XYZ Ltd is a group of doctors, dentists, professional sports players and celebrities with excess funds who wish to find small companies with great innovative ideas and invest in them. Several of the small companies present their idea to XYZ under a televised show broadcasted on national TV.

The following information has been derived from the past three years’ financial statements of ABC Ltd, one of the small companies looking for investment from XYZ.

**Balance sheets, December 31**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2012** | **2011** | **2010** |
| Current assets |  |  |  |
| Cash | 50,000 | 45,000 | 94,000 |
| Account receivable, net | 130,000 | 120,000 | 110,000 |
| Merchandise inventories | 250,000 | 230,000 | 195,000 |
| Other current assets | 45,000 | 53,000 | 42,000 |
| Total current assets | 475,000 | 448,000 | 441,000 |
|  |  |  |  |
| Property plant and equipment, net | 196,000 | 191,000 | 175,000 |
|  |  |  |  |
| Total assets | 671,000 | 639,000 | 616,000 |
|  |  |  |  |
| Current liabilities |  |  |  |
| Accounts payable | 175,000 | 195,000 | 185,000 |
| Accrued liabilities | 1,000 | 6,500 | 21,000 |
| Total current liabilities | 176,000 | 201,500 | 206,000 |
|  |  |  |  |
| Long-term liabilities | 230,000 | 250,000 | 295,000 |
| Total liabilities | 406,000 | 451,500 | 501,000 |
|  |  |  |  |
| Shareholders’ equity |  |  |  |
| Common shares | 110,000 | 95,000 | 65,000 |
| Preferred shares, note 5 | 25,000 | 25,000 | 25,000 |
| Retained earnings | 130,000 | 67,500 | 25,000 |
| Total shareholders’ equity | 265,000 | 187,500 | 115,000 |
| Total liabilities and shareholders’ equity | 671,000 | 639,000 | 616,000 |

**Income statements**

|  |  |  |
| --- | --- | --- |
|  | **2012** | **2011** |
|  |  |  |
| Net sales | £723,700 | £694,000 |
| Cost of goods sold | 347,350 | 344,500 |
| Gross margin | 376,350 | 349,500 |
|  |  |  |
| Operating expenses | 183,500 | 179,750 |
|  |  |  |
| Income from operations | 192,850 | 169,750 |
| Interest expense | 37,525 | 39,450 |
| Income before income tax | 155,325 | 130,300 |
| Income tax expense | 38,831 | 32,575 |
|  |  |  |
| Net income | £116,494 | £97,725 |

Additional information:

1. The common shares are traded on the stock exchange. At the end of 2012, the value of the share was £15.00, and at the end of 2011, the value per share was £14.00.
2. The number of shares outstanding on the market is as follows:
   * 1. *2012:* 25,000
     2. *2011:* 15,000
     3. *2010:* 10,000
3. All sales are made on credit.
4. The company’s income tax rate is 25%.
5. The preferred shares are cumulative; no par value, £2.50; 10,000 Shares authorised; 2,000 shares issued and outstanding.

**Complete the following:**

You, the consultant, have been hired by XYZ to assist in the analysis of the financial statements and provide a recommendation as to whether XYZ should invest or not invest in this company. You should justify your recommendation based on the calculation of the following financial ratios:

* Current ratio (Liquidity)
* Operating profit margin (Profitability)
* Return on Ordinary Shareholders’ Funds (ROSF) (Profitability)
* Average settlement period for trade receivables (Efficiency)
* Earnings per share (Investment)