

NDT

NDT (Non-Destructive Testing) is located in Strood, Kent and undertakes inspection and testing for the engineering industry – welding and crack inspection, ultrasonic and radiography inspection as well as destructive tests, material analysis and hardness surveys. This involves both on-site and laboratory work. NDT operates in a very specialised market with only about a dozen competitors in the UK. Its clients include many blue-chip companies and about 80 per cent of its turnover comes from 20 per cent of its



clients. It started life as a management buy-out from Royal Insurance, who decided it was not part of its core business. The 12 owner-directors each owns 5000, £1 shares (total share capital £60,000). The buy-out was financed by a two-year, interest free debenture loan of £50,000 from Royal Insurance, repayable in two annual instalments and secured by a floating charge on the assets of the company. At One year after the buy-out the company made a profit of only £4,327 on turnover of £352,516. The 12 directors were paid £182,622. NDT's balance sheet from that year is shown below.

FIXED ASSETS (incl. vehicles: £56,000 and buildings: £40,000)		<u>£116,032</u>
CURRENT ASSETS		
Stocks	4,350	
Debtors	53,334	
Cash	<u>9,348</u>	<u>67,032</u>
CREDITORS DUE WITHIN ONE YEAR		
(incl. debenture loan: £37,700 and vehicle HP: £32,441)		<u>(103,395)</u>
NET CURRENT LIABILITIES		<u>£(36,363)</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		£79,669
CREDITORS DUE IN MORE THAN ONE YEAR		<u>(15,342)</u>
		<u>£64,327</u>
Share capital		£60,000
Retained profit		<u>4,327</u>
		<u>£64,327</u>



At this point NDT were successful in securing a contract from Aiton, of Derby, to test pipework in a power station. The contract was initially only for 10 weeks and the managing director, Roy Davenport, expected to finance this by using NDT's overdraft facility. Aiton was a large engineering firm and typically paid creditors in about six weeks. However, the initial work disclosed some major problems which resulted in the need to test all the

pipework in the power station. Staff on site were doubled after the first week, doubled again in the third week and doubled again two weeks later. NDT realised that the contract value would be over £3 million – ten times their current level of turnover.

The problem for Roy was how to finance this extremely lucrative work. Initially he relied on overdraft but within three weeks he had exceeded his modest overdraft facility of £20,000. The bank were very supportive but insisted that it could not provide the necessary funds without personal guarantees from the directors and not all of the 12 directors would agree to this. Roy decided to factor NDT's debts. Initially with some 80 customers on their books this worked well but the factoring company started to notice the heavy concentration of debt with Aiton. They agreed to a 40 per cent concentration, then a 59 per cent concentration and finally a 70 per cent concentration, but still the size of Aiton's debts kept mounting. When the concentration came to an unagreed 99.8 per cent the factoring company refused to accept any more invoices to Aiton.

Roy now had a major problem since Aiton currently owed NDT over £200 000 and, despite this extremely lucrative contract, there were no funds to pay salaries this month. He decided that he would go to Aiton and request a £100,000 advance on the work being undertaken plus a revision to the payment terms, which would mean that NDT received weekly payments one month in arrears. Aiton agreed to the revised terms but not the advance. Looking at the cash-flow projections Roy realised that there was no way that the firm could undertake the work and survive without the advance. He decided to forego the extra profit and withdraw from the contract.

Within 24 hours of him taking his men off site Aiton agreed to make the advance to NDT. What had not been meant as a threat, had the same effect. Aiton realised that NDT was willing to walk away from the highly profitable contract because it could not finance the large cash flow deficit it created. Profit is not the same as cash flow.

Case questions:

1. Was NDT right to take the contract?
2. Was the bank right to do what it did?
3. Was the factoring company right to do what it did?
4. Was NDT right to pull out of the contract?
5. Was there any other course of action open to NDT?