

MBA General Management, UWTSD

Module: LCMB7002 Financial Management

Assessment 1

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Introduction

Part A

Balfour Beatty PLC is a world-wide infrastructural company. The company is headquartered in the UK. The company engages in the provision of construction services, support services as well as infrastructural investments. The company is involved in works across the UK, the United States, Ireland, south and east Asia as well as Canada. Balfour Beatty was incorporated in the 1909. It was started with a total capital of £50,000.00 (Schündeln, 2012). George Balfour the engineer and his friend Andrew Beatty the accountant spear headed the formation of the company (Halstead, 2012). The initial focus of the company was to deal with tramways where their first contract included the construction of the Dunfermline and District Tramways (Prior, 2017). Balfour Beatty played major part in the initiation, planning and advancement of Scotland's hydroelectric power, the construction of dams, power stations as well as creation of transmission lines (King, 2015). Balfour Beatty has attained tremendous success over the years to the extent that by the end of September 2018, the company had grown to a rank of the biggest construction company in the UK (Brodie, 2008). The company operates a business model where its services are divided into three segments. The segments include the construction service segment, the support service segment

and the infrastructure development segment (O'sullivan and Sheffrin, 2003). The construction service segment involves the physical constructions of assets, while the support service segments engages in the provision of support to the existing functions of assets (Roth, 2012). Some of these support services include asset maintenance as well as renovation. In terms of the segment for Infrastructural Investments, it engages in the procurement as well as disposal of the infrastructural assets (Huston, 2015). These usually include the roads, the hospitals, military housings, waste as well as biomass among other investments. The Infrastructure Investments segments also entails the division for housing development (Menary, 2018). The business has been involved in the management of construction business in both the UK and the USA. The company's long-standing strategy is to engage in the development of its business operations through foreign expansion, acquisitions as well as disposals (Rob, 2009). The company's fundamental aim is to be a market leader through the development of both short and long term customer relationships through sufficiently developed supply chains (Bill, 2008).

Balfour Beatty has investments across various markets. These are diversified through both industry and geography (Obaidat and Al-Hajaia, 2013). Such a broad perspective alongside focused industrial expertise as well as knowledge for every single market served ensures that there is extra values in terms of the company and client relationships (Diaz, 2012). The company operates within the UK, the USA, Canada, Ireland, Scotland, south and Middle East Asia and in other oversee countries. Balfour Beatty has a number of competitors and some of the major ones include Katerra. Hensel Phelps Construction, Fluor, Bechtel Corporation, Interserve and Costain Group. Although, it has to be noted that Balfour has continued to position its self within the market in manner that it can best defend its self against the competitive market forces and also influence the forces in its

favour(McConnell, 2009). The organisation is highly flexible and adaptable in a way that it is able to change with the changing market environment (Slee, 2011). It is because of such flexibility and adaptability that the company has managed to remain sustainably competitive in spite of the enormous cut throat competitive within the market (Baron and Michael, 2012).

Some of the major events to have taken place in the company over the past five years include the resignation of Martin Chown, the company's UK procurement director. There have also been accusations levied against Balfour Beatty on account of a series of labour abuses of migrant workers that the company employees on a large scale basis. In the same manner, in the month of august of the year 2014, the corporation did rebuff three proposals provided by their competitor within the UK. The offer included a request for the two companies to form a merger (Clarkson, 2010). The last bid which had put Balfour Beatty at a valuation of two billion pounds was solidly vetoed by company's board on the 20th August 2014. Another major event took place on 22nd January 2016 where the high court did order 30 construction firms to make a disclosure of all the emails as well as correspondences associated with blacklisting by 12th December 2016. This was after it had appeared that supervisors at Balfour Beatty had made to reference to excluded employees as sheep. Although, the company did agree some settlements on 11th May 2016 and an official apology by forty firms implicated was pronounced in court before closing the case.

