
Hebe PLC

Interpretation of Accounts (Ratios)

2010

Debentures

Part B - Comments

DEBENTURES

Remember to use the following headings and ratios when commenting on part B. These will be used from a **Debentures point of view**.

Performance		State of Affairs			Prospectus	
Profitability	Dividend Policy	Liquidity	Gearing	Security	Sector	
1. ROCE	1. Dividend Cover	1. Acid Test	1. Gearing	1. Security	2. Sector	
1. EPS	2. Dividend Pay out		2. Interest Cover			

Try to use the following sentence to help you remember the headings for Debenture comments -
Patricia Doyle Loves Grading In School

NOTE

You might have to calculate some ratios still for part B - calculate them quickly using your calculator and make a record of the figures.

Exam Tip

Each comment should have the following parts

1. Compared to two years (this year and last year or projected year)
2. Must say if it is an **improvement** or **disimprovement** and a **positive** or **negative** trend
3. Would the party (shareholder, bank manager or debenture holder) be **satisfied** or **dissatisfied** and why
4. Must include the phrases that are in bold in this document - don't not para phrase as these are the common phrases used in the marking schemes

PERFORMANCE

PROFITABILITY

ROCEQuestions to answer

1. Say what you see - compared to previous years.
2. Is this an improvement/dis-improvement, positive or negative trend.
3. Say if the company is profitable - compared to risk free investments.
4. Compared to debenture & preference rates.
5. Would debenture holders be satisfied/dissatisfied? And why

Template

1. In _____ the ROCE is ____%. In _____ the ROCE was _____%
2. This is an improvement / dis-improvement of ____% and is a positive / negative trend
3. The company is profitable / not profitable as the return is higher than risk free investment of 0-1%
4. The company is borrowing at a rate of ____% (debenture) and getting a return higher / below this - why borrow at a rate higher than the return. The company is / is not making effective use of resources.
5. Debentures holders would be satisfied / dissatisfied - as the company is making more/less efficient use of its resources available to them.

Tip - Fill in the blank as per your workings and use the correct statement to complete your comment

Suggested Solution (2011 - Hebe PLC)

1. In 2009 the ROCE is 6.51%. In 2008 the ROCE was 13%
2. This is a dis-improvement of 6.49% and is a negative trend.
3. The company is profitable as the return is higher than risk free investment of 0-1%
4. But is below the debenture rate interest of 8% and below preference share capital rate of 10%
5. Debentures would be dissatisfied - as the company is making less efficient use of its resources available to them.

Tip - MUST include the text that is in bold

Earnings Per shareQuestions to answer

1. Say what you see - compared to previous years.
2. Is this an improvement/dis-improvement, positive or negative trend.
3. Would debenture holder be satisfied/dissatisfied?

Template

1. In 2020 the EPS is ____c. In 2019 the EPS was ____c
2. This is an improvement / dis-improvement of ____c and is a positive / negative trend.
3. **Debenture holders would be satisfied / dissatisfied as the management is using / not using the resource available to them efficiently.**

Tip - Fill in the blank as per your workings and use the correct statement to complete your comment

Suggested Solution (2011 - Hebe PLC)

1. In 2009 the EPS is 15c. In 2008 the EPS was 21c
2. This is a dis-improvement of 6.49% and is a negative trend.
3. **Debentures would be dissatisfied as the management is not using the resources available to them efficiently.**

Tip - MUST include the text that is in bold

DIVIDEND POLICY

Dividend CoverQuestions to answer

1. Say what you see - compared to previous years.
2. Is this an improvement/dis-improvement, positive or negative trend.
3. Would debenture holders be satisfied/dissatisfied?

Template

1. In _____ the Dividend cover is ____times, In _____ the Dividend cover was _____ times
2. This is an improvement / dis - improvement and is a positive / Negative trend. **It means more / less profit is being retained for expansion purposes and repayment of loans.**
3. Debenture holders would be satisfied / dis - satisfied with this as the company will find it

Tip - Fill in the blank as per your workings and use the correct statement to complete your comment

difficult to repay the loan.

Tip - MUST include the text that is in bold

Suggested Solution (2011 - Hebe PLC)

1. In 2009 the Dividend cover is 1.33 times, in 2008 the Dividend cover was 1.4 times.
2. This is a dis-improvement of .7 time and is a negative trend. **It means less profit is being retained for expansion purposes and repayment of loans.**
3. **Debenture holders would be satisfied with this as their company will find it difficult to repay the loan.**

Dividend Pay-out

Questions to answer

1. Say what you see - compared to previous years.
2. Is this an improvement/dis-improvement, positive or negative trend.
3. Would debentures be satisfied/Dissatisfied?

