2-4. Analyzing Financial Performance Using Ratio Analysis – Manufacturers Bank is evaluating Aluminum Industries, Inc., which has requested a $3 million loan, to assess the firm’s financial leverage and risk. On the basis of the debt ratios for Aluminum, along with the industry averages and Aluminum’s recent financial statements (which follow), evaluate and recommend appropriate action on the loan request.

**Aluminum Industries, Inc. Income Statement for the**

**Year Ended December 31, 2009**

Sales revenue $30,000,000

Less: Cost of goods sold 21,000,000

Gross profit $ 9,000,000

Less: Operating expenses

Selling expense $3,000,000

General and administrative expenses 1,800,000

Lease expense 200,000

Depreciation expense 1,000,000

Total operating expense 6,000,000

Operating profit $3,000,000

Less: Interest expense 1,000,000

Net profit before taxes $2,000,000

Less: Taxes (rate = 40%) 800,000

**Net profits after taxes $1,200,000**

**Aluminum Industries, Inc. Income Statement for the**

**Year Ended December 31, 2009**

|  |  |  |  |
| --- | --- | --- | --- |
| **Assets** |  | **Liabilities and Stockholders Equity** |  |
| Current assets |  | Current liabilities |  |
| Cash | $1,000,000 | Accounts payable | $8,000,000 |
| Marketable securities | 3,000,000 | Notes payable | 8,000,000 |
| Accounts receivable | 12,000,000 | Accurals | 500,000 |
| Inventories | 7,500,000 | Total current liabilities | $16,500,000 |
| Total current assets | $23,5000,000 | Long-term debt (including financial leases) | $20,000,000 |
| Gross fixed assets (at cost) |  | Stockholders’ equity |  |
| Land and buildings | $11,000,000 | Preferred stock (25,000 shares, $4 dividend) | $2,500,000 |
| Machinery and equipment | 20,500,000 | Common stock (1 million shares, $5 par) | 5,000,000 |
| Furniture and fixtures | 8,000,000 | Paid-in capital in excess of par | 4,000,000 |
| Gross fixed assets | $39,500,000 | Retained earnings | 2,000,000 |
| Less: Accumulated depreciation | 13,000,000 | Total stockholders’ equity | $13,500,000 |
| Net fixed assets | $26,500,000 | **Total liabilities and stockholders equity** | **$50,000,000** |
| **Total assets** | **$50,000,000** |  |  |
|  |  |  |  |

**Industry Averages**

Debt ratio 0.51

Debt-equity ratio 1.07

Times interest earned ratio 7.3