# *Are we Doing Good to Expand?*

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## Abstract:

This paper is a solved case study on ABC Telecommunications which wanted to expand their operations and sought for a detailed study about their organization. Three 3 years annual reports of ABC telecommunications and also collected its competitors financial information to do a thorough financial analysis such as , ratio analysis, corporate valuations, trend projections and so on to conclude that it has all competencies to enter a new market.

Key Words: Financial analysis, Corporate Decision Making, SWOT analysis

## Introduction:

ABC Telecommunication is an American corporation headquartered in Texas. It is the largest provider both of mobile telephony and of fixed telephony in the United States, and also provides broadbandsubscription television services. As of 2010, the company was the seventh largest company in the United States by total revenue, and the fourth largest non-oil company. It is the third-largest company in. As of 2011, it became the 14th largest company in the world by market value, and the 9th largest non-oil company. It is also the 20th largest mobile telecom operator in the world, with over 100.7 million mobile customers.

Through its subsidiaries, affiliates, and operating companies, holding company ABC Telecommunication is the industry-leading provider of wire line voice communications services in the US. Customers in 22 states use their branded telephone, Internet, and VoIP services; it also sells digital TV under the U-verse brand. Key markets include California, Illinois, and Texas. The company's corporate, government, and public sector clients use its conferencing, managed network, and wholesale communications services.

“The board meeting is in two weeks time, and there are questions over how good our financial situation is” Richard Keen the CEO of ABC telecommunication told his CFO. He added “one of the board members suggested the idea that it is time to enter new global markets”, there are emerging economies that we can invest in and they want to know the company’s financial status and discuss this idea.

Andreas Santos is the CFO of ABC telecommunication who was hired back in 2006. He witnessed the company's financial status for many years and know exactly if the company can go ahead with such a big step or not, and he will have to demonstrate for the board the real financial situation and give the best recommendation he can.

The CEO of the company called for a meeting with the CFO and his assistant to summarize the financial situation of the company. Andreas briefed him about the situation and gave an overview about the following:The revenues increased $2,238, or 7.6%, in 2012 and $2,048, or 7.4%, in 2011. Data revenues accounted for approximately 53% of wireline operating revenues in 2012, 49% in 2011 and 45% in 2010. Data revenues include IP, strategic business and traditional data services.

Andreas continued to explain about the credit situation of the company "on December 11, 2012, we amended and extended for an additional one-year term our existing $5,000, four-year revolving credit agreement (Four-Year Agreement) with a syndicate of banks until December 2016. We also entered into a new $3,000, five-year revolving credit agreement (Five-Year Agreement), with a syndicate of banks, to replace our expiring 364-day revolving credit agreement. In the event advances are made under either agreement, those advances would be used for general corporate purposes. Advances are not conditioned on the absence of a material adverse change. All advances must be repaid no later than the date on which lenders are no longer obligated to make anyadvances under each agreement. Under each agreement,we can terminate, in whole or in part, amounts committed bythe lenders in excess of any outstanding advances; however,we cannot reinstate any such terminated commitments.At December 31, 2012, we had no advances outstandingunder either agreement and were in compliance with allcovenants under each agreement."

## Operation Income:

Operating income has increased $3,779, or 41.0%, in 2012 and decreased $10,355, or 52.9%, in 2011. Our operating margin was 10.2% in 2012, compared to 7.3% in 2011 and 15.7% in
2010. Operating revenues and expenses for 2012 reflect only a partial year's results for our sold Advertising Solutions segment, as discussed below. Operating income for 2012 reflects continued growth in wireless service and equipment revenue driven mostly by data revenue growth and increased revenues from services and strategic business services, partially offset by a decline in voice revenues and higher wireless handset subsidies and commissions. Our 2012 operating income also reflects a noncash charge of $9,994 from actuarial losses related to pension and postemployment benefit plans. Operating income for 2011 and 2010 included actuarial losses of $6,280 and $2,521, respectively. Operating income in 2011 also reflected charges of $4,181 related to our decision to terminate the acquisition of T-Mobile USA, Inc. (T-Mobile) and noncash charges of $2,910 related to impairments of directory intangible assets.

## Cost of Sales and Service:

Cost of services and sales expenses increased $379, or 0.7%, in 2012 and $4,579, or 9.1%, in 2011. The increase in 2012 resulted from increased wireline costs attributable to growth in U-verse subscribers, higher wireless handset costs related to strong smartphone sales and a higher actuarial loss on benefit plans. These increases were partially offset by lower traffic compensation costs and other nonemployee related expenses. The sale of our Advertising Solutions segment reduced cost of services and sales expenses $787 in 2012.
Excluding the increase of $1,668 related to the actuarial loss, expense increases in 2011 were primarily due to higher wireless handset costs from strong smartphone sales, partially offset by lower financing-related costs associated with our pension and postretirement benefits (referred to as Pension/OPEB expenses) and other employee-related expenses.

