FIN 2601 Practise Questions

Financial Ratio Analysis

Question 1

Consider the accounting relationship: Equity = Assets – Liabilities.

What impact would an increase in net profit have on the statement of financial position of a firm that does not pay any dividends?

Question 2

Except for management, name 5 other possible users of financial ratio analysis.

Question 3

Suppose you are looking to invest some spare funds in a business. You have identified two possible firms in which to invest. Below are extracts from the financial statements of each firm.

	Firm 1 *(R)*	**Firm 2** *(R)*
Total Assets	4 000 000	6 000 000
Debt (15% interest)	1 000 000	3 000 000
Shareholders' equity	3 000 000	3 000 000
Total liabilities and equity	4 000 000	6 000 000
Sales	2 000 000	3 000 000
Cost of goods sold	400 000	600 000
Operating expenses	400 000	600 000
Earnings before interest and tax	1 200 000	1 800 000
Interest	150 000	450 000

Earnings before tax	1 050 000	1 350 000
Tax expense (30%)	315 000	405 000
Earnings available to shareholders	735 000	945 000

i. Calculate ROE for both firms and indicate which firm you would invest in.

ii. If you wanted the lowest possible risk investment, which one of the two would you choose? (Base your answer on ROE, the debt ratio and the times interest earned ratio).

Question 4

A firm has a current market share price of R 55, 200 000 shares outstanding and total equity worth R 2 000 000. The firm has no preference shares issued. Earnings available to ordinary shareholders for this year is R 500 000.

i. What is the firms P/E ratio?

ii. What is the market to book ratio for the firm?

iii. Why would the market value a share higher than the book value thereof?

Question 5

Below is an excerpt from Chair industries' financial statements:

	R
Short term deposits	50 000
Accounts receivable	300 000
Accounts payable	800 000
Inventory	2 400 000
Cost of goods sold	3 200 000
Sales	4 800 000

Chair industries made purchases of R 2 600 000 over the year. Assume 360 days in a year.

i. Calculate the current ratio and inventory turnover ratio for Chair industries.

ii. Assume inventory was only R 1 200 000. The current ratio would then be 1, 94 and the inventory turnover ratio would be 2, 67.

   What can you say about the relationship between the current ratio and the inventory turnover ratio in this scenario?

iii. Calculate the average collection (ACP) and average payment (APP) periods for Chair industries.

iv. Calculate the Quick ratio for Chair Industries.

v. Looking at the current and quick ratios you have calculated as well as the inventory turnover ratio, what can happen with regards to the liquidity of the firm is it experiences a sudden drop in sales?

Question 6

The following ratios are applicable to a firm:

Return on assets (ROA)	= 8,1
Net profit margin	= 5%
Total asset turnover	= 1, 62

and net profit for the firm for the year was R 105 901, 00.

(Hint: Use the modified Dupont system of analysis)

i. Calculate the firms’ sales for the year.

ii. Now that you have sales, calculate the firms total assets.

iii. Given that the firms ordinary shareholders equity is equal to R 608 102, 21, what is the firms’ financial leverage multiplier and return on equity?