Chapter 4

4.00 Case Studies

4.10 Company 1 (Ink Manufacturers Sdn Bhd)

Company : Ink Manufacturers Sdn Bhd * (name changed)

Industry involved : Manufacturer of printing ink & printing rolls.

Annual turnover : RM3,650,000 (FYE December 2003)

Number of employees: 22

General Manager : Mr ES Soon.

Percentage of export transaction: 10% export sales.

Percentage of import transaction: 90% imported raw materials.

Average Gross Margin: 10%

Foreign exchange hedging facility: nil

Transaction costs for hedging: Forex spread around 100 basis points if needed.

Background

The company was started as a partnership between Computer Forms (M) Bhd since 1974. Computer Forms has since been listed on the 2nd board. Mr ES Soon, the general manager of Ink Manufacturers Sdn Bhd (Ink Mfg), is currently heading the day-to-day management of the company. Ink Mfg's core products are printing ink, which forms 95% of revenue & printing rolls for psycrostating contributes the other 5% .

Sales (90 days terms granted – averaging 120-150 days)

Sales are mostly to the local printing customers with a market size of about RM300,000,000 per month generated from 4000 players. According to the general manager, their account receivables (AR) is manageable with 70% of the AR collectible within 90 days. AR more than 150 days (the balance 30% of total AR) is accorded to valued customers on a very selective basis.

Purchases (90 – 120 days terms granted)

90% of ink's raw materials are purchased from China, Japan, and Holland. Ink is made from resin, pigment, and oil. Bulk of the accounts payable (AP) is payable with 90 to 120 days without any difficulties.

Company Directions

1) Maintain their stance to concentrate on reputable buyers and hence cut down on the credit terms for better cash flow. Ink Mfg aspires to be independent from bank borrowings.
2) Shifting more business to exports sales, which currently accounts for 10% of the revenue.

3) To expand the business of their new product line: Printing rolls for psycrostate printings (mass printing). Main buyers are government schools & offices (used for exam/memo printings).
4) To quickly intergrate and build-up their newly acquire company's business in Penang into Ink Mfg's wing. Expected to contribute an additional revenue of around RM30,000 per month.

General View on Ringgit's Peg at RM3.80/USD

Ink Mfg believes that pegging Ringgit at RM3.80/USD did promote trade certainty but it was noted that prior to the pegging, quite a few ink manufacturers suffered losses for locking in their raw materials at above RM4.00/USD during the financial crises. Ink Mfg views the economy as still relatively sluggish as compared to the pre-crisis period. Ink Mfg's buyers are noted to be more price-sensitive since the crises. The company opinioned that the original purpose of Ringgit's pegging had been served. However, exchange rate certainty since 1998 had also set-in complacency.

Short Term Effects on Re-peg of Ringgit

Upon the repegging of Ringgit, the company believes that their account receivable (Overseas US Dollar credit sales that Unicolour has not received cash settlements) will be worth less. Basing on their relatively thin margin of around 10%, an upward valuation of Ringgit's peg would effectively wipe-off their gross margins related to the export deals. Ink Mfg's exports business constituted 10% of its total annual revenue. When commented on the relatively small portion of the export sales (10%) and the possible savings from a high portion imports purchases (90%) where purchases are done in US Dollar, Ink Mfg revealed that the imports of raw materials for ink from China were mostly purchased in bulk. Per order of raw material will last around six months. If re-pegging of Ringgit is in within the next few months, they will still be holding on to higher costs stocks.

Long Term Effects on Re-peg of Ringgit

The company opinioned that the long term effects of the Ringgit repeg will not be significant since the import content of inks will be cheaper by the quantum of revalued Ringgit. The company has a local market size of around 4000 potential buyers. Any savings from cheaper raw material may be competed away by numerous manufacturers locally.

Mitigation Plans in Place

1) Ink Mfg is diversifying their risks of concentration in the local market.

2) Ink Mfg is gradually shortening credit terms granted to customers to improve cash flow and minimize foreign exchange risks over a lengthy period.

Change in Company Directions?

All remains status quo except for their aspirations to increase export sales to diversify the customer base to avoid the strong bargaining powers of local buyers.