Part B

Company's financial performances

Balfour Beatty PLC has current assets amounting to £2.33 Billion. This amount is big enough to cover the company's total liabilities valued at £966 Million (Hamilton, et al. 2011). The implication for this kind of financial position is that the company is able to meet its financial obligations. There is therefore no need for any potential investors to worry about the company's debt to equity ratio (Huang and Diewert, 2011). As much as any company's operating cash flows are of critical importance, it is the earnings which indicate the level of profitability of the company (Alexander, 2015). This is usually after it has accounted for its overall gains as well as losses for none core aspects and the non-cash expenditures. Beatty PLC does earn much more interest than it pays out. In spite of the debt-to-equity ratio of the company being greater than 40%, the company looks to be in a sound financial condition (Hoskins, 2009). This is particularly the case when the company's earnings and current assets are compared against its interest payments as well as overall liabilities correspondingly. The company can continue to be strong by maintain a healthy operating cash flow. The company did experience a fall in the cash reserves in 2018 to a tune of negative 307.0 million. Although, the company earned a cash flow from its investment activities of 150.0 million. The implication in this case is that the company did earn more from selling its present assets than the expenditure it incurred while purchasing other assets (Richardson, 2006). Additionally, the company did use 130.0Millions for operations while the cash spent for financing the operations totalled 349.0 million. Year after year there was an increase in both earnings and dividends per share excluding extraordinary items at a rate of 33.3% and 4.0%, correspondingly. The positive trend in growth related to dividend payments is a critical indicator because there only a handful of companies within the construction industry that pay dividends.

Financial ratios

Rations	Formulas	2015	2016	2017	2018
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Liquidity ratios					
The current ratio	the current assets/ the current liabilities	0.88	0.91	0.92	0.96
The cash ratio	the ash and Cash equivalent/ the current liabilities	0.28	0.3	0.38	0.31
Profitability ratios					
The return on Assets	income/Assets	-0.040	0.010	0.030	0.03
the return on equity ratio	Net Income/shareholders' Equity	-0.26	0.03	0.16	0.11
Gearing ratio					
the debt to equity ratio	Gross debt / equity	5	5	4	3
the debt ratio	Gross debt / assets	2	2	2	2
Efficiency ratios					
Inventory Turnover	Cost of Sales/ Inventory	47	66	61	74
Total Asset Turnover	Net Sales/Total Assets	3.345358345	2.977634	2.929267	3

Evaluation of ratio

The company's liquidity ratios and more particularly the current ratio have fluctuated between 2014 and 2015 below 1 . This is somewhat a cause for concern. It is a cause for concern because this measure evaluates where a business can be in a position of paying off its debts that are due within a period of one year from the assets expected to be turned into cash within that same year. In the same manner, the cash ratio across the past five years indicates a ration of less than one. This is also equally concerning because this ratio is a measure of whether it is possible to turn into a final product and sold for cash those assets that cannot easily or quickly be turned into cash. It is important to note though that as much as the current and cash ratios do not appear to demonstrate a favourable condition for the company as explained above, the pattern of their fluctuations suggest that the company is continuously improving its liquidity position. Current

rations have been increasing from 0.88 to 0.96 between 2015 and 2018. In the same manner, cash ratio for the company has been progressively increasing from 0.28 to 0.3 between 2015 and 2018. This further suggests that company's liquidity position is progressively increasing year by year. In terms of the profitability of the company, ratio analysis suggests that the company is doing much better than the industrial average. The company has been able to consistently improve its profitability for the past 4 years. The company's return on assets was in negatives as of 2015. It has however progressively improved to 0.23 as of 2018. This suggests that the company's profitability is growing systematically and hence it's able to turn its investments into profit. In terms of the return on equity, as much as there has been consistent increase in terms of the return on equity, the company doesn't demonstrate an efficient use of the shareholders money to generate its profits since all the ratios for the past five years has been less than one. In terms of the gearing ratios which are basically debt ratios, the ratios attained suggest that the company has been aggressively pursuing its growth and expansion through debt. The analysis suggest that the company has been heavily reliant on debt to finance its assets. Although, it should be noted that the company's Debt-to-equity ratio measures have been positive indicating that company's capacity to repay its obligations. As far the efficiency ratios are concerned, the ratio did measure the number of times average inventory is sold or turned over the course of a given period. The ratio focuses on measuring the amount of times the company did sale its total average inventory dollar over a given financial period. In terms of Balfour Beatty PLC and the ratios analysed, it is clear that the company has been efficient in its use of the assets to generate sales. The company has consistently had a higher ratio for the past five years. These higher turnover ratios suggest that the company uses its assets in an efficient manner. In addition, the company's inventory turnover ratios has progressively keep improving from 47 to 74 between 2015 and 2018. In the same manner,

the total asset turnover ratio is a general efficiency ratio which measures the degree of efficiency of the company's asset management and application. The company's total asset turnover ratio has been progressively stable between 2015 and 2018. It has fluctuated around three times which is generally better indication of the company's positive performance across the years.