Template

1. In _____ the DPS is _____c. In _____ the DPS was _____c
2. This is an improvement / dis-improvement of _____c. This is a positive / negative trend.
3. Debenture holders would be satisfied / dis - satisfied **with this in the short terms as it indicates how much the company is / is not retaining for expansion and paying interest.**

Tip - Fill in the blank as per your workings and use the correct statement to complete your comment

Tip - MUST include the text that is in bold

Suggested Solution (2011 - Hebe PLC)

1. In 2009 the Dividend pay-out is 75%. In 2008 the Dividend pay-out was 71.42%
2. This is a slight improvement and a positive trend.
3. Debenture holders would not be satisfied **with this as the company is not retaining enough for expansion and paying interest.**

Note - This can also be included under Profitability.

Note - Dividend Pay-Out

1. Dividend pay-out should be less than 50% for Debenture holders to be satisfied.
2. If above 50% - they are paying out too much dividend - this means that debenture holders will not be happy as the company is not retaining enough money for expansion and paying interest.
3. If below 50% - Debenture holders would be happy as the company should have enough retained for expansion and paying interest.
4. The formula to calculate Dividend payout is = $\text{DPS/EPS} \times 100/1 = \%$

STATE OF AFFAIRS

LIQUIDITY

Acid Test RatioQuestions to answer

1. Say what you see - compared to previous years.
2. Is this an improvement/dis-improvement, positive or negative trend (compare to recommended ratio)
3. Does it have a liquidity problem - can they pay debts in the short term.
4. Would Debenture holders be satisfied/dis-satisfied.
5. Will the company be able to pay back the debt if the trends continue.

Tip - Fill in the blank as per your workings and use the correct statement to complete your comment

Template

1. In _____ the acid test ratio is _____. In _____ the acid test ratio was _____
2. This is an improvement / Dis-improvement of _____c and is above the recommended ratio of 1:1
3. _____PLC does / does not have a liquidity problem and are able / not able to pay their debts as they fall due in the short term. This is because they have €____in liquid assets for every euro it owes in the short term.
4. Debenture Holders will be happy / not happy as _____PLC will / will not have problems paying out dividends or other short-term debts as they fall due.
5. If this trend continues, the ability to pay interest would / would not come under pressure and funds would / would not be available to invest for the purpose of repaying the loan.

Tip - MUST include the text that is in bold

Suggested Solution (2011 - Hebe PLC)

1. In 2009 the acid test ratio was 0.36:1. In 2008 the acid test ratio was 1:1.
2. This is a dis-improvement of .64c and is below the recommended ratio of 1:1.
3. **Hebe PLC does have a liquidity problem and are unable to pay their debts as they fall due in the short term. This is because they have €0.36 in liquid assets for every euro it owes in the short term.**
4. **Debenture holders will be dissatisfied as Hebe PLC will find it difficult paying interest or other short terms debts as they fall due.**
5. **If this trend continues, the ability to pay interest would come under pressure and funds would not be available to invest for the purpose of repaying the loan.**

GEARING

Gearing

Questions to answer

1. Say what you see - compared to previous years.
2. Is this an improvement/dis-improvement, positive or negative trend and if the company is a lowly/highly geared company.
3. Does it depend on outside borrowing.
4. Would debenture holders be satisfied/dis-satisfied.

Template

1. In _____ the gearing ratio is _____%. In _____ the gearing ratio was __%
2. This is an improvement / dis - improvement and is a positive / negative trend. But the company is a Lowly / highly geared company.
3. **This means the company is dependent / less dependent on outside borrowing and would appear to be less / more of a risk from outside investors. Debenture holders would be satisfied / dis-satisfied as the business is now less / more dependent on outside borrowing However, if using the Debt-to-equity ratio it is a negative / positive trend as it has improved / Dis-improved from .% to __% this is a positive /**

Tip - Fill in the blank as per your workings and use the correct statement to complete your comment.

negative trend.

4. **Debentures would be satisfied / dissatisfied as the company is now more / less dependent on outside borrowing than before and there is a less significant / significant risk to the firm from outside investors. The business is highly geared and is financed more by debt than by equity.**

Tip - MUST include the text that is in bold

Suggested Solution (2011 - Hebe PLC)

1. In 2009 the gearing ratio is 43.48%. In 2008 the gearing ratio was 37%
2. This is a dis-improvement of 6.48% and is a negative trend. But the company is still a lowly geared company.
3. **This means the company is dependent on outside borrowing and would appear to be a risk from outside investors. Debenture holders would be dissatisfied as the business is dependent on outside borrowing and would will be paying higher interest payment,**
4. **Debenture holders would be dissatisfied as the company is now more dependent on outside borrowing than before and there is a significant risk to the firm from outside investors. The business is lowly geared and is financed more by equity than by Debt.**