Exchange Rate Regime

The company feels that adopting a floating exchange rate is too volatile. He suggested that a peg to Singapore Dollar (currency basket regime with proven track record) or change their preferred trading currency to Singapore Dollar. Unicolour believes that the Singapore dollar is more stable as a trading medium.

4.11 Company 2 (Steel Trader Sdn Bhd)

Company : Steels Trade Sdn Bhd * (name changed)

Industry involved : Trading of steels products and general building materials.

Annual turnover : RM14,900,000 (FYE December 2003)

Number of employees: 7

Managing Director : Mr CS Wong

Percentage of export transaction: 50%

Percentage of import transaction: 50%

Average Gross Margin: 5%

Foreign exchange hedging facility: Adhoc and on cash collaterised basis.

Transaction costs for hedging: Forex spread at around 100 basis points.

Background

Steel Trader was incorporated in 2000 and is principally involved in the trading of a variety of steel products as well as building materials. Ranges of products are ore, billets, bars, rods, plates, coils, sheets, pipes etc. Steel Trader is headed by Mr CS Wong (CEO/MD) and Ms Ooi MF (COO). Mr CS Wong has more 10 years of experience in the steel industry. The company's authorized and PUC are RM500,000 respectively.

Sales

70% to 80% of sales are generated from overseas buyers. Major trading countries are New Zealand and Australia. Other overseas trading partners are from Taiwan, Vietnam, Thailand, South Africa, Philippines, Singapore, Indonesia, Korea, China, and Papua New Guinea. Most of the sales are commissioned sales. 2003's commissioned sales averaged at around USD6,000,000. Steel Trader wishes to capture such commissioned sales into their invoiced deals, hence, earning a bigger margin.

Purchases

Steel and building material products are sourced locally as well as from Taiwan, China, Vietnam, Thailand, Korea, Ukraine, and South Africa. Steel Trader's major local supplier is Amsteel Mills Bhd.

Business direction

Steel Trader wishes to move in directly to export sales and rely less on commissioned sales accorded by local/foreign manufacturers.

General View on Ringgit's Peg at RM3.80/USD

Steel Trader is of a view that the Ringgit pegging at RM3.80/USD had helped them to save on the hefty charges of export proceeds hedging. The level of certainty is high in terms of the actual Ringgit amount that will be received upon currency conversion of US Dollar. Steel Trader believes that the economy is picking up. The company feels that the pegging of Ringgit had outlived its purpose but the continuation will always be welcomed.

Short-Term Effects on Re-peg of Ringgit

The company is a steel trader with slim profit margins of around 5%. Its export sales are quoted in US dollar an upward repeg of Ringgit (appreciation) more than 5% will result in it getting the same amount in USD but lower amount of Ringgit after conversion. Probed Steel Trader on the possibility of raising prices to compensate for the loss exchange, it reiterates that steel is a commodity product, sales is expected to fall in the wake of such revaluation.

Long Term Effects on Re-peg of Ringgit

Steel Trader revealed that long-term effects are not significant and hence will not affect their bottom line. Acknowledged that steel is in demand, over the long run, shortages will pump prices up across the board.

Mitigation Plans in Place

1) Currently, the company trades steel products mostly for commission sales basis. The are actively seeking bank facilities for working capital purposes in order for them to move into invoiced sales to earn more margins. Accordingly, they had USD6,000,000 of commission sales in 2004.

2) The company is also exploring Transferable Letters of Credit (LC) that transfers the ultimate buyer's LC favouring Steel Trader to another LC favouring the ultimate seller to earn a margin from the deal. Both LCs are denominated in the same foreign currency (buys US dollar and sells in US dollar as well) hence, fluctuation on the exchange rate fully mitigated.
3) As for sales to ultimate local buyers, the company will seek Bank Negara Malaysia's approval to allow it to receive payments from resident buyers in foreign currency. This is intended to shield Steel Trader from adverse currency adjustment.

Change in Company Directions

No change on the company's business direction in view of the possible repeg of Ringgit.

Exchange Rate Regime

The company agreed that peg at RM3.80/USD gave them a slight advantage due to the sliding US Dollar. It's exports become relatively cheaper. Steel Trader prefers that the peg to remain since trade certainties rank high on its list. Foreign exchange risk will be factored into their corporate planning but the fact remains that steel is a commodity product that has substitutes and not differentiation noticeable.

