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| You have just been hired as a loan officer at Fairfield State Bank. Your supervisor has given you a file containing a request from Hedrick Company, a manufacturer of auto components, for a $1,000,000 five-year loan. Financial statement data on the company for the last two years are given below: |

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| --- | --- | --- | --- | --- |
| Hedrick Company | | | | |
| Comparative Balance Sheet | | | | |
|  | This Year | | Last Year | |
| **Assets** |  |  |  |  |
| Current assets: |  |  |  |  |
| Cash | $ | 306,000 | $ | 410,000 |
| Marketable securities |  | 0 |  | 105,000 |
| Accounts receivable, net |  | 895,000 |  | 602,000 |
| Inventory |  | 1,420,000 |  | 850,000 |
| Prepaid expenses |  | 78,000 |  | 64,000 |
|  |  |  |  |  |
| Total current assets |  | 2,699,000 |  | 2,031,000 |
| Plant and equipment, net |  | 3,321,700 |  | 3,085,100 |
|  |  |  |  |  |
| Total assets | $ | 6,020,700 | $ | 5,116,100 |
|  |  |  |  |  |
| **Liabilities and Stockholders Equity** |  |  |  |  |
| Liabilities: |  |  |  |  |
| Current liabilities | $ | 1,250,000 | $ | 760,000 |
| Bonds payable, 10% |  | 1,220,000 |  | 1,170,000 |
|  |  |  |  |  |
| Total liabilities |  | 2,470,000 |  | 1,930,000 |
|  |  |  |  |  |
| Stockholders equity: |  |  |  |  |
| Preferred stock, 8%, $30 par value |  | 600,000 |  | 600,000 |
| Common stock, $40 par value |  | 2,000,000 |  | 2,000,000 |
| Retained earnings |  | 950,700 |  | 586,100 |
|  |  |  |  |  |
| Total stockholders equity |  | 3,550,700 |  | 3,186,100 |
|  |  |  |  |  |
| Total liabilities and stockholders equity | $ | 6,020,700 | $ | 5,116,100 |
|  |  |  |  |  |
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| Hedrick Company | | | | |
| Comparative Income Statement and Reconciliation | | | | |
|  | This Year | | Last Year | |
| Sales (all on account) | $ | 5,420,000 | $ | 4,330,000 |
| Cost of goods sold |  | 4,090,000 |  | 3,250,000 |
|  |  |  |  |  |
| Gross margin |  | 1,330,000 |  | 1,080,000 |
| Selling and administrative expenses |  | 530,000 |  | 510,000 |
|  |  |  |  |  |
| Net operating income |  | 800,000 |  | 570,000 |
| Interest expense |  | 122,000 |  | 117,000 |
|  |  |  |  |  |
| Net income before taxes |  | 678,000 |  | 453,000 |
| Income taxes (30%) |  | 203,400 |  | 135,900 |
|  |  |  |  |  |
| Net income |  | 474,600 |  | 317,100 |
|  |  |  |  |  |
| Dividends paid: |  |  |  |  |
| Preferred stock |  | 48,000 |  | 48,000 |
| Common stock |  | 62,000 |  | 31,000 |
|  |  |  |  |  |
| Total dividends paid |  | 110,000 |  | 79,000 |
|  |  |  |  |  |
| Net income retained |  | 364,600 |  | 238,100 |
| Retained earnings, beginning of year |  | 586,100 |  | 348,000 |
|  |  |  |  |  |
| Retained earnings, end of year | $ | 950,700 | $ | 586,100 |
|  |  |  |  |  |
|  | | | | |

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| Marva Rossen, who just two years ago was appointed president of Hedrick Company, admits that the company has been “inconsistent” in its performance over the past several years. But Rossen argues that the company has its costs under control and is now experiencing strong sales growth, as evidenced by the more than 24% increase in sales over the last year. Rossen also argues that investors have recognized the improving situation at Hedrick Company, as shown by the jump in the price of its common stock from $38 per share last year to $54 per share this year. Rossen believes that with strong leadership and with the modernized equipment that the $1,000,000 loan will enable the company to buy, profits will be even stronger in the future. |

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| Anxious to impress your supervisor, you decide to generate all the information you can about the company. You determine that the following ratios are typical of companies in Hedrick’sindustry: |

|  |  |  |
| --- | --- | --- |
|  |  |  |
| Current ratio | 2.3 |  |
| Acid-test ratio | 1.2 |  |
| Average collection period | 31.0 | days |
| Average sale period | 60.0 | days |
| Return on assets | 9.5 | % |
| Debt-to-equity ratio | 0.65 |  |
| Times interest earned | 5.7 |  |
| Price-earnings ratio | 10 |  |
|  | | |

