Ratio computation and analysis

34. Given the financial statements for Jones Corporation and Smith Corporation shown here:

a. To which one would you, as credit manager for a supplier, approve the extension of (short-term) trade credit? Why? Compute all ratios before answering.

b. In which one would you buy stock? Why?

JONES CORPORATION

Current Assets		**Liabilities**	
Cash	$ 20,000	Accounts payable	$100,000
Accounts receivable	80,000	Bonds payable (long term)	80,000
Inventory	50,000		
Long-Term Assets		**Stockholders' Equity**	
Fixed assets	$ 500,000	Common stock	$150,000
Less: Accumulated depreciation	(150,000)	Paid-in capital	70,000
Net fixed assets*	350,000	Retained earnings	100,000
Total assets	$ 500,000	Total liab. and equity	$500,000

Sales (on credit)	$1,250,000
Cost of goods sold	750,000
Gross profit	500,000
Selling and administrative expense†	257,000
Less: Depreciation expense	50,000
Operating profit	193,000
Interest expense	8,000
Earnings before taxes	185,000
Tax expense	92,500
Net income	$ 92,500

*Use net fixed assets in computing fixed asset turnover.
†Includes $7,000 in lease payments.

SMITH CORPORATION

Current Assets		**Liabilities**	
Cash	$ 35,000	Accounts payable	$ 75,000
Marketable securities	7,500	Bonds payable (long-term)	210,000
Accounts receivable	70,000		
Inventory	75,000		
Long-Term Assets		**Stockholders' Equity**	
Fixed assets	$ 500,000	Common stock	$ 75,000
Less: Accum. dep.	(250,000)	Paid-in capital	30,000
Net fixed assets*	250,000	Retained earnings	47,500
Total assets	$ 437,500	Total liab. and equity	$437,500

*Use net fixed assets in computing fixed asset turnover.

SMITH CORPORATION (Continued)

Sales (on credit)	$1,000,000
Cost of goods sold	600,000
Gross profit	400,000
Selling and administrative expense†	224,000
Less: Depreciation expense	50,000
Operating profit	126,000
Interest expense	21,000
Earnings before taxes	105,000
Tax expense	52,500
Net income	$ 52,500

†Includes $7,000 in lease payments.

COMPREHENSIVE PROBLEM

Lamar Swimwear
(trend analysis and industry comparisons)

Bob Adkins has recently been approached by his first cousin, Ed Lamar, with a proposal to buy a 15 percent interest in Lamar Swimwear. The firm manufactures stylish bathing suits and sunscreen products.

Mr. Lamar is quick to point out the increase in sales that has taken place over the last three years as indicated in the income statement, Exhibit 1. The annual growth rate is 25 percent. A balance sheet for a similar time period is shown in Exhibit 2, and selected industry ratios are presented in Exhibit 3. Note the industry growth rate in sales is only 10 to 12 percent per year.

There was a steady real growth of 3 to 4 percent in gross domestic product during the period under study.

Exhibit 1

LAMAR SWIMWEAR
Income Sheet

	200X	200Y	200Z
Sales (all on credit)	$1,200,000	$1,500,000	$1,875,000
Cost of goods sold	800,000	1,040,000	1,310,000
Gross profit	$ 400,000	$ 460,000	$ 565,000
Selling and administrative expense*	239,900	274,000	304,700
Operating profit (EBIT)	$ 160,100	$ 186,000	$ 260,300
Interest expense	35,000	45,000	85,000
Net income before taxes	$ 125,100	$ 141,000	$ 175,300
Taxes	36,900	49,200	55,600
Net Income	$ 88,200	$ 91,800	$ 119,700
Shares	30,000	30,000	38,000
Earnings per share	$2.94	$3.06	$3.15

*Includes $15,000 in lease payments for each year.