Question 5

(a)

50

(i) **Cash Purchases** = total purchases less credit purchases

Total purchases = cost of sales + closing stock - opening stock

Total purchases = 752,000 + 65,000 - 55,000

Total purchases = 762,000

Credit purchases = $\frac{90{,}000 \times 12}{2}$ = 540,000

Cash purchases = 762,000 - 540,000 = **222,000** **[12]**

(ii) **Dividend Yield**

$\frac{\text{Dividend per share} \times 100}{\text{Market price}} = \frac{7 \times 100}{125} =$ **5.6%** **[10]**

(iii) **Price earnings ratio**

$\frac{\text{Market price}}{\text{EPS}} = \frac{125}{23.6} =$ **5.3 to 1**
5.3 years **[10]**

(iv) **Return on Capital Employed**

$\frac{\text{Operating profit} \times 100}{\text{Capital employed}} = \frac{145{,}000 \times 100}{1{,}128{,}000} =$ **12.85%** **[9]**

(v) **Dividend Cover**

$\frac{\text{Net profit - preference dividend}}{\text{Ordinary dividend}} = \frac{133{,}000 - 15{,}000}{35{,}000} =$ **3.37 times** **[9]**

(b)

35

Profitability [6]
The ROCE has improved from 10.3% in 2014 to 12.85% in 2015. Doherty Ltd is a profitable company. The return is well above the return from risk free investments of 2**%**. The return is also above the company's cost of borrowing of 6%. The company is making efficient use of its resources.
Shareholders will be pleased with this. If this upward trend continues the debentures can be paid in 2017 without having to sell the secured assets.

Dividend Policy [6]
The dividend per share has improved from 6c in 2014 to 7c in 2015. The dividend yield has improved from 5.22% in 2014 to 5.6% in 2015. This is above the return from risk free investments of 2%. The dividend cover has also improved from 2.2 times in 2014 to 3.37 times in 2015. While shareholders will be happy with the improving trends, they will feel that the company has the scope to pay a higher proportion of profits in dividends. Alternatively they could be pleased that profits and cash are retained for the purpose of repaying debenture holders/expansion.

Liquidity [5]
The quick ratio has improved from 1.2 to 1 in 2014 to 1.63 to 1 in 2015. Doherty Ltd. has good liquidity. It should have no problem paying short term debts when they fall due. There is 163c available in liquid assets for every €1 owed in the short term. Shareholders will be pleased with this as there is good ability to pay a dividend and interest as well as having funds available for investment.

Market Price of a Share [4]
The market price of a share has improved from €1.15 in 2014 to €1.25 in 2015. This indicates market confidence in the company which will please shareholders. The price earnings ratio has fallen from 8.7 years to 5.3 years and this means it will take a shorter time-period for an ordinary shareholder to recover his/her investment in one share.

Gearing [6]
The gearing has improved from 54% in 2014 to 44.33% in 2015. The company has moved into a low geared position. The company is not dependent on outside borrowing and is not at risk from outside investors. The interest cover has improved from 6 times in 2014 to 12.08 times in 2015. The company has no problem paying its interest charges.

Sector [5]
The company is in the tourist sector. This is a growing industry at the moment. As economies around the world recover, people have more disposable income to spend on holidays. The weakness of the euro against sterling and the dollar also makes Ireland a cheaper destination for foreign visitors. If there is continued economic growth and the euro remains weak, then future prospects are good.

Overall shareholders will be happy with this and I would buy the shares in the company. **[3]**

(c) **15**

(i) **Gearing -** This is a measure of how a business is financed on a long-term basis. It measures the relationship between fixed interest debt (loans/debentures + preference shares) and total capital employed/equity. When this is less than 50%/100%, the business is lowly geared. Above 50%/100% is highly geared. Low gearing is preferable.

(ii) **Benefits of low gearing -** When fixed interest debt is a small proportion of overall capital it has the following benefits:
1. Low interest repayments means more profits are available for investment elsewhere in the business.
2. Shareholders are more likely to get a dividend when gearing is low.
3. The business should find it easier to raise additional loan finance.
4. Less risk of liquidation due to not being able to make interest payments.

(iii) **Possible ways to reduce gearing**:
1. Sell more ordinary shares.
2. Reduce or repay loans.
3. Increase reserves/retained profits.
4. Convert long-term debt to ordinary shares.