4.12 Company 3 (Camera Distributor Sdn Bhd)

Company : Camera Distributor Sdn Bhd * (name changed)

Industry involved : Distribution of photographic equipments.

Annual turnover : RM16,600,000 (FYE December 2003)

Number of Employees: 20

Managing Director : Mr Lai

Percentage of export transaction: -

Percentage of import transaction: 40%

Average Gross Margin: 10% - 15%.

Foreign exchange hedging facility: Yes.

<u>Background</u>

Camera Distributor Sdn Bhd (Camera Dist) was incorporated in December 1994 and is principally involved in importing, distributing, and wholesaling of photography products such as analogue and digital cameras, films, and its related equipments. Camera Dist is the authorized distributors for brands such as Vivitar, Ricoh, Nikon, Casio, and Pentax in Malaysia. The main person behind Camera Dist is Mr Lai who has more than 24 years of experience in the industry.

Sales (sales terms 120 days)

Sales had been on the uptrend. FYE 2003 recorded a revenue of around RM16,000,000 whilst in FYE 9/2004 (9 months management) sales had pick-up to around RM20,000,000. The jump is fueled by a relatively good demand for digital cameras. Price range for cameras start from RM200 to several thousands. Bulk of AR around 96% is collectible within the normal trade cycle.

Profile of Major Buyers

QS Citifoto Sdn Bhd – Biggest photo shop in Klang Valley with 20 retail chains. More than 10 years in business.

Pakard Photo Sdn Bhd – Relative large photo shop in Melaka with 6 shops. More than 40 years in business.

Public Photo Suppliers – Reputable photo shop retailer and wholesaler in southern as well as eastern Peninsular Malaysia. More than 30 years in business.

Purchases (purchase terms from cash up to 60 days)

Managing director indicated that most of their purchases are on Document against Payment (DP cash basis) to Document against Acceptance (DA terms basis) 60-days basis from Hong Kong (Vivitar & Ricoh) and Malaysia (Nikon). Nikon Malaysia is providing a 1.5% per month. discount if purchases are on DP/cash basis. Savings from Nikon is substantial since the annualized discount amounts to 18% p.a. Bulk of AP is payable within trade terms.

Company Directions

1) Camera Dist is compiling a database on all the photo shops around Klang Valley to "data-mine" critical information to help their sales team to gauge stocking levels, timing of dealer-service, best selling models, dealer acquisitions etc. Futuromic's sales personnel will be equipped with PDAs to capture such information to be downloaded later into their server.
2) Camera Dist is expanding their distribution channels to include supermarkets (Mega Pertama, Kuantan), hypermarkets (Carrefour), computer shops and electrical shops (HSL Electrical) to boost sales.

General View on Ringgit's Peg at RM3.80/USD

The managing director informed that 40% of their camera purchases are from Hong Kong. Hong Kong Dollar is also partially pegged to US dollar. The company has the benefit of a pricing certainty even after foreign exchange conversion. The managing director has also indicated that the economy is showing signs of improvement. The company feels that the re-peg of Ringgit will have a minimal effect on them.

Short Term Effects on Re-peg of Ringgit

The managing director announced that most of the camera purchases are from Hong Kong and within Malaysia. If Hong Kong re-pegs concurrently with Malaysia to maintain purchasing power parity (PPP), their margins will remain status quo. If Hong Kong dollar does not re-pegs and remains the same, the company will benefit from a stronger Ringgit to buy Hong Kong dollar denominated cameras from Ricoh & Vivitar.

Long Term Effects on Re-peg of Ringgit

The managing director foresees certain buyers will bargain with their company to lower the sales price in view of the foreign exchange gains that had been made by the company. However, the managing director stressed that they deal mostly with long established clients whom are not price sensitive and prioritizes service deliveries.

Mitigation Plans in Place

1) The company is leaning towards service deliveries rather than on pricing. No doubt margin is slim for digital cameras, the company is relying on volume to generate the required profits.
2) The company also sells analogue cameras to boast bottom line. Analogue cameras are able to generate a margin of around 15%.

Change in company direction

The company maintains that the company's direction does not change since they are not adversely affected by Ringgit's movement. The company stands to benefit more if their main import country, Hong Kong maintains peg while Ringgit appreciates higher.

