**School of Finance and Economics**

**25742 Financial Management**

**Autumn 2011 Case Study**

**Fangio Brothers Smash Repairs**

**Due Date: 5.00pm Friday May 20 2011**

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Fangio Brother’s Smash Repairs Pty Ltd (FBSR) is a smash repair business located in the western suburbs of Sydney. The business was started by two brothers in the late 1950’s but is now run by Roberto and John Fangio, the two sons of one of the founders of the business. Roberto and John each own 30% of the issued ordinary shares in the company but several other family members also own shares and the company is expected to perform well and pay annual dividends. The company’s Board of Directors consists of Roberto, who is Managing Director, John, their sister Mary and their cousin Maria who is the company secretary. There is one independent director and he is Michael Potter a family friend and the family tax accountant. The company chairman is their Uncle, Juan Fangio who was the other founder of the company. Maria works in the business as the Accountant/Office Manager and has recently completed an MBA at UTS.

The smash repair business has been through some turbulent times in recent years mainly due to the increasing dominance and control exerted by the major insurance companies. FBSR has survived and managed to remain profitable through the reorganisation of the industry and is a registered repairer for the major insurance companies and this ensures a steady stream of insurance work. On top of this John has built up a good reputation with two historic car clubs that has resulted in restoration work on vintage cars that has proved profitable and interesting work.

The company operates from premises that it has owned since the business was incorporated. At the time of incorporation it was decided to purchase two adjoining blocks of land and construct the workshop, spray booth and office on one block and keep the other as an investment or for future expansion. During the years the buildings have been renovated and updated several time with the last occasion being only eighteen months ago when a new spray booth was constructed. The workshop etc is still contained on one block. The other block is still vacant, not very securely fenced and has to be maintained by one of the local lawn mowing contractors to keep the grass and shrubs tidy. This maintenance currently costs $16,000 p.a. and is expected to increase by 3% p.a. for the next ten years. This expense will be eliminated if the site is developed. For some time now Mary and Maria have been advocating selling the land as it would release a significant amount of money which could be paid out to shareholders as a special dividend. However Juan has always had a dream that the land would be used to expand the business and is not keen to sell. The company is working at full capacity five days a week and Saturday overtime is not unusual. Some historical car work had to be declined recently. The major bottleneck is the spray booth where cars have to remain for a minimum drying period. The company has two spray booths but one can only be used for parts not full bodies. The company also had a problem with the parking of vehicles during the day and could only use the spare ground for parking during dry weather. In wet weather shuffling cars was not only frustrating but an inefficient use of staff time.

Some months ago Juan had asked Roberto and John to investigate the feasibility of expanding the business and John has just completed an overseas trip (a combination of work and holiday with his wife and family) during which he completed some research into the latest techniques used in the smash repair business in Europe. He had also studied the latest spray booth technology and had been very impressed by a new German spray booth. The trip had been very expensive and it had cost $37,500 for airfares, accommodation and meals. As most of the trip was business the company has paid for this expense. On returning from the trip John met with Juan, Roberto and Maria to outline an idea that he had been considering for some time.

John stated at the meeting that he believed that if the company added a new spray booth and workshop at the back of the vacant block he would be able to significantly increase business particularly in the restoration of vintage and historical cars. Car clubs were growing and keeping the cars in pristine condition was important to the enthusiasts in these clubs. FBSR had built up a solid reputation for high quality work in this area and this work provided far bigger margins than insurance work. He firmly believed that FBSR would also be able to take on more insurance work with the increased spraying capacity. John tabled a projected revenue forecast for both the historical car business and increased insurance work. The forecast revenue is detailed in Appendix 1. He also outlined some preliminary estimates on the costs involved. The building to house the spray booth and workshop would cost about $250,000 to erect. The building would be constructed on the back half of the block and the front half of the block would be converted to an all weather car park for cars awaiting repair and customer and staff parking which would improve efficiency. The costs of the car park construction are estimated to be $75,000. The biggest cost would be the spray booth and the associated equipment. He had a firm quote from the German company and the total cost including all shipping, installation and testing would be $350,000.

Juan was very excited and said this was just what he had anticipated and would like to see the company at least double its size before he finally stood down as Chairman of the company. Both Maria and Robert were less enthusiastic. Maria argued that the company was profitable and provided a good return to the family particularly those that work in the company. A larger company would only bring more problems and John had not considered the extra staff that would be needed to work in the new premises. The land was very valuable and a local company had recently offered $235,000 for the block. Maria firmly believed that the company should take the money and carry on the business at current levels of activity. At this Juan got angry and stated that the land had only cost the equivalent of $5,000 which is next to nothing and was bought for the company to expand. He stated selling the land is not to be considered and the market value is not relevant.

Robert was more restrained and stated his concern was the level of investment required and raising the cash. The company certainly did not have any spare cash. The company had borrowed the amount required for the last renovations and were still making payments on the term loan from the bank. In the current climate he was concerned that additional finance of that magnitude would be difficult to obtain from the bank. He felt that a proper business plan should be produced and a short report prepared for all board members and the full Board should make the final decision. Robert emphasised that John and Maria should work as a team and assemble all the data required to make the decision and meet in about a month to agree on the base data to be included in the analysis. A summary of the data presented at the meeting and any relevant discussion is shown below:

1. After considerable discussion it was agreed that the sales figures presented by John as shown in Appendix 1 would be used in the analysis. Maria however did not believe the increased insurance business would be achieved because the company accepted all insurance work currently offered to them. She believed that this revenue should be excluded from the analysis but had been overruled by Roberto as John had stated that more business would be offered by the insurance companies due to the improved quality of the new spray booth. (If this new insurance business was excluded from the analysis the increased headcount could be reduced by one from year 2 onwards and material costs and general consumables would decrease also).
2. The quote for the German machine had been confirmed in writing but they had also included an offer to train key staff to use the new technology which would cost $35,000 which FBSR would take up. This would occur prior to the commencement of commercial operations and would involve a supervisor travelling to Germany. The tax office had confirmed that the $35,000 would be a tax deduction at the time the amount was paid although Maria said the company did have the opportunity of spreading this cost and about 20% of the cost of John’s overseas trip over ten years for accounting purposes.
3. The number of employees would be increased. At the start of the new business a new supervisor would be required for the new area. One of the current employees will be promoted. The increase in wages cost of his promotion including all on-costs will be $16,000 p.a. His current position in the current building would have to be replaced at a total cost per annum of $65,000. Details of the other agreed increases in wages are shown in Appendix 1. It was also agreed that an allowance would be made in the analysis for all wages to increase by 3% p.a.
4. There was no additional information available on building costs and it had been agreed that a 5% contingency be included on both the building and car park. Increased building maintenance costs are shown in Appendix 1.
5. The parts and material costs for the new business have been estimated as a percentage of revenue. The percentage for insurance work is 45% and for the historical car work is 20%. The costs of all general consumables i.e. paint, nuts, bolts cleaning rags etc. are shown in Appendix 1
6. Roberto has told John that there are old tools and equipment held in the current warehouse that could be used in the new building. Although several years old they are fully depreciated and the new project could have them at no cost. The tools had recently been appraised for insurance purposes and had a market value of $10,000.
7. Maria has analysed the cash flow and the company would have to borrow $600,000 to finance the project. The bank has given preliminary approval but want to see a final business plan. The interest rate would be 8.25% p.a. and the loan will be repayable over 7 years with a monthly repayment figure of $9,427.
8. The company pays tax at a corporate tax rate of 30%.
9. Michael Potter has stated that a return of 15% on an investment of this type is appropriate.
10. Land is not depreciable and no capital gains tax will apply. In ten years it is estimated that the land could be sold for about $336,000. The tax office has determined that the buildings and car park can be depreciated at 7% straight line based on cost and the spray booth can also be depreciated at 20% straight line.
11. Roberto has asked that the project be analysed over ten years as it is very uncertain if the business will continue after that date.
12. In ten years the old tools will have no value and the spray booth would only have a scrap value of $10,000. The buildings will not add to the land value at the time of sale and can be considered to have no value in ten years time.
13. There would be an increase in inventory of common spare parts at the start of the project with a value of $20,000.

**Required:**

**As friends of Maria you have been asked to assist her in the preparation of a recommendation. You are to prepare the following:**

1. **An executive summary making a firm recommendation to accept or reject the project. The executive summary must contain concise reasons for your recommendation and a summary of your financial analysis. The report must address Maria’s concerns regarding the insurance business. The report should be a maximum of two A4 pages (Single space 12 font). (5 Marks)**
2. **Readable spreadsheets clearly showing the NPV of the project and all other calculations that are used to support your decision and analyse Maria’s concerns regarding the insurance business. (15 Marks)**

This assignment is expected to be completed as part of a group to assist your learning. The maximum number of students in a group is four (no exceptions). You may complete the assignment as an individual but this is not recommended. Groups do not have to be formed from within the same class but only one assignment is to be submitted for marking. The assignment should have a cover sheet clearly showing the names and student numbers of the group members and the day, time and name of the lecturer. The case study will be returned to this class in the last lecture when the model answer will be reviewed. Students may hand in the assignment in class or place in the assignment box outside the School of Finance and Economics before 5 pm Friday May 20 2011. Late penalties as outlined in the subject outline will apply.

Although most of the material you need to complete this case study is covered in topics 5 and 6 students are expected to have studied chapter 9 particularly the sections on scenario analysis and sensitivity analysis.

It is important that students refer to The Faculty of Business Guide to Writing Assignments particularly in regard to the contents of the executive summary. This is available on the Faculty of Business web site.

It should be noted that Lecturers will not discuss the case study in class as it is important that all students receive the same clarifications and hints. If you wish to ask questions on the case study please place the question on UTS online and the question will be answered within two working days. It is important that all students regularly check UTS online for clarification and/or hints. Questions on the case study **WILL NOT** be answered in classor by personal e-mail.

**APPENDIX 1**

**Fangio Smash Repairs**

**Revenue Forecast $**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Year 1** | **Year 2** | **Year 3** | **Year 4** | **Year 5** |
| **Historic Cars** | 500,000 | 625,000 | 700,000 | 750,000 | 772,500 |
| **Insurance** | 75,000 | 150,000 | 200,000 | 250,000 | 257,500 |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| From year 4 onwards total revenue will only increase in line with the expected general rate of inflation which is expected to be 3%. | | | |  |  |  |  |  |
|  |  | |
|  | |  | |

**Wages Forecast $**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Year 1** | **Year 2** | **Year 3** | **Year 4** | **Year 5** |
| **Number of New Employees** | 2 | 3 | 4 | 4 | 4 |
| **Wages Cost** | 120,000 | 185,400 | 254,616 | 262,254 | 270,122 |

Note: The above figures exclude the increased cost of the supervisor and the new employee in the old building. Wages costs are expected to increase by 3% p.a. from year 4 onwards

**Other Forecast Costs $**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 |
| Materials Historic Cars | 100,000 | 125,000 | 140,000 | 150,000 | 154,500 |
| Materials Insurance | 33,750 | 67,500 | 90,000 | 112,500 | 115,875 |
| Building Maintenance | 5,000 | 7,500 | 15,000 | 20,000 | 20,600 |
| General Consumables | 57,500 | 77,500 | 90,000 | 100,000 | 103,000 |

Note: All the costs shown above are expected to increase by 3% from year 4 onwards