Comparison to major competitor(s) and/or sector average

Through the acquisition of Mansell, Balfour has been able to differentiate itself while also creating a competitive advantage. Although through its evolution, Balfour has been able to develop distinct advantages such as size, geographic coverage as well as research and development competence. It has also acquired partnership arrangements which have further reinforced its position. In addition, the company seeks to always improve and also upgrade its products as well as service offering. It does it through reorganisation or acquires a merger. All these make it quite hard for a new entrant to penetrate the market and threaten Balfour's position in any way. There are more than 80,000 companies contained within the UK building construction industry and all of these are of variable sizes. In analysing Balfour's major competitors including Amec plc and Kier Group within the UK, certain aspects stand out. Amec's follows a strategy which is focused on making it the leading supplier for engineering of high value, project management and consultancy services within distinct market sections in the global energy as well as industrial development industries (Evans, 2016). To be able to differentiate itself from Balfour, Amec's engages itself in the production of offshore gas as well as oil production engagements (Clarke, 2015). It has some similarities with Kier in the sense that it also involved in metal and mineral mines which is basically a clear one stop shop entity. The company's major business offerings are in gas and oil (McLintock, 2009). It is also involved in offering minerals as well as metal mining, industrial, wind energy, earth and

nuclear offerings. Unlike Balfour consequently, Amec has its focus on the non-domestic construction, as opposed to social housing and property development (Shiller, 2011). Just like Balfour, Amec is predominantly prosperous within the public sector market. It has in addition embarked upon a strategy which emphasizes growth through merging as well as acquisitions which continues to aid its profitability.

The other company major competitor to Balfour as indicated already is Kier. Kier has a wide network including regional contracting businesses within the UK. The company demonstrates major project expertise and is in a position of offering a full life span of services for buildings, including the management of facilities (Hartcup, 2011). To put it simply, it is construction, development as well as a service group. It is a specialist in building as well as civil engineering, private house construction, property development as well as support services (Trotman and Gibbins, 2009). Just like Balfour, Kier is a well-recognised business. In the same manner like Balfour, Kier has also been able to develop its own infrastructure investment corporation (Fernandes, 2014). Just like Balfour, Kier does embrace the social as well as environmental facets of geared towards growth and sustainability. Unlike Balfour however, Kier is engaged in opencast mining and the administration of facilities. (Velez-Pareja, and Tham, 2008). It is also notable that Balfour as well as Kier have operations within distinctly comparable markets and the expertise offered by both companies is more or less the same (Hoskins, 2009). As indicated through ratio analysis, it is evident that Balfour enjoyed a growth in its profitability from 2015 to 2018 (Dauchy, 2013). This growth in profitability is demonstrated by the positive trend in terms of both the return on Assets and equity (Seow, et al. 2010). The company's return on assets grew from -0.04 to 0.03 between 2015 and 2018. In the same manner, the company's return on equity equally grew from -0.26 in 2015 to

0.11 in 2018 (Labardin and Marc, 2009). This could be attributed to lower operational costs across that span of operations and hence enhanced profits. These performances are much better than Kier which whose return on assets and equity respectively were between -0.3 and 0.02 in the same period.

Recommendation on how to improve the financial management of the company

It is recommended that the company considers a union or an acquirement of Kier within the near future. This would aid the provision of the added benefit of being able to consolidate its position while also being able to create critical mass in terms of the share of the market in areas like private house buildings as well as PFI. It is also critical that management considers hiring experts and external auditors to continuously investigate the debt level of the company to keep them as low as possible. It is also recommended that the company adopts a much more differentiated technique for its services and products to curb against duplication by the competitors. It's also recommended that the company invests a lot more in enhanced marketing to ensure that its products and services reach a much wider audience and thereby growing its sales. It is also important that the company considers the tailoring of its services to meet the local needs as well as requirements. In so doing, the company would be in a position of improving its relations with its customers and thereby enhancing its sales.