## Corporate Decision:

Richard interfered here and interrupted Andreas, “ok ok Andreas this is too much information for a meeting to discuss what we will present the board with, why don’t you prepare a full financial analysis report and include summary about what you are trying to tell me”.

Andreas then started thinking what he could present and called his assistant to discuss what is needed to be prepared. “Roy, why don’t you collect some financial information about the market, specially the area that that the board is looking at as potential market, prepare some financial analysis that shows the financial positions about the big companies operating there?” Andreas asked. “This sounds good boss, but don’t you think we need to clearly show our financial situation?” Roy replied. “I think we can perform financial analysis of our company and compare it to the financial situation of the other companies.”

Andreas liked the idea and requested Roy to proceed with the financial analysis asking him to prepare a complete report and a presentation that the CEO can use during the board meeting. He asked Roy to prepare an introductory report about the company’s financial situation, and do the necessary financial analysis.

## Methodology:

Latest three years ( 2010-2012) annual reports of ABC telecommunications were collected and analysis such as, Ratio analysis, Corporate Valuation, SWOT analysis, Trend statements were made and the results were interpreted.

## Review of Literature:

Malíková, Olga; Brabec, Zdeněk (2012)talks about how to seek the most efficient investment opportunity in today's financial market. The best way to perform the analysis on a company to evaluate its efficiency is through studying the financial statements and performing a financial analysis on it. The result of the ratios are influenced by the presumption related to the financial statements that have been prepared.

Lan, Z. Joe (2012) says that financial statements can be used to analyze the company's position in the market and its performance using the statements as tools to measure how financially the company is stable. The Analysis is going to be made on the three most important financial statements applicable for investment research are reportedly the income statement, the balance sheet, and cash flow statement. A completed transaction links all three statements.

Sharma, Anil K.; Kumar, Satish; Singh, Ramanjeet (2012) reveals that value relevance of financial statements, is negligible in Indian markets. However, some ratios based on these financial statements show significant association with stock market indicators. The results depart from financial studies conducted in other markets. The results further indicate that the value relevance of Return is statistically significant and is a useful measure for investment decision. ROMIC, LIDIJA (2011), financial statements are meant to be understood by readers who are knowledgeable of the economic activities and accounting strategies in the business world.

**EMPIRICAL ANALYSIS**

**Trends Statements:**

Looking at the table No.1, it is obvious that the figures for 2012 are higher than the figures for 2011; this can be seen on the graph looking at the red curve being higher than the blue curve.

The trend shows that companies assets growing from year to another faster than the increase of liabilities. As the two curves look alike, with 2012 curve is higher, this indicates that the company is operating on a defined financial policy which is enhancing the figures while maintaining the ratios of assets to liabilities. This is good to enhance the shareholders equity and maintain profitability for the company from one year to another.

**Comparative financial statements:**

Table no.2 describes the comparative analysis of the financial statement for the year 2010-2012, which are given below:

A. <u>Compare between 2010 & 2011.</u>

1) Cash and cash equivalent was reduced by 61% from 2010 to 2011. This is a huge decrease in cash. This could be due to the use of the cash in some long term investments. As such, looking at the long term investments between 2010 and 20101 we find a 54% increase in investments; this justifies the reduction in Cash that we spotted.
2) We noticed a reduction in total current assets by around 17%. This is the result of the cash reduction we spoke about and other current assets.
3) Looking at the total assets, we find an increase of 0.4% regardless the reduction in current assets. This indicates that the company has increased investing in fixed assets from 2010 to 2011 as a financial strategy.
4) Comparing the company's liabilities between 2010 and 2011, we find that all liabilities are reduced, except for the total stockholders' equity. This means that stockholders are increasing their investments in the company which indicates a good financial strategy.
5) Another important area that we find between 2010 and 2011 is that the total debts were reduced, and as a result, the total interest paid was also reduced.