Exchange Rate Regime

The managing director indicated that they are indifferent about the choice of exchange rate regime that will be suitable for them. He noted that he has foreign exchange hedging lines to sufficiently mitigate the fluctuation risks. Furthermore, Nikon has a local office in Malaysia, and as such, Nikon cameras are deemed local purchases using Ringgit.

4.13 . Company 4 (Metal Furniture Mfg Sdn Bhd)

Company : Metal Furniture Mfg Sdn Bhd * (name changed)

Industry involved : Manufacturer of metal based furnitures.

Annual turnover : RM8,000,000 (FYE December 2003)

Number of Employees: 95

Managing Director : Mr Goh

Percentage of export transaction: 100%

Percentage of import transaction: - (gradually increasing)

Average Gross Margin: 15%-20%.

Foreign exchange hedging facility: Not needed.

Background

Metal Furniture Mfg Sdn Bhd (MFM) was incorporated in 1992. The company is principally involved in the manufacturing of metal-based furniture such as bed-room set, dining set, lawn-set. MFM's products are 100% for the export market. The company incorporated another a sister company (trading arm) in 1994 to market their line of furniture to the local market.

Sales (Terms from Cash up to 45 days)

The major export countries are Australia, Ireland, United Kingdom, and Spain, which form 30%, 10%, 5%, and 5% of the export revenues respectively. The company deals mostly in sight Letters of Credits for relatively new customers while the long established ones are given credit terms on document against acceptance basis.

Purchases (Terms from 90 days to 120 days)

Raw material purchases are procured locally. The main component for their manufacturing processes is steel. The company acknowledged the fact that raw material prices had risen significantly for the past couple of years due to the huge demand from China. Indicated that purchasing from local suppliers is more cost effective than to source steel from overseas suppliers due to economies of scale that the local suppliers have (especially steel importers with approved permits). However, components other than steel, will be gradually sourced from China due to costs reasons.

Company Directions

Business remains status quo and they are concentrating their business with existing buyers from overseas whom, have proven to be reliable and consistent buyers that are not price-sensitive. In order to improve sales margin, the company is gradually sourcing component from China due to lower costs than that could be produced locally.

General View on Ringgit's Peg at RM3.80/USD

The company feels that the Ringgit's peg to 3.80 per US dollar is favourable to ensure certainty since the lead-time from order to delivery may take one month. Any adverse fluctuations in between may affect their sales margins. Moreover, the company does not have hedging facilities citing costs reasons. The company is of a view that the economy is improving and export sales remain healthy owing to our competitive exchange rate. The company hopes that the Ringgit's peg at RM3.80/USD will continue as they have been enjoying the benefits of certainty of trade minus the costly need to hedge export proceeds.

Short Term Effects on Re-peg of Ringgit

The company does not foresee any major changes to the volume of sales in USD since their oversea buyers are mostly long established and have consistent orders. Only the converted proceeds to Ringgit will be lesser than previously if Ringgit repegs to a higher level or floats entirely.

Long Term Effects on Re-peg of Ringgit

The company believes that they can ride on their forte of manufacturing quality products and ensuring on time delivery will allow them to gradually charge a slight price increase in the event Ringgit strengthens by more than the company's tolerance level which is 10% or ~RM3.40.

Mitigation Plans in Place

1) The company has been anticipating for a change of exchange rate regime since the exchange control and Ringgit's peg started in 1998. Upon the pegging at RM3.80/USD six years ago, the company had restructured its costing to a RM3.50 level i.e. pricing quotation of an additional 7.8%. If the re-peg of Ringgit is within RM3.50 – RM3.80 range, the company is still fine. If Ringgit strengthens below RM3.50, margins will be squeezed.

2) US dollar export proceeds will be retained in their foreign currency accounts opened with Malaysian financial institutions for payments of imported components from China.

3) The imported components from China serve to lower product costs to improve margins. At the same time, the company is also increasing their sales prices gradually by costing at an even stronger Ringgit i.e. less than RM3.50.

Change in Company Direction

The company does not think that there will be any change in company direction in view of Ringgit's movement.

Exchange Rate Regime

The company's hope to maintain the pegging infers their choice of a fixed exchange rate regime. The company perceives that forward contract hedging is expensive. The principal running the business is always doing market intelligence from trade associations, trade partners, bankers, oversea buyers/suppliers to ascertain the wellbeing of the economy. Hence, foreign exchange risk will always be at the back of the principal's mind.