Part C

Year	Cash flow	Cash flow
	A	B
0	-85	-90
1	10	25
2	20	30

3	40	35
4	55	40

Payback Period (PBP),

From the formula

Payback = $A + (B - C)/D$ where,

A is the year before crossing Investment value within cumulative cash flows

B is initial cash outlay or Investment

C is cumulative flow of cash

Year	Cash flow	Cash flow	cumulative	cumulative
	A	B	A	B
0	-85	-90	-85	-90
1	10	25	-75	-70
2	20	30	-55	-40
3	40	35	-15	-5
4	55	40	40	35

Pay back for A = $3 + (15/55) = 3.272727273$ years

Payback for B = $3 + (5/40) = 3.125$ years

On the basis of the calculated payback period, project B should be considered since it pays back earlier at 3.125 years than project A which pays back at 3.272727273.

Accounting Rate of Return (ARR),

From the formula Average annual profit/ Initial investment

Initial investment for A = 85

$$\text{Average revenue} = ((10+20+40+55)/5)/85$$

$$=0.294117647*100$$

$$=29\%$$

ARR for project B

From the formula Average annual profit/ Initial investment

Initial investment for A = 90

$$\text{Average revenue} = ((25+30+35+40)/5)/90$$

$$\text{ARR} = 29\%$$

Both projects should be accepted as per the ARR analysis since they both have an ARR of 29% which is greater than the required accounting rate of return of 10.5%.

The Internal Rate of Return (IRR)

Year		
	A	B
-	(85.00)	(90.00)
1.00	10.00	25.00
2.00	20.00	30.00
3.00	40.00	35.00
4.00	55.00	40.00
NPV	(7.30)	(7.62)
IRR	13%	15%

According to the results attained from IRR analysis as indicated in the excel spread sheet attached, both projected should be pursued since they boast of an internal rate of return which is greater than the minimum required rate of return of 10.5%.

The Net Present Value (NPV)

	A	B
0	-85	-90
1	10	25
2	20	30
3	40	35
4	55	40
NPV	(£7.30)	(£7.62)

According to the NPV analysis, both projects should be rejected since they have a negative

Net present value

Advantages and Disadvantages of PBP capital project technique

PBP or Payback Period Capital project is the method which is useful in determining years which are taken in recovering initial investments (Varshney & Maheshwari, 2010). The formulae which is used is dividing initial investment by annual cash flow.

The formulae to calculate Payback period is given by

Payback = $A + (B - C)/D$ where,

A is the year before crossing Investment value within cumulative cash flows

B is initial cash outlay or Investment

C is cumulative flow of cash

And Z is cash flow in a year of crossing investment value in cumulative cash.

The advantages of this method for capital projects are:

Simplicity is one of the most significant advantages of the payback method. In payback method, several project are easily compared before the project considered to be with the shortest payback time is given priority.

The drawbacks or Disadvantages of Payback method are described below:

There is ignoring the money value in accordance with time while using capital project. In this capital project, the cash flows attained within the early years for the project are given a high weight compared to cash flows attained by the company in the years following.

Does not always put into considerations cash flows that are obtained in the aftermath of the period of payback. In some cases, within some projects, huge cash flows are not realised until the period of payback has been able to elapse. There is a possibility for the projects to have higher returns on the investment as well as being preferable to the projects which are having short payback times.

The payback method does not put into consideration the profitability of the project. Projects having short payback period does not necessarily make it profitable.

The methodology does not put into consideration the return on investment for the project. Some given companies need capital investment in order to exceed given obstacles of return rate; for that matter a given project will be declined. This capital project method does not put into consideration rate of return for the projects.

The disadvantages and advantages of IRR technique for Capital Project

The IRR is also referred to as the Internal Rate of Return method for capital projects. This tool is very useful when one is carrying out the assessment of small business for projects (Velez-Pareja & Tham, 2008). The internal Rate of Returns or simply IRR is very useful in measuring the return rates for projected flow of cash which is generated by capital Investment.

The advantages of using the IRR are described below;

The methodology is very useful since it attaches value to time for the money. IRR is simply calculated through measuring or calculating interest rate when the now value for future cash flows is equalling to the needed capital investment. Some of the advantages of this is that there is timing of the future year cash flow values as well as considering them. Therefore in this method, equal weights are attached to cash flows through using time value for money (Free, 2010).

