands on the brink of remarkable growth and success. With a strong track record of financial performance, the company has demonstrated its ability to manage resources efficiently and generate impressive returns. Despite past challenges, Paramount Paper Inc. has maintained remarkable profit margins and a commendable return on equity, surpassing industry averages. To support this expansion, Paramount Paper Inc. will require approximately $2,028,308 million in external funding. This strategic step is crucial to ensuring the company can meet growing market demands without compromising its current operations.

Warren Badges' statement that "there's more to us than meets the eye" truly encapsulates the current state of the company. With a solid financial foundation and strategic growth plans, Paramount Paper Inc. is well-positioned for the future. By addressing past compliance issues and enhancing financial transparency, the company can bolster its credibility and persuade credit rating agencies to upgrade their assessments.

To convince rating agencies, Paramount Paper Inc. must emphasize strong financial metrics, substantial growth potential, and strategic initiatives that ensure compliance and good governance. With the necessary external funding, the company can achieve its strategic objectives and deliver greater value to its stakeholders.

In conclusion, Paramount Paper Inc. exemplifies how operational efficiency and prudent financial management can lead to significant success. The company not only has the capacity for continued growth but also the potential to achieve higher levels of success in the future. Indeed, "there's more to us than meets the eye" aptly describes Paramount Paper Inc.'s true potential, and with the right steps, the company is poised for a bright future ahead.

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