Question 5

(a)

50

(i) Cash Sales

Debtors x 12 / Credit sales = 2	Credit sales =	43,000 x 12 / 2		
Credit Sales	=	€258,000		
Cash sales	=	€950,000 – €258,000	=	**€692,000** **[12]**

(ii) Return on Capital Employed

Profit before interest x 100 / Capital employed	=	€65,000 x 100 / €792,000	=	**8.21%** **[8]**

(iii) Earnings per share

Net profit after pref. dividend / Number of ordinary shares	=	€47,000 – €5,000 / €350,000	=	**12 cent** **[10]**

(iv) Dividend Yield

Dividend per share x 100 / Market Price	=	10c x 100 / 130c	=	**7.69%** **[12]**

(v) Period to recoup price

Market price / Dividend per share	=	130 / 10c	=	**13 years** **[8]**

(b)

40

Bank Loan Application

Profitability [6]
The company is profitable but less profitable in 2013 than in 2012. The ROCE has disimproved from 10.1% to 8.21%. This is less than the interest of 9% to be charged on the loan. The manager would have to question why the company would borrow at 9% if the ROCE in the company was only 8.21%.

Liquidity [6]
The acid test of 0.45:1 is very poor. It has worsened from 0.90:1 in 2012. Shannon plc has a serious liquidity problem. It has only 45c of liquid assets available for each €1 owed in the short term. The liquidity problem will worsen if the loan is granted. The company will have difficulty in making interest repayments if the current trend continues. Annual interest on loan would be €31,500

Gearing [6]
The company is just above the neutral gearing point at 50.5% [1.02 to 1] and now can be termed highly geared. This gearing has become less favourable after rising from 48% to 50.5%. The gearing will get worse if a loan of €350,000 is given. The gearing with the loan would rise to 65.67% [1.91 to 1].
The interest cover has disimproved from 4 times to 3.61 times. This cover will get much worse if a loan of €350,000 is given.

Security [6]
The fixed assets are valued at cost €790,000 but one should question the depreciation policy to ascertain the real value of the tangible assets. One should also question the value of the intangible assets. The investments have a market value of €200,000 but cost €210,000. Already, €300,000 is committed to securing the debentures. The balance sheet value of tangible fixed assets is €480,000 leaving €180,000 after security committed to debentures. The security is not adequate.

Dividend Cover/Policy [5]
The dividend cover is 1.2 times. This has worsened from 1.25 times in 2012. The dividend cover is low and will get worse. Not enough of the company's earnings are being retained. This would jeopardise repayment of the loan.

Sector [5]
Shannon plc is in the Construction Industry. There is grave concern about the industry in the current economic climate and prospects are not encouraging in the medium term. Property developers are finding it hard to sell properties and this has a knock on effect on the building industry and building has almost come to a standstill. In the short term prospects are not good due to lack of finance
Long term prospects are better as demand is/will be greater than supply.

Purpose of Loan [4]
The loan is required for future expansion. This expansion should be more specific. It is questionable whether Shannon plc could generate extra income to service the loan.

Conclusion [2]
The bank manager **should not grant** the loan based on the above figures. The company has a falling profit and a serious liquidity problem. The company is highly geared making it vulnerable to outside investors. It has a very generous dividend policy and not enough profits are being retained in the business.

10

(c) Liquidity and Solvency

Liquidity measures the ability of the company to pay its short term debts as they fall due. The acid test ratio is a good indicator of liquidity as it includes only liquid assets i.e. cash and debtors. [5]

Solvency is the ability of a company to pay all of its debts as they fall due for payment (long term). Solvency is the most important indicator of a business's ability to survive in the long term. A business is solvent if its total assets exceed its outside liabilities. Debt to equity or total debt to total assets are good guides. [5]