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| **Required:** |

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| --- | --- |
| **1.** | You decide first to assess the rate of return that the company is generating. Compute the following for both this year and last year: |

|  |  |
| --- | --- |
| **a.** | The return on total assets. (Total assets at the beginning of last year were $4,400,000.) **(Round your answers to 1 decimal place. Omit the "%" sign in your response.)** |

|  |  |  |
| --- | --- | --- |
|  | This year | Last year |
| Return on total assets | % | % |
|  | | |

|  |  |
| --- | --- |
| **b.** | The return on common stockholders’ equity. (Stockholders' equity at the beginning of last year totaled $4,569,320. There has been no change in preferred or common stock over the last two years.) **(Round your intermediate calculations to the nearest whole number and final answers to 1 decimal place. Omit the "%" sign in your response.)** |

|  |  |  |
| --- | --- | --- |
|  | This year | Last year |
| Return on common stockholders' equity | % | % |
|  | | |

|  |  |
| --- | --- |
| **c.** | Is the company’s financial leverage positive or negative? |

|  |  |
| --- | --- |
|  |  |
| This year |  |
| Last year |  |
|  | |

|  |  |
| --- | --- |
| **2.** | You decide next to assess the well-being of the common stockholders. For both this year and last year, compute: |

|  |  |
| --- | --- |
| **a.** | The earnings per share. **(Round your answers to 2 decimal places. Omit the "$" sign in your response.)** |

|  |  |  |
| --- | --- | --- |
|  | This year | Last year |
| Earnings per share | $ | $ |
|  | | |

|  |  |
| --- | --- |
| **b.** | The dividend yield ratio for common stock. **(Round your intermediate calculations to 2 decimal places and final answers to 1 decimal place. Omit the "%" sign in your response.)** |

|  |  |  |
| --- | --- | --- |
|  | This year | Last year |
| Dividend yield ratio | % | % |
|  | | |

|  |  |
| --- | --- |
| **c.** | The dividend payout ratio for common stock. **(Round your intermediate calculations to 2 decimal places and final answers to 1 decimal place.Omit the "%" sign in your response.)** |

|  |  |  |
| --- | --- | --- |
|  | This year | Last year |
| Dividend payout ratio | % | % |
|  | | |

|  |  |
| --- | --- |
| **d.** | The price-earnings ratio. **(Round your intermediate calculations to 2 decimal places and final answers to 1 decimal place.)** |

|  |  |  |
| --- | --- | --- |
|  | This year | Last year |
| Price-earnings ratio |  |  |
|  | | |

|  |  |
| --- | --- |
| **e.** | The book value per share of common stock. **(Round your answers to 2 decimal places. Omit the "$" sign in your response.)** |

|  |  |  |
| --- | --- | --- |
|  | This year | Last year |
| Book value per share | $ | $ |
|  | | |

|  |  |
| --- | --- |
| **f.** | The gross margin percentage. **(Round your answers to 1 decimal place. Omit the "%" sign in your response.)** |

|  |  |  |
| --- | --- | --- |
|  | This year | Last year |
| Gross margin percentage | % | % |
|  | | |

|  |  |
| --- | --- |
| **3.** | You decide, finally, to assess creditor ratios to determine both short-term and long-term debt paying ability. For both this year and last year, compute: |

|  |  |
| --- | --- |
| **a.** | Working capital. **(Omit the "$" sign in your response.)** |

|  |  |  |
| --- | --- | --- |
|  | This year | Last year |
| Working capital | $ | $ |
|  | | |

|  |  |
| --- | --- |
| **b.** | The current ratio. **(Round your answers to 2 decimal places.)** |

|  |  |  |
| --- | --- | --- |
|  | This year | Last year |
| Current ratio |  |  |
|  | | |

|  |  |
| --- | --- |
| **c.** | The acid-test ratio. **(Round your answers to 2 decimal places.)** |

|  |  |  |
| --- | --- | --- |
|  | This year | Last year |
| Acid-test ratio |  |  |
|  | | |

|  |  |
| --- | --- |
| **d.** | The average collection period. (The accounts receivable at the beginning of last year totaled $527,000.) **(Round your intermediate calculations to 2 decimal places and final answers to the nearest whole number. Use 365 days in a year.)** |

|  |  |  |
| --- | --- | --- |
|  | This year | Last year |
| Average collection period | days | days |
|  | | |

|  |  |
| --- | --- |
| **e.** | The average sale period. (The inventory at the beginning of last year totaled $710,000.) **(Round your intermediate calculations to 2 decimal places and final answers to the nearest whole number. Use 365 days in a year.)** |

|  |  |  |
| --- | --- | --- |
|  | This year | Last year |
| Average sale period | days | days |
|  | | |

|  |  |
| --- | --- |
| **f.** | The debt-to-equity ratio. **(Round your answers to 2 decimal places.)** |

|  |  |  |
| --- | --- | --- |
|  | This year | Last year |
| Debt-to-equity ratio |  |  |
|  | | |

|  |  |
| --- | --- |
| **g.** | The times interest earned. **(Round your answers to 1 decimal place.)** |

|  |  |  |
| --- | --- | --- |
|  | This year | Last year |
| Times interest earned |  |  |