4.14 Company 5 (Printer Co Sdn Bhd)

Company : Printer Co Sdn Bhd * (name changed)

Industry involved : Commercial Printing.

Annual turnover : RM13,500,000 (FYE December 2003)

Number of Employees: 115

Managing Director : Mr Tham

Percentage of export transaction: 20%-30%

Percentage of import transaction: nil (100% locally sourced)

Average Gross Margin: 20%.

Foreign exchange hedging facility: Yes.

Background

Printer Co Sdn Bhd (PC) began business in 2002 and is principally involved in the commercial printing business. The founders of the company have been this printing line for more than 12 years. PC prints and converts box boards, brochures, memoirs, pamphlets, flyers, promotional items, children nursery books, and labels. PC is basically a family owned business headed by the managing director Mr Tham.

Sales (Terms 60 to 90 days)

PC's sales revenue is contributed by the following sectors i.e. 80% from fast moving consumer goods (FMCG) consisting of Nestle Group, Guinness Anchor, Kellogg, Johnson & Johnson, and Kentucky Fried Chicken. The balance 20% is contributed by diversified sectors from banking, automotive, pharmaceutical, and insurance. From 2003/2004 onwards, PC moved to export sales (10% of revenue) by securing printing businesses from a famous Belgium publishing house (Hinkler Books Ltd). PC aspires to push the export business portion up to 20% by 2005/2006. PC is enjoying the benefits of an appreciating Euro as a result of US dollar's slide (with which Ringgit is being pegged to).

Purchases (Terms 30 to 60 days)

100% of PC's raw materials are purchased via local agents. Paper are purchased on a very short term ranging from 14 days to 30 days owing to the rising paper costs while ink and other materials are granted a term period of between 30 to 60 days. PC indicated that they would continue to purchase locally due to costs reasons. The Malaysian government had imposed a 25% import tariff for papers imported from non-ASEAN countries while the import tariff is 5% for papers imported from ASEAN countries.

Company Directions

PC is taking advantage of the strong Euro dollar by increasing their export sales to the European countries. They have secured a printing contract with a publishing house from Belgium. These export sales contributes 10% of PC's turnover in 2003/2004. PC has stationed on of their family members in Europe to set-up a regional office in Europe for marketing purposes.

General View of Ringgit's Peg at RM3.80/USD

The managing director indicated that they are well aware that Ringgit may be revalued in view of the continuously sliding US dollar and trade pressures for China to float it Yuan. The company is making admirable margins from the appreciating Euro dollar as well as the relatively cheaper sales price that PC could quote owing to Ringgit's undervalued position. The company agrees that Ringgit's peg had outlived its original purpose but they are also benefiting from the current situation. The company hoped that the peg would not be reviewed soon.

Short Term Effects on Re-peg of Ringgit

Margins from their export sales will be eroded since PC's export sales are on contract basis. The net margin remains comfortable. Export business constituted only 10% of their annual turnover, as such the re-peg effect would not be severe.

Long Term Effects on Re-peg of Ringgit

Over the long run, an revised peg of Ringgit (appreciates) would effect on PC's competitiveness but the managing director indicated that they are not a printing business that competes on price alone. Export sales will remain robust due to the overall lower product costs as compared to the western countries.

Mitigation Plans in Place

1) PC is beginning to retain export proceeds in their foreign currency accounts and hedging their export proceeds that needed to be converted to Ringgit for working capital purposes.

2) PC is also on capital expenditure expansion. Printing machines purchased from suppliers are given a two-years credit terms. PC is riding on the fact that Ringgit will re-pegs to a higher level within this two years to reduce the costs of capital expenditure acquisition. PC has ordered a machine costing USD1.6 million (about RM6 million) recently and if Ringgit repegs 10% higher to RM3.50, effectively, the machine will only costs RM5.6 million two years down the road, a RM400,000 savings.

Exchange Rate Regime

PC favours a fixed exchange rate regime preferably remaining at RM3.80/USD. But if Ringgit re-pegs to a higher level, PC will have to rely on their other competitive advantages to secure businesses. Foreign exchange risk has played