Q.5 Interpretation of Accounts **50**

(a)

(i) The Opening Stock if the Rate of Stock Turnover is 8 based on Average Stock

$$\frac{\text{Cost of sales}}{\text{Average stock}} = 8 \text{ times}$$

$$\text{Average stock} \times 8 = 536{,}000$$

$$\text{Average stock} = \frac{536{,}000}{8} = 67{,}000$$

$$\text{Average stock} = \frac{? \; + \; 75{,}000}{2} = 67{,}000$$

$$\text{Opening stock} = €59{,}000$$

[12]

(ii) Interest cover **[8]**

$$\frac{\text{Profit before interest \& tax}}{\text{Interest}} = \frac{120{,}000}{16{,}000} = 7.5 \text{ times}$$

(iii) Return on Shareholders' funds **[10]**

$$\frac{\text{Net profit – preference dividend}}{\text{Shareholders' funds}} = \frac{104{,}000 - 12{,}000 \times 100}{582{,}000} = 15.81\%$$

(iv) Market price if the price earnings ratio is 6 times **[10]**

Price earnings ratio × earnings per share 6 × 20c = 120c

104-12 = 92

92/460 = 20c

(v) Dividend yield **[10]**

$$\frac{\text{Dividend per share}}{\text{Market price per share}} \times 100 = \frac{7.83}{120} \times 100 = 6.53\%$$

48-12 =36 36/460 =7.83

(b)

40

The Shareholders would **be**/**not be** 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 2019 is 10.15%. In 2018 the return was 9.8%. It has improved very slightly by 0.35%.
- The return on shareholder's funds is also very good at 15.81%.
- The company is in a profitable position as the return of 10.15% is better than the return from risk free investments of 1-2% maximum and is above the debenture interest rate of 4% and the preference share capital rate of 6%.
- The company is making efficient use of its resources this year.
- The earnings per share have improved by 1.5c per share from 18.5c in 2018 to 20c in 2019.

Dividend Policy [7]

- The dividend per share has disimproved, falling slightly from 8.33c in 2018 to 7.83 cent in 2019.
- The dividend cover is 2.56 times, the firm is paying out 39.06% of its available profits in dividends. Last year's dividend cover was 2.22 times meaning the firm was paying out 45.03% of available profits to shareholders. This is a small improvement, as slightly more is being retained for expansion purposes and the repayments of loans.
- The yield is 6.53%, a slight disimprovement from last year's 6.72% but is higher than the return from risk free investments of 1-2% and 4% debentures, but similar to the 6% return on preference shares.

State of Affairs

Liquidity [7]

- The acid test (quick ratio) has disimproved slightly from 1.1:1 in 2018 to 1.08:1 in 2019, above the ideal of 1:1.
- Robinson plc does not have liquidity problems and is able to pay its bills as they arise because it has 108c available in liquid assets for every euro it owes in the short-term.
- It will not have problems paying dividends and other short-term debts as they fall due.

Gearing [7]

- Gearing has improved. It has gone from being highly geared in 2018 at 55.76% down to 50.76% in 2019, still technically highly geared, but only just. The debt to equity ratio has disimproved from 55.76% to 103.1%.
- This is a positive trend, Robinson plc are now less dependent on outside borrowing and would appear to be less of a risk from outside investors. If using the debt to equity ratio it is a negative trend etc.
- Interest cover has risen slightly from 7 times in 2018 to 7.5 times in 2019. The firm should not have any difficulty making interest payments.
- These figures should mean that the firm has more money available for paying dividends, or reinvesting, or paying off debt. However, the debentures are listed for repayment in 2023/2024. Robinson plc has not put aside sufficient resources to be able to repay these when the time comes.
- Selling the investments is not going to raise enough to pay off the debentures, and if the firm delays, the investments may fall further in value.

Investment Policy

- The firm has investments currently valued at €130,000 which is a fall in value from €200,000. Shareholders would be disappointed with this. This would indicate poor management of those resources by management.

Prospects

Sector [5]

Robinson plc is in the home renovation and insulation industry.

- In the short term this industry is growing as more people take advantage of government grants to insulate their homes and reduce the high cost of home heating fuels.
- In the long term, economic uncertainty may cause some people to delay investing in their homes. Alternatively it may cause others to invest if moving house is no longer an affordable option.

Share Performance [5]

- The earnings per share has risen slightly from 18.5c in 20.18 to 20c in 2019.
- The price earnings ratio has dropped slightly in the same period from 6.7 years to 6 years, meaning it will take 6 years to make back the market price of the share at current performance levels.
- The share price has fallen slightly from €1.24 to €1.20 since 2018.
- This indicates a lack of confidence in the firm by the stock market.

(c) **10**

Explain how a faster stock turnover can increase the profitability of a business.

- Each time stock is sold, because it contains a mark-up, profitability increases.
- If the cost of buying the extra stock increases at a slower rate than the mark-up then profitability increases.
- The more times the stock is turned over the greater the mark-up and profit will be increased.
- Where stock turnover is high less stock may be held resulting in reduced stock holding costs (insurance, waste etc.) which could lead to an increase in profitability.
- A faster stock turnover means that the firm may enjoy economies of scale, such as bulk-buying discounts, which will reduce costs and increase profitability.