5. Interpretation of Accounts **(100)**

(a) Ratios (45)

(i) The Cash Purchases if the average period of credit received from creditors is 1.5 months (10)

Average period of credit received from creditors

$$= \frac{\text{Creditors}}{\text{Credit Purchases}} \times \frac{12}{1} \ \mathbf{(1)} \qquad = \quad 1.5 \ \mathbf{(1)}$$

$\Rightarrow$ Credit Purchases

$$= \frac{\text{Creditors}}{1.5} \times \frac{12}{1} \qquad = \quad \frac{32{,}000 \ \mathbf{(1)}}{1.5 \ \mathbf{(1)}} \times \frac{12}{1} \ \mathbf{(1)}$$

$$= \quad 256{,}000 \ \mathbf{(1)}$$

$\Rightarrow$ Cash Purchases

= Total Purchases – Credit Purchases **(1)** = 630,000 **(1)** – 256,000 **(1)**

= €374,000 **(1)**

(ii) The Earnings per Share (9)

$$= \frac{\text{Net Profit} - \text{Preference Dividend}}{\text{Number of Ordinary Shares Issued}} \ \mathbf{(2)} \qquad = \quad \frac{108{,}000 \ \mathbf{(2)} - 9{,}600 \ \mathbf{(2)}}{550{,}000 \ \mathbf{(1)}}$$

= €0.1789 <u>or</u> 17.89 cent **(2)**

(iii) The Dividend Yield (10)

Dividend per Share

$$= \frac{\text{Total Ordinary Dividends}}{\text{Number of Ordinary Shares Issued}} \ \mathbf{(2)} \qquad = \quad \frac{32{,}400 \ \mathbf{(1)}}{550{,}000 \ \mathbf{(1)}}$$

= €0.0589 / 5.89 cent **(1)**

$\Rightarrow$ Dividend yield

$$= \frac{\text{Dividend per Share}}{\text{Market Price per Share}} \times \frac{100}{1} \ \mathbf{(2)} \qquad = \quad \frac{0.0589 \ \mathbf{(1)}}{1.40 \ \mathbf{(1)}} \times \frac{100}{1}$$

= 4.21% **(1)**

(iv) The Interest Cover (8)

$$= \frac{\text{Net Profit before Interest}}{\text{Interest}} \ \mathbf{(2)} \qquad = \quad \frac{108{,}000 \ \mathbf{(2)} + 36{,}000 \ \mathbf{(1)}}{36{,}000 \ \mathbf{(1)}}$$

= 4 times **(2)**

(v) How long it would take one ordinary share to recover its 2009 market price (assume current performance is maintained)? (8)

Length of time

$$= \frac{\text{Market Price}}{\text{Earnings per Share}} \ \mathbf{(2)} \qquad = \quad \frac{1.40 \ \mathbf{(2)}}{0.1789 \ \mathbf{(2)}}$$

= 7.83 years **(2)**

** Full marks awarded for correct answer even if no workings or wrong workings are shown.
** Figures in brackets show breakdown of marks if answer incorrect.
** Penalise 1 mark if ratios not given to 2 decimal places where appropriate.
** Penalise 1 mark if appropriate units (cent, €, times, %, years) omitted from final answers.

(b) Indicate if the Ordinary shareholders would be satisfied with the performance, state of affairs and prospects of the company. Use available relevant information to support your answer. (40)

Performance

(i) Profitability **(8)**

Any 4: (4 × 2)

- Clinton plc is a profit able business
- Return on Capital Employed has increased from 9.58% in 2008 to 13.51% in 2009 //
- this indicates that the firm is earning over 4½-5 times the return from risk-free investments of about 2-3% //
- the return is above the rate being paid on debentures (10%) //
- profitability is good and has increased by approximately 4% since 2008 showing a more efficient use of resources // *etc*.

(ii) Dividend policy **(7)**

- dividend per share has decreased from 6.2 cent in 2008 to 5.89 cent 2009 - slight deterioration of 0.31c since 2008 (1)

Any 3: (3 × 2)

- the company's dividend cover has increased from 2.5 times in 2008 to 3.04 times in 2009 //
- a larger percentage of the profits is being retained in 2009 than 2008 - the company is re-investing ample profits back into the business //
- dividend yield has declined has from 4.77% in 2008 to 4.21% in 2009 - deterioration of 0.56% since 2008 //
- shareholders would prefer a higher dividend yield //
- it is only slightly higher than the return available from risk-free investments of about 2-3% //
- the real return to ordinary shareholders would be 14.5% (4.77 × 3.04) based on available profits as a percentage of market value // *etc*.

State of Affairs

(i) Liquidity **(5)**

- the company does not have a liquidity problem (1)

Any 2: (2 × 2)

- the working capital ratio in 2009 is 1.69:1 //
- quick ratio has improved from 0.89:1 in 2008 to 1.07:1 in 2009 //
- the company has €1.07 in liquid assets for every €1 that it owes

(ii) Gearing **(5)**

- the company is lowly geared and is not dependent on outside borrowing (1)

Any 2: (2 × 2)

- interest cover was 5.3 times in 2008 and it has fallen to 4 times in 2009 //
- 4 times is adequate, but the trend is poor //
- the gearing has fallen from 52% in 2008 to 39.4% in 2009 //
- there is a greater chance of getting a dividend and there is little risk from outside investors

(ii) Investment policy **(5)**

- investments made by the company cost €140,000 (1)
- these investment now have a value of €120,000, a drop in value of 14.3% (2)
- indicates poor management of resources but shareholders must take into account the global economic downturn (2)

Prospects

(i) Value of Share **(5)**

- the market value of each share is up from €1.30 to €1.40, an increase of 7.7% (1)
- the earnings per share has improved from 14.5c to 17.89c per share (2)
- indicates confidence in the company by the market and the shareholders should be happy (2)

(ii) Sector **(5)**

- the company operates in the soft drinks industry (1)
- highly competitive sector in which many global brands dominate the market (2)
- with an increasingly health conscious population, forecasts for the future indicate a slowing down for products from this sector (2)

(c) The net profit percentage for 2008 was 28%. Give **five** different explanations for the increase/decrease in 2009. (15)

Any 5: **(5 × 3)**

- cash losses //
- stock losses //
- mark downs during sales //
- incorrect valuation of stock //
- increased purchase prices without a corresponding increase in sale price(s) //
- change in sale mix //
- decrease in gains //
- increase in expenses without a corresponding increase in sales price(s) // *etc*.