Interest Cover

Questions to answer

1. Say what you see - compared to previous years.
2. Is this an improvement/dis-improvement, positive or negative trend. It is above/below the recommended ratio of 3:1.
3. What does it mean - is there enough money for expansion, paying dividends and interest.
4. Would debenture holders be satisfied/dis-satisfied.
5. Make reference to when the debenture will be paid off.
6. Also make reference to the bank account and debtors

Template

1. In _____ the Interest Cover is _____ times. In _____ the interest cover was _____ times
2. This is an improvement / dis-improvement and is a positive / negative trend. **It is above/below the recommended ratio of 3:1**
3. **This means the firm has more / less money available for expansion, paying dividends and paying interest/loans.**
4. **Debenture holders would be satisfied / dissatisfied with this.**
5. **The Debentures are not listed for repayment until _____. _____ plc had enough time to put aside resources to be able to repay these when the time comes.**
6. **The bank account is / is not overdrawn, and Debtors owe €____. _____ PLC should / should not follow this up.**

Tip - Fill in the blank as per your workings and use the correct statement to complete your comment.

Tip - **MUST** include the text that is in bold

Suggested Solution (2011 - Hebe PLC)

1. In 2009 the Interest Cover is 3.71 times. In 2008 the interest cover was 4.7 times
2. This is a dis-improvement of .99 times and is a negative trend **but is still above the recommended ratio of 3:1.**
3. **This means the firm has less money available for expansion, paying dividends and paying interest/loans.**
4. **The company is still well able to meet its interest commitments, but the worsening trend combined with poor liquidity would concern debenture holders.**
5. **However, the Debentures are not listed for repayment until 2024. Born to Run plc had enough time to put aside resources to be able to repay these when the time comes.**

SECURITY**Security****Questions to answer**

1. Say what the fixed assets value is, and the depreciation policy should be questioned.
2. Look at the investment have they improve / dis-improved. Would debenture holders be satisfied / dissatisfied.
3. Is there an existing loan (Debenture), does the value of the tangible asset cover the value. Is there security for a new loan.

4. If the tangible assets are high, they should be questioned.

Template

1. Tangible fixed assets including investment are valued at € _____. **The depreciation policy should be questions to ascertain the true value of tangible assets.**
2. The investment cost € _____ but now has a value of € _____. **This shows efficient / inefficient investment decision by management. Debenture holders would be dissatisfied with this.**
3. There is an existing loan (Debenture) of € _____ to be repaid in _____. **The value of the tangible assets in adequate / not adequate to cover this loan (Debenture). There is / is no security for this loan (Debenture)**
4. The intangible assets figure should be questioned / not questioned as they are / are not generating income for a high amount (Only included if the intangible figure is high)

Tip - Fill in the blank as per your workings and use the correct statement to complete your comment.

Suggested Solutions (2011 - Hebe PLC)

1. Tangible fixed assets including investment are valued at €820,000 **The depreciation policy should be questions to ascertain the true value of tangible assets.**
2. The investment cost €120,000 but now has a value of €95,000. **This shows inefficient investment decision by management. Debenture holders would be dissatisfied with this.**
3. There is an existing loan of €300,000 to be repaid in 2015. **The value of the tangible assets in are adequate to cover this loan. There is no security for a new loan.**

Tip - MUST include the text that is in bold

PROSPECTS

SECTOR

SectorQuestions to answer

1. Say what sector the business is.
2. Say what the short-term goals are.
3. Say what the long-term goals are.

Template

1. _____ plc is in the _____ industry.
2. In the short term this industry is growing / not growing as more _____

3. In the long term this industry is growing / not growing as more _____

Tip - Fill in the blank as per your workings and use the correct statement to complete your comment.

Suggested Solution (2011 - Hebe PLC)

1. Born To Run plc is in the sportswear retail sector.
2. **In the short-term** prospects are not that encouraging due to the fact that the company operates as a retailer in the sportswear industry, which is highly competitive, with leading brands dominating the industry.
3. **In the long term**, are better with rising incomes and a greater emphasis on keeping fit and buying new sportswear on a regular basis. However, to protect itself from competition Born2Run would need to spend large amounts of money on brand proliferation and advertising but considering their current liquidity situation, this may prove difficult.

Tip - MUST include the text that is in bold

Note - Make sure to a positive or negative for short term and long term prospectives

OVERALL

The debenture holders would not be satisfied with the performance, state of affairs and prospects of the company.

Note - Always say if the party (debenture, shareholder, or bank manager) would be satisfied or not satisfied. Marks will be given for this and students leave it out