Question 5

(a) **50**

(i) Opening Stock

Cost of Sales / Average stock	= 10	875,000 / 10 x Average Stock	
Average Stock	= 87,500		
Opening Stock	= (87,500 x 2) less 80,400		**€94,600** [10]

(ii) Gearing

Debt Capital x 100 / Capital employed	= 240,000 + 100,000 x 100 / 932,800	=	**36.45%** [9] **0.364 5to 1** **0.574 to 1**

(iii) Earnings per share

Net profit after preference dividend / Number of ordinary shares	=	40,800 / 550,000	=	**7.42c** [10]

(iv) Dividend Yield

Dividend per share x 100 / Market Price	=	4.55 x 100 / 90	=	**5.05%** [12]

(v) Period to recoup share price

Market price / Dividend per Share	=	90 / 4.55c	=	**19.78 years** [9]

(b)

Bank Loan Application

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Return on Capital Employed [7]
The company is profitable but less profitable in 2010 than in 2009. The ROCE has disimproved from 8.1% to 7.0%. This is less than the 8% interest to be charged on the loan. Why borrow/ loan at 8% if the return is only 7%.

Liquidity [7]
The acid test ratio of 0.43 to 1 is very poor. It has worsened from 0.7 to 1 since 2009.
Sully plc has a serious liquidity problem. It has only 43c of liquid assets available for each €1 owed.
The Liquidity problem will worsen if loan is granted. The company will/may not be able to pay extra interest

Gearing [6]
The company is lowly geared but gearing has become less favourable after rising from 32% to 36.45%. The gearing will get worse with a further loan of €400,000. The gearing with the loan will be 56%. The Interest Cover has disimproved from 5 times in 2009 to 3.3 times in 2010. This cover will get much worse if a loan of €400,000 is granted

Security [6]
The Fixed Assets are valued at cost at €942,800 but one should question the depreciation policy to ascertain the real value of the tangible assets. One should also question the value of intangible assets
The Investments have a market value of €90,000 but cost €150,800.
Already €240,000 is committed to securing debenture. The balance sheet value of tangible fixed assets is €642,000 leaving €402,000 after security committed to debentures. The security is not adequate.

Dividend Cover/policy [5]
The Dividend Cover is 1.6 times. This has worsened from 1.9 times in 2009. The Dividend Cover is low. Not enough of earnings are retained. This would jeopardise the repayment of the loan.

Sector [5]
Sully plc is involved in the construction industry. There is grave concern about the industry in the current climate and prospects in not encouraging in medium term
Further questions about current value of fixed assets and serious question about the ability of Sully plc to generate any/enough profits to pay back/service loan as the construction industry has declined significantly in recent times due to the slow down in economic growth.
Property developers are finding it hard to sell properties and this in turn has a knock on effect for companies in the construction industry as building has almost come to a standstill. The overall worsening state of the economy is having a very negative effect on the construction industry.

OR

Purpose for which loan is required
The loan is required for future expansion. Future expansion should be more specific.
It is questionable whether Sully plc could generate extra income to service the loan.

Conclusion [4]

(c) **10**

Limitations of ratio analysis

- It analyses past figures only and these figures are quickly out of date (historical). It merely gives us clues to the future.
- Ratios do not show seasonal fluctuations
- Firms use different accounting bases and therefore company comparisons are not accurate
- Financial Statements give limited pictures of a business. Other important aspects of a company are not revealed in the Financial Statements. Accounts alone cannot measure aspects which may be extremely significant such as monopoly position, economic climate, staff morale and management/staff relationships.