B. Compare between 2011 & 2012

1) The most significant different that we see when comparing the assets of 2011 and 2012 is the cash increase that the company achieved. An increase of 121% of cash and cash equivalents were achieved, and it is believed that this increase is the result of the good investment strategy that the company is following.
2) As such, the total current assets for the company have increased by around 10%.
3) On the other hand, the long term investments were reduced by 17%. This is an indication that some of the long term investments came with good results that increased the cash company possess.
4) In terms of liabilities comparison, there is a huge decrease in short terms liabilities which is 52%. This is a good indication as well that the company is able to settle its short term debts through the cash that it generated as a result of its investment policy.
5) The percentage for deferred long term liabilities was also increased by around 16%. This is a clear indication on the good reputation and financial stability that the company has in which lenders are willing to defer their loans as the result of trust.
6) Monetary interest is also reduced by around 12%, this is the result of two matters, the first is the deferral of long terms liabilities and the second the settlement of short term debts that the company performed which is a definite improvement to lower the company's liability.

**Ratio Analysis – Comparison with Industry**

**Liquidity Ratios:**

ABC Telecommunication current ratio throughout the three years is less than 1. This is not good in general though the ratio has increased to 0.75 in 2012.The Quick Ratio in the past three years was less than 1. This means that the assets that can be converted into quick cash are not enough to cover current liabilities.

In comparison with other companies in the telecommunication industry we find that current ratio for ABC Telecommunication is lower than its competitors. The company needs to have a financial policy that will increase this ratio to indicate that its assets are more than its liabilities

Comparing the quick ratio of the three companies on the period 2010 – 2012 we find that ABC Telecommunication average ratio is less than the market. The company has to adopt a financial policy that can increase this ratio.

**Assets Ratios:**

Average collection period was decreased to around 43 days in years 2011 and 2012. This indicates a positive improvement in faster collection. The average collection period compared to the two competitors is in between the norms.When comparing the average of inventory turnover for the three companies, we find that ABC Telecommunication has less turnover rate. This means that the company has either poor sales or excess inventory compared to its competitors

Fixed Assets turnover shows that the company has a stable generation of sales from the investments over the previous years.Looking at the comparison of the assets turnover rate for the three companies, the turnover rate is the least. This means either the company doesn't generate many sales out of its investments or that the investments are too high in the company.

The number of total assets turnover is 0.46 to 0.47 across the three years is consistent. Similar to the previous ratio and when comparing the figures for the three companies, it indicates that ABC Telecommunication has a less total assets turnover rate

**Profitability Ratios:**

In 2009, the gross profit margin was 59% which represented a good figure indicating a high margin of profit for the company.The company's gross profit margin decreased to 58% and 55% in the years 2011 and 2012 respectively. This is because of the increase in cost of sales which has been faster than the increase in revenues. It could be due to inflation or rise in salaries or other aspects in the market that affects the cost of sales.

On comparing the average gross profit ratio of the three companies for 2010, 2011 and 2012 we find that ABC Telecommunication profit margin is higher than its competitors which mean the company generates more profits than the other two in the mentioned period.

**Leverage Ratio:**

The debt ratio of ABC Telecommunication went down from 24% in 2009 to 22% in 2010 and 23% in 2011. These figures mean that the company is safe in terms of not being a risky company and the chances of bankruptcy are minimum.

**Cash Flow Status:**

Seeing a negative cash flow doesn’t necessary have to be something bad. This is due to the cash outflow being more than the cash inflow during the period we are studying. Investors can wait until they see other figures in the financial modeling to have the clear idea if this negative cash flow is a result of poor credit management or just a result of a mismatch of expenditure and income during a particular period.

Also, the company has its working capital (current assets and liabilities) changing, so even if the company made sales, that doesn’t mean that it collected the cash related to them.

The company may have used cash on items that don’t appear in the income statement. Like building plants or borrowed cash in preparation of getting more equipment.

As such, looking at the cash flow being negative can’t be judged by itself. We have to look at the company’s figures in general.

**Corporate Valuation**:

Looking at the ROIC being 4.87% in 2012 means that the growth didn’t add value since it is less that WACC of 10%. This means that investors didn’t get the return they required.

Usually a high growth could cause negative cash flow, which is fine if the ROIC is bigger than WACC. In the case of the company we are analyzing, cash flow is negative, and ROIC is less than WACC, and this gives an indication of poor credit policy and that the company didn’t provide the desired return on investments for the investors.

As EVA measures how much the company value has become in a certain period of time, seeing EVA in negative for the period of 2012 means that ABC telecommunication lost value at the end of the year compared to the value during the year opening. This value in 2011 was positive, and in 2012 got negative, which means that there were serious issues with the company’s profitability during 2012.

Market Value added for ABC Telecommunication is relatively high. This means that the company has created substantial wealth for the investors. However, we have to look at the market norms to know if this amount is above the benchmark or investors could have invested in other companies for even higher return on investments.