The other advantage of IRR is that it's very simple to understand and to use. This method is a very easy measure for calculating and providing simple means for comparing the different projects that are under consideration. IRR provides small business owners with snapshots illustrating how this capital project would be very useful in providing great potential cash flow. At the same time it could be very useful in budgeting for example providing snapshots illustrating savings or potential value for purchasing new equipment as compared to making repairs for the old ones.

Hurdle Rate within this capital project are not necessarily needed, within capital project budgeting analysis, the capital cost, or hurdle rate is the needed return rate where investors make an agreement for funding the project. Sometimes is a very subjective figure that typically concludes as rough approximation. IRR method need not necessitate hurdle rate as well risk mitigation for shaping wrong rates. Therefore, once there is calculation of the IRR, projects that have IRR exceeding the estimated capital cost are chosen.

Given the fact that IRR is very advantageous, it also has some disadvantages; some of the disadvantages of IRR capital project are illustrated below;

It does not put into consideration the project sizes. IRR method does not put into consideration or account project size when a comparison of projects is carried out. Within this, cash flows are always matched to amounts of capital outlays which were used in generating the cash flows (Mankiw, 2014). The problem arises when given projects need or require different capital outlay capital, always smaller projects give a return of a very high IRR. One of the example for this is that, a project having an outlay capital of \$500,000 and projects \$25,000 cash flow may be having an IRR of 7.94% within the next 5 years, and a project having \$50,000.00 capital and projects cash flows for \$5,000 within the next five years may rise an IRR of 15.20%. Therefore, considering on the IRR, the small project to investors may look more attractive than the big project which ignores the fact that the big project may generate a very high cash flow and bigger profits (Morby, 2019). The other detriment of IRR capital project is that it offers or ignores future costs, the IRR only puts into consideration only the flow cash being rising from the injected capital therefore ignoring the future costs that may potentially affect the profits. For example when considering the investment in trucks, one could only consider the maintenance requirement changes and price

fluctuations. Within the dependent project, it would be a necessity for one to put into consideration the land where the fleet of the vehicles are to be parked, these costs may not be considered when calculating the IRR yet they are very useful in the cash flows generated during the operations of these fleet of vehicles.

The IRR also ignores the reinvestment rates, given the fact that the IRR allows one to give calculations of the values for future cash flows, it gives implicit assumptions that the given cash flows can be invested again at same rates as IRR. This assumption is not very practical because sometimes the IRR give high opportunities.

The advantages and disadvantages of NPV technique for capital project

The NPV is a very popular method which is used by different managers in evaluating the profitability of projects (O'Sullivan & Sheffrin, 2003). The technique is a very simple one but has a number of limitations.

NVP can be calculated from

$$NVP = \sum (Q / (1+k)^t) - A$$
 where Q signifies the Net period Cash Flow, k signifies the Discount Rate or simply rate of return, t signifies time period number, and C represents initial Investment.

Some of the advantages for the Net Present Value method are described below:

The very important feature for this technique is that it bases on an idea which presents that the dollars today in the bank have a more value than the dollars to be received in the near or far future. Using this technique there is a possibility of valuing the project since there is production of the dollar amount; therefore, stakeholders can clearly see value contribution of the project to them. Another fact is that while calculating the NPV, the company's capital cost is used as discount rate and this represents the minimum return rate of which shareholders need to invest into the company.

The Disadvantages of using the NPV technique

Some of the disadvantages of Net Present value is that requires guesses about future flows of cash as well as estimating capital costs for the company.

The method also is not very applicable when one is comparing projects whose investments amounts are differing. A very large project that is requiring a lot of money should also be having very high NPV, this does not make it a good investment as compared to very small project.

Conclusions

Largely, Balfour Beatty's capital structure is highly balanced. The implication for this kind of structure is that its returns will be sustainable over the long term future. This has been confirmed by the analysis of the company's debt to equity ratio. The ratio is presently balanced at 100.560%. The implication for this is that Balfour Beatty has not used unreasonably lop-sided debt to enhance its returns. The company has a capacity to realise growth in profits without necessarily incurring a considerable debt burden. In the same manner, through the return on equity analysis, the company

appears to be above the industry average in terms of its profitability. It is encouraging and it appears to be in excess of its cost of equity.

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