Advanced Medical Technology Corporation

Background

Advanced Medical Technology Corporation (AMT) dealt with scientific instruments that made access to certain organs and vessels quicker and less invasive. Currently, AMT has a line of credit with Sunnyvale Bank for $6 million. Sunnyvale Bank would not increase the current line. The president of Advanced Medical Technology Corporation, Peter Haskins, requested a line of credit from Western National Bank of San Francisco in the amount of $8 million to finance its activities.

Issues

1. What are the financial projections for the upcoming 3 years, 1986, 1987 and 1988? Assume that sales grow at 35% a year and operations do not change. Forecast the income statement and balance sheet. (Exhibits 1 & 2)

2. How much external financing will be necessary? (Exhibit 2)

3. If we were the bank, would we make the loan?

Analysis:

Exhibits 1 and 2 show the Pro Forma Income Statements and Balance Sheets respectively. The income statements indicate that while Advanced Medical

Technology Corporation’s (AMT) projected gross profit increases over the years, the heavy investment in research and development causes an operating loss and subsequently a negative net income. To finance the level of R & D AMT wants to do, increasing amounts of external financing are necessary.

Using the assumptions outlined in the Exhibits 1 and 2, in 1988 a $32,767,000 loan will be necessary for the company to continue its operations. This is roughly four times the amount requested by Haskins.

The ratio analysis, displayed in Exhibit 3, yielded the following results: Over the coming three years (86-88) AMT will continue to see negative returns on assets, indicating that the company is not generating any profits from its deployed assets. Low Debt to Assets ratio shows that AMT is not highly leveraged and has a low risk for running into problems with creditors. However, this means that AMT is very dependent on Equity which also has its risks.

Even though Debt to Assets is somewhat positive news for creditors, AMT's Times Interest Earned ratio will make creditors very nervous about their creditworthiness. If EBIT continues to get deeper in the "Red", AMT will have a more difficult time paying back creditors.

Difference in two liquidity ratios (Current Ratio and Acid Test) indicates that good portion of the firms assets are ties in inventory reducing its liquidity significantly if we take a conservative approach. Gradually increasing, the asset turnover figures indicate that AMT's efficiency to generate revenues from its assets is improving.

For several reasons, we would not extend the loan to AMT. First, while the company is not highly leveraged, the company is not generating profits so the debt only increases year by year. In essence, they are borrowing to finance more borrowing. Second, the cash conversion cycle is increasing. As shown in Exhibit 3, once the materials for a product have been paid for by AMT, by 1986, it takes them 303 days to receive payment for that item. The number of days it takes to collect increases over time.

Also, the times interest earned ratio is negative. Projections indicate that not only is it negative, it will continue to sink further into the red. While the company does not currently have trouble meeting required payments, if this trend continues, it will soon.

The comments from the other two San Francisco are not favorable to AMT. Bank of San Francisco indicated that while it enjoyed dealing with Haskins, his requests were never ending and they did not believe the quality of his assets substantiated increasing the line. Sunnyvale’s loan officer, Mr. Flint, had similar comments. He said that AMT kept low balances in its account and often did not keep acceptable collateral for the account.

Alternatives

The company has a number of alternatives to taking out a loan to finance its growth. First, it could sell new equity. However, with the ROE that it currently has, it may have a difficult time attractive buyers at a reasonable price. AMT could also consider changing its pricing structure. This may be a reasonable alternative since AMT is a pioneer in its markets and may be able to set initial prices.

A third alternative would have to do with cost savings. AMT could save significantly by reducing the amount of inventory kept on hand. Currently, the company keeps 10 to 12 weeks of inventory. AMT is currently pursuing savings through collection improvement. As slow pays are common in the industry, this may prove difficult. Currently, AMT extends 30 day credit to everyone without underwriting. More stringent credit guidelines may aide the collection process as well.

A final option for AMT would be to merge with Biological Labs. As the case states, the banks have a positive relationship with Biological Labs. This may give AMT the ability to finance its growth through credit. Also, based on the information provided, it seems to have a ready source of cash to invest in AMT.

Recommendations

As indicated above, we would not extend the loan to AMT. Given that, the most attractive option for AMT would be to merge will Biological Labs. Since it has bought the requisite amount of stock to be eligible for the merger in 1990, this seems to be a viable alternative for AMT. In addition, Haskins should continue with his efforts to tighten up collections. Increasing efficiency on this front should assist in providing some needed cash.

Finally, the actual growth of the company is exceeding the sustainable growth rate by a substantial margin (Exhibit 4). They are achieving this by relying very heavily on financial leverage and a gradual increase in the asset turnover ratio. Also, the operational performance is getting worse each year. Because of this the company should change its focus from growth to earnings and liquidity. Such was the case with Dell Computer Corporation[1] as discussed in the text.

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[1] Higgins, Robert C. Analysis for Financial Management. McGraw Irwin. Boston: 2004. p123.