**SWOT analysis:**

**Strengths:**

- Strong brand image as the company is the leading in US market.
- Robust financial position that includes huge assets value and high market value
- Largest provider for landline telephone and second largest mobile phone providers in USA.
- Acquisition of other telecom companies in USA

**Weaknesses**

- Fixed assets are huge in size which could generate a cash flow issue.
- Intangible assets consist more than 20% of the total assets in which they need to be well monitored
- Network security issues
- Geographical concentration in USA, no much of international market experience

**Opportunities:**

- Investments in global network providers
- Less short term liabilities and good position for long term liability
- New markets in emerging countries
- High market value that can generate higher capital

**Threats:**

- Laws and regulations in some countries that could limit the business
- Expansion in locations outside USA
- Technical failures and network coverage

## Conclusion:

From the Analysis we finds that the company should adopt the strategy of acquisition in the emerging markets rather than trying to open a new company. As ABC telecommunication has many subsidiaries, management has experienced the value of having independent smaller companies that generate revenue with less close management. Talking about emerging economies, ABC telecommunication will be targeting middle east or east Asia for the investment they are planning to have. Being located only in USA, they will need the local market experience, and for that, they need to search for the countries that their telecommunication operators are ready to merge with bigger organizations and treat this as the door to those markets.

The company needs to come up with a penetration strategy to compete in new markets. It has to provide more of promotions, lower prices and other stuff that will attract customers.

- Promotions on consumer smart phones
- Promotions for business entities targeting the large organizations to partner with
- Land line promotion that include new TV channels and fast internet connection

Thus, the main strategy that ABC telecommunication should adopt in the new market is the price penetration strategy. This is the best way to grow faster in new market. To conclude the company has all competencies to enter a new market

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*Table No.1: Trend Analysis*

| | Trend Analysis | |
|---|---|---|
| | 2011 | 2012 |
| Cash And Cash Equivalents | 38.41219 | 85.13766 |
| Net Receivables | 395.0815 | 93.6863 |
| Inventories | 123.9508 | 89.01756 |
| Total Current Assets | 557.4445 | 91.42415 |
| Long Term Investments | 120.6897 | 127.2852 |
| Property Plant and Equipment | 2758.514 | 107.6046 |
| Goodwill | 1967.415 | 97.33451 |
| Intangible Assets | 1617.749 | 96.29227 |
| Other Assets | 179.2302 | 100.8287 |
| Total Fixed Assets | 6643.598 | 101.7242 |
| Total Assets | 7201.043 | 100.7573 |
| Accounts Payable | 739.321 | 92.39946 |
| Short/Current Long Term Debt | 192.355 | 46.90939 |
| Total Current Liabilities | 931.676 | 83.33739 |
| Long Term Debt | 1576.343 | 94.7157 |
| Other Liabilities | 1110.559 | 113.7122 |
| Deferred Long Term Liability Charges | 589.9492 | 109.1989 |
| Minority Interest | 8.099439 | 61.88235 |
| Total Stockholder Equity | 2992.515 | 104.1678 |
| Total Liabilities | 7201.043 | 100.7573 |

