Q.5 Interpretation of Accounts **50**

(a)

(i) Cash sales if the average period of credit given to debtors is 1.5 months

$$\frac{\text{Debtors}}{\text{Credit sales}} \times 12 = 1.5 \text{ months}$$

$$\frac{78{,}000}{X} \times 12 = 1.5 \quad 936{,}000 = 1.5x \qquad x = 624{,}000$$

Cash sales = total sales–credit sales

960,000 – 624,000 = €336,000 [10]

(ii)

$$\text{Dividend yield} = \frac{\text{dividend per share}}{\text{market value}} \times 100$$

$$\text{DPS} = \frac{\text{Ordinary dividend}}{\text{Issued ord. shares}} \times 100 = \frac{35{,}000}{500{,}000} \times 100 = 7 \text{ cent}$$

$$\text{Dividend yield} = \frac{\text{dividend per share}}{\text{market value}} \times 100 = \frac{7}{135} \times 100 = 5.19\%$$ [10]

(iii) Dividend cover $\frac{\text{net profit – preference dividend}}{\text{Ordinary dividend}}$

$$\frac{90{,}000 - 20{,}000}{35{,}000} = 2 \text{ times}$$

[10]

(iv)

$$\text{Return on capital employed} = \frac{\text{net profit + interest}}{\text{capital employed}} \times 100$$

$$\frac{90{,}000 + 15{,}000}{1{,}087{,}000} \times 100 = 9.66\%$$ [10]

(v) $\text{EPS} = \frac{90{,}000 - 20{,}000}{500{,}000} = \frac{70{,}000}{500{,}000} \times 100 = 14 \text{ cent}$

$$\frac{\text{Market value}}{\text{EPS}} = \frac{135}{14} = 9.64 \text{ years}$$ [10]

(b) **40**

The shareholders would **be very satisfied** with the performance, state of affairs and prospects of the company for the following reasons: **[2]**

Performance

Profitability [7]

The return on capital employed for 2018 is 9.66%. In 2017 the return was 5.8%. It has increased by 3.86%, this indicates a healthy trend. Shannon plc is a profitable company as the return of 9.66% is better than the return from risk free investments of 1 - 2% and is better than the debenture rate of 6%. They are making more efficient use of their resources this year.

Dividend Policy [7]

The dividend cover is 2 times. Last year's dividend cover was also 2 times. Shareholders would like to see slightly more profits being retained for expansion purposes and the repayment of loans.

The dividend per share has risen from 5c in 2017 to 7c in 2018. Shareholders would be happy with this improvement, based on current performance this trend is likely to continue. Dividend yield has improved from 4% to 5.19%. Shareholders would be happy that the dividend yield is above the return from risk free investments of 1 – 2%.

State of Affairs

Liquidity [7]

The quick ratio has improved from 0.86:1 to 1.07:1. This is a positive trend and would please shareholders. Shannon plc does not have a liquidity problem. This ratio is above the ideal ratio of 1:1. For every euro Shannon plc owes in the short term it has €1.07 available in liquid assets. This improvement indicates Shannon plc will have no difficulty in paying shareholders a reasonable dividend.

Gearing [7]

The gearing has improved. It has gone from being highly geared in 2017 at 56% to being lowly geared in 2018 at 46%/85.18%. The firm is now financed more by equity than debt. Interest cover has improved from 4.3 times in 2017 to 7 times in 2018. This improving trend would please shareholders as it will make the payment of interest easier.

Investment Policy

Investments which cost €210,000 now have a market value of €250,000, which represents an increase of €40,000 (19%). This indicates efficient use of resources by management and would please shareholders.

Prospects

Sector [5]

Short term prospects are encouraging as the company operates in the renewable energy industry which is a growing industry as more people are becoming environmentally aware e.g. households can receive grant aid for the insulation of solar panels. Long term prospects are even more encouraging as oil supplies are anticipated to be depleted in approximately forty five years. People are actively looking to employ renewable sources of energy.

Market Value of Shares [5]

The share price has risen from €1.25 to €1.35 (10c/8%) since 2017 and this trend is likely to continue based on this year's performance. This will please shareholders as it indicates stock market confidence in the company. Based on current earnings, the time it takes to recover its value is 9.6 years which is also an improvement from 2017 of 12.5 years. This means the share is becoming relatively less expensive to buy as it will take a shorter time period for a shareholder to recover his/her investment in one ordinary share.

$\boxed{\textbf{10}}$

(c) (i) The current ratio is 1.29:1. This is below the ideal ratio of 2:1.
The acid test ratio is 0.68:1. This is also below the ideal of 1:1.

(ii) Gener8 Ltd is not liquid which is very serious, as a company that is not liquid may be forced into bankruptcy. Therefore Shannon plc will want to know can the company take any positive action to improve its liquidity position.
The poor liquidity of Gener8 Ltd could be a significant factor in whether Shannon plc decides to buy this company or not.