

Jarmon Company, Income Statement for the Year
 Ended 12/31/2010

Sales (all credit)		\$ 600,000
Less cost of goods sold		<u>460,000</u>
Gross profit		\$ 140,000
Less operating and interest expenses		
General and administrative	\$ 30,000	
Interest	10,000	
Depreciation	<u>30,000</u>	
Total		<u>70,000</u>
Earnings before taxes		\$ 70,000
Less taxes		<u>27,100</u>
Net income available to common stockholders		\$ 42,900
Less cash dividends		<u>31,800</u>
Change in retained earnings		<u>\$ 11,100</u>

Jan Pama, associate credit analyst for the Merchants National Bank of Midland, Michigan, was assigned the task of analyzing Jarmon's loan request.

- a. Calculate the financial ratios for 2010 corresponding to the industry norms provided as follows:

RATIO	NORM
Current ratio	1.8
Acid-test ratio	0.9
Debt ratio	0.5
Times interest earned	10.0
Average collection period	20.0
Inventory turnover (based on cost of goods sold)	7.0
Return on common equity	12.0%
Operating return on assets	16.8%
Operating profit margin	14.0%
Total asset turnover	1.20
Fixed asset turnover	1.80

- b. Which of the ratios reported in the industry norms do you feel should be most crucial in determining whether the bank should extend the line of credit?
- c. Prepare Jarmon's statement of cash flows for the year ended December 31, 2010. Interpret your findings.
- d. Use the information provided by the financial ratios and the cash flow statement to decide if you would support making the loan.