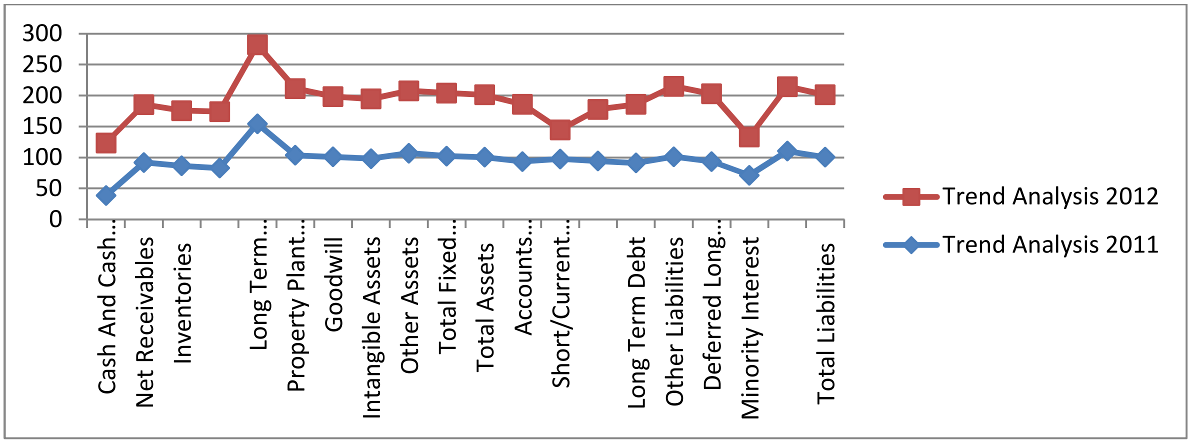


*Table No.2- Comparative Analysis*

| Period Ending | 2010 - 2011 | 2011 – 2012 |
|---|---|---|
| Assets | | |
| Current Assets | | |
| Cash And Cash Equivalents | -61.59% | 121.64% |
| Net Receivables | -8.15% | 2.00% |
| Other Current Assets | -13.39% | 2.78% |
| Total Current Assets | -17.20% | 10.42% |
| Long Term Investments | 54.57% | -17.65% |
| Property Plant and Equipment | 3.69% | 3.77% |
| Goodwill | 1.13% | -3.75% |
| Intangible Assets | -1.80% | -1.94% |
| Other Assets | 6.85% | -5.64% |
| Total Assets | 0.40% | 0.35% |
| Liabilities | | |
| Current Liabilities | | |
| Accounts Payable | -6.53% | -1.15% |
| Short/Current Long Term Debt | -2.24% | -52.02% |
| Total Current Liabilities | -5.68% | -11.65% |
| Long Term Debt | -8.88% | 3.95% |
| Other Liabilities | 1.15% | 12.42% |
| Deferred Long Term Liability Charges | -6.40% | 16.67% |
| Minority Interest | -28.71% | -13.20% |
| Total Stockholder Equity | 10.23% | -5.50% |
| Total Liabilities | 0.40% | 0.35% |

***Ratio Analysis***

**Table No.3- Liquidity Ratios:**

| Ratio | 2010 | 2011 | 2012 | Average | Industry average |
|---|---|---|---|---|---|
| Current ratio | 0.68 | 0.60 | 0.75 | 0.68 | 0.74 |
| Quick Ratio | 0.54 | 0.47 | 0.59 | 0.53 | 0.70 |

**Table No.4- Assets Ratios**:

| Ratio | 2010 | 2011 | 2012 | Average | Industry average |
|---|---|---|---|---|---|
| Avg. Collection period | 47.94 | 43.41 | 43.42 | 44.92 | 46.44 |
| Inventory turnover | 18.92 | 22.59 | 24.08 | 21.86 | 62.5 |
| Fixed Asset Turnover | 0.50 | 0.50 | 0.51 | 0.51 | 0.59 |
| Total asset turnover | 0.46 | 0.46 | 0.47 | 0.46 | 0.485 |

**Table No.5- Profitability Ratios:**

| Ratio | 2010 | 2011 | 2012 | Average | Industry average |
|---|---|---|---|---|---|
| Gross profit margins | 59% | 58% | 55% | 57% | 48% |
| Net Profit Margin | 10% | 16% | 3% | 10% | 5% |
| ROI | 5% | 7% | 2% | 4% | 3% |
| ROE | 12% | 17% | 4% | 11% | 8% |

**Table No.6- Leverage Ratio:**

| Ratio | 2010 | 2011 | 2012 | Average |
|---|---|---|---|---|
| Debt Ratio | 24% | 22% | 23% | 23% |
| Debt to Equity ratio | 64% | 53% | 58% | 58% |

**Table No.7-Cash Flow Status:**

| Element | 2011 | 2012 |
|---|---|---|
| NOPAT | 22394000 | 7719000 |
| Net Operating Working Capital | -14000000 | -7767000 |
| Total Net Operating Capital | 149716000 | 158663000 |
| Net investment in operating capital | N/A | 8947000 |
| Free Cash Flow | N/A | -1228000 |

**Table No.8-** ***Corporate Valuation Model***

| Period | 2010 | 2011 |
|---|---|---|
| NOPAT | 22,394,000 | 7,719,000 |
| Total Net Operating Capital | 149,716,000 | 158,663,000 |
| ROIC | 14.96% | 4.87% |
| NOPAT | 22,394,000 | 7,719,000 |
| Total Net Operating Capital | 149,716,000 | 158,663,000 |
| WACC | 10% | 10% |
| EVA | 7,422,400 | -8,147,300 |
| Price Per Share | 37.7 | |
| Number of Shares | 5,770,000,000 | |
| Value of Debts | 61,300,000 | |
| Market Value | 217,590,300,000 | |
| Book Value | 167,097,000 | |
| MVA | 217,423,203,000 | |