Question 5 – solution

45

Cash Purchases

Credit Purchases =	$\frac{102,000 \times 12}{2.4}$	=	€510,000	
Cash Purchases =	620,000 – 510,000		=	110,000 **[9]**

Interest Cover

$\frac{\text{Net profit before interest}}{\text{Interest}} = \frac{60,000}{27,000}$ = 2.22 times **[8]**

Dividend Yield

$\frac{\text{DPS x 100}}{\text{Market Price}} = \frac{4.92\text{c x } 100}{120\text{c}}$ = 4.1% **[12]**

Period to recoup price

$\frac{\text{Market price}}{\text{Dividend per share}} = \frac{120}{4.92}$ = 24.39 years **[8]**

Projected Market Value of Ordinary Share

Price Earnings Ratio x Earnings per Share = 14 x 8c = €1.12 **[8]**

(b) **35**

Performance [15]

The ROCE and ROEF of 6.5% and 4.8% respectively are both disappointing. [8]
The ROCE of 6.5% is only marginally better than the return from risk free investments of around 5%. This indicates an inefficient use of funds and shareholders would be unhappy.
The Return on Equity Funds of 4.8% is less than the Return from risk free investments.

The dividend per share is 4.92c and the dividend Yield is 4.1%. This yield is less than the Return from risk free investments of about 5%. [7]
Dividend Cover is 1.125 times indicating that a very small percentage of the profits is being retained.
The Dividend Cover is low to maintain the yield at 4.1%.

State of Affairs [10]

Liquidity: The Acid Test ratio of 0.99 to 1 shows that the company is liquid. [5]
For every €1 of short-term debt, the company has 99c available in liquid assets .

Gearing: The company is highly geared at 59.6%. This indicates that the company is dependent on outside borrowings and therefore at risk from outside investors. The Interest Cover is 2.2 times. [5]

Prospects [10]

1 point @ 4 marks is compulsory and
3 others at 2 marks each

Market Value: The Market value of Ordinary Share was 1.20 and is projected to fall to €1.12 **-** a **fall** of 6.6% in value. [4]
The shareholders would be unhappy with this as it indicates a lack of market confidence in the company.

ROCE: The ROCE of 6.5% is expected to rise to 8.5%. [2]
This represents an improving prospect.

Liquidity: The Acid Test figure of 0.99 to 1 is expected to rise to 1.1 to 1 a slight improvement. [2]

Gearing: The company is highly geared at 59.6% indicating that it is dependent on outside borrowing and therefore at risk. The gearing will improve in 2007, the projected figure being 58% which is still high but the trend is good. [2]

Sector: The company is in the pharmaceutical sector. With an aging and increasingly health conscious population, prospects are good

(c) **20**

Bank Loan Application

Yes/No [2]

2 points at 5 marks each (Gearing and ROCE)
2 points at 4 marks each

Gearing [5]
The company is highly geared
The gearing will get worse with a further loan of 150,000.
The gearing with the loan will be 65%.
The Interest Cover will get worse

Return on Capital Employed [5]
The ROCE will be 8.5% next year
which is less than the 10% interest to be charged on the loan.

Dividend Cover/policy [4]
The Dividend Cover is 1.1 times and is projected to increase to 1.31 times.
The Dividend Cover is low
Not enough of earnings are retained for repayment of the loan.

Purpose for which loan is required [4]
The loan is required for future expansion
and should generate extra income to service the loan.

Security
The Fixed Assets are valued at 680,000
but one should question depreciation policy to ascertain the real value of the assets.
The Investments alone have a market value of 210,000
which would provide security for the loan of 150,000.
The security is adequate.

Liquidity
The liquidity ratio of 0.99 to 1
It is expected to improve to 1.1 to 1 in 2007.
However the extra interest payment will cause this to be less favourable

Question 6 – solution

20

(a)

Statement of Capital and Reserves on 1/1/2006

		€		€	
Assets					
Buildings and grounds	(500,000 – 20,000)	480,000	[2]		
Equipment	(70,000 – 21,000)	49,000	[2]		
Furniture	(20,000 – 10,000)	10,000	[2]		
Investments		70,000	[1]		
Stock – health food for resale		1,300	[1]		
Stock – oil		640	[1]		
Contract cleaning prepaid		250	[1]		
Cash at bank		7,250	[1]	618,440	
Liabilities					
Creditors for supplies		1,250	[1]		
Customers advance deposits		4,300	[1]		
Loan		50,000	[2]		
Interest on loan (14 months @ €400 per month)		5,600	[2]		
Issued Capital		300,000	[1]	(361,150)	
Reserves 1/1/2006				**257,290**	[2]

12

(b)

Health Shop Profit and Loss Account for the year ended 31/12/2006

	€		€	
Shop receipts			65,000	[2]
Less expenses				
Cost of goods sold (1,300 + 42,100 – 1,600)	41,800	[5]		
Light and heat	200	[1]		
Insurance	500	[1]		
Telephone	340	[1]		
Wages and salaries (70% x 12,000)	8,400	[2]	51,240	
Profit from Health shop			13,760	

36

(c)

Profit and Loss Account for year ended 31/12/2006

Income						
Interest received			3,500	[1]		
Profit from health shop			13,760	[1]		
Customer's fees		W 1	254,350	[5]	271,610	
Less Expenses						
Wages and salaries	(86,220 – 8,400)		77,820	[2]		
Insurance	(6,200 – 500)		5,700	[1]		
Light and heat		W 2	3,260	[5]		
Purchases – supplies		W 3	36,950	[3]		
Loan interest		W 4	1,600	[3]		
Laundry			800	[1]		
Postage and telephone	(1,660 – 340)		1,320	[1]		
Depreciation –	Buildings		11,400	[1]		
	Equipment		12,600	[1]		
	Furniture		5,000	[1]		
Contract cleaning		W 5	2,550	[3]	(159,000)	
Net Profit for year					112,610	[6]
Add Reserves 1/1/2006					257,290	[1]
Profit and Loss balance 31/12/2006					369,900	