
Debenture

Interpretation of Accounts (Ratios)

Template

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 0-2%*
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*. Preference share capital has a rate of ____%. 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 (2018 - Born to Run)

1. In 2017 the ROCE is 10.75%. In 2016 the ROCE was 12.4%
2. This is a *dis-improvement of 1.65%* and is a *negative trend*.
3. The company is *profitable* as the return is *higher than risk free investment of 0-2%*
4. The company is borrowing at a rate of **6%** (debenture) and getting a return *higher*. Preference share capital has a rate of **4%**. The company *is / making effective use of resources*.
5. Debenture holders would be *satisfied* - as the company is making *more 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 ____ the EPS is ____c. In ____ 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 (2018 - Born to Run)

1. In 2017 the EPS is 18.86 c. In 2016 the EPS was 20 c
2. This is a *dis-improvement* of 1.14 c and is a *negative trend*.
3. Debenture holders 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.

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

Suggested Solution (2018 Born to Run)

1. In 2017 the Dividend cover is 2.28 times, In 2016 the Dividend cover was 1.3 times.
2. This is an *improvement* and is a *positive trend*. It means *more profit is being retained* for expansion purposes and repayment of loans.
3. Debenture holders would be *satisfied* with this.

Tip - MUST include the text that is in bold

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 Dividend payout is ____%. In _____ the Dividend payout was _____%
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

Suggested Solution (2018 Born to Run)

1. In 2017 the Dividend pay-out is 43.96 %. In 2016 the Dividend pay-out was 50 %
2. This is an *improvement* and a *positive trend*.
3. Debenture holders would be *satisfied* with this in the short term as it indicates how much money the company *is* retaining for expansion and paying interest

Tip - MUST include the text that is in bold

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 = $DPS/EPS \times 100/1 = \%$

STATE OF AFFAIRS

LIQUIDITY

Acid Test Ratio**Questions 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.

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 / below* 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 *satisfied / dis - satisfied* 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 - Fill in the blank as per your workings and use the correct statement to complete your comment

Suggested Solution (2018 Born to Run)

Tip - MUST include the text that is in bold

1. In 2017 the acid test ratio was 0.88:1. In 2016 the acid test ratio was 1.3:1
2. This is a *dis-improvement* of .42c and is *below* the recommended ratio of 1:1
3. Born-to-run PLC does have a liquidity problem and will not be able to pay their debts as they fall due in the short term. This is because they have €88 in liquid assets for every euro it owes in the short term.
4. Debenture Holders will be *dis-satisfied* as Born-to-run PLC will 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* 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 is the company 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* and is finance more by *debt / equity* than by *equity / debt*
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 and would will be paying *higher / lower* interest payment,
4. Debentures would be *satisfied / dissatisfied* as the company is now *more / less*

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

dependent on outside borrowing than before and there is a less significant / significant risk to the firm from outside investors.

Suggested Solution (2018 Born to Run)

1. In 2017 the gearing ratio is 53.76%. In 2016 the gearing ratio was 41%
2. This is a *dis-improvement* and is a *negative trend*. But the company is a *highly geared* company and is finance more by *debt* than by *equity*
3. This means the company is *dependent* on outside borrowing and would appear to be *more* 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. Debentures 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.

Tip - MUST include the text that is in bold

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.

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

4. Debenture holders would be *satisfied / dissatisfied* with this. The company is *still / not* able to meet its interest commitments, but the *worsening / improving* trend combined with *good / poor* liquidity would concern debenture holders.
5. The Debentures are not listed for repayment until _____. _____plc has *enough / not 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.

Suggested Solution (2018 Born to Run)

1. In 2017 the Interest Cover is 5.5 times. In 2016 the interest cover was 6.3 times.
2. This is a *dis-improvement* 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. Debenture holders would be *satisfied* with this. The company is *still* able to meet its interest commitments, but the *worsening* trend combined with *poor* liquidity would concern debenture holders.
5. The Debentures are not listed for repayment until 2024. Born to Run plc has *enough* time to put aside resources to be able to repay these when the time comes.

Tip - MUST include the text that is in bold

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 / satisfied* with this.
3. There is an existing loan (Debenture) of € _____ to be repaid in _____. The value of the tangible assets are *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 (2018 Born to Run)

1. Tangible fixed assets including investment are valued at **€650,000**. The depreciation policy should be questions to ascertain the true value of tangible assets.
2. The investment cost **€200,000** but now has a value of **€150,000**. This shows inefficient investment decision by management. Debenture holders would be dissatisfied with this.
3. There is an existing loan (Debenture) of **€300,000** to be repaid in 2024. The value of the tangible assets in *adequate* to cover this loan (Debenture). There *is* security for this loan (Debenture)

Tip - MUST include the text that is in bold

PROSPECTS

SECTOR

Sector

Questions 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 _____ sector / industry.
2. In the short term this industry *is / is not* growing as more _____

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

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

Suggested Solution (2018 Born to Run)

1. ***Born To Run*** plc is in the ***sportswear retail*** sector.
2. In the short-term prospects this industry *is not* growing as 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, this industry *is* growing as rising incomes and a greater emphasis on keeping fit and buying new sportswear on a regular basis.

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**Template**

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

Suggested Solution (2018 Born to Run)

1. 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