QUESTION 3

The following information relates to Sino Merchandising, a public company:

Years ended 31 December	**2006**	**2007**
	$	**$**
Net profit	800,650	960,300
Debenture interest	50,000	50,000
Profit after interest	750,650	910,300
Dividends	330,000	430,000
Retained profit for the year	420,650	480,300

Balance Sheet extracts at 31 December	**2006**	**2007**
	$	**$**
Ordinary shares of $1 each	2,000,000	2,000,000
6% Preferred shares of $1 each	500,000	500,000
Accumulated profits	1,100,400	1,580,700
5% Debentures	1,000,000	1,000,000

The company's Ordinary Share prices on 31 December 2006 and 2007 were $2 and $3 respectively

REQUIRED

(a) Calculate the following ratios, correct to two decimal places, for both 2006 and 2007:

(i) Earnings per Ordinary Share ($'s)
(ii) Price earnings
(iii) Dividend yield
(iv) Dividend cover for Ordinary Shares
(v) Net profit to total assets employed

All workings must be shown

(20 marks)

A potential investor is more likely to invest in the ordinary shares of a company with a low gearing ratio than in the ordinary shares of a company with a high gearing ratio

REQUIRED

(b) Explain the reasons for this.

(5 marks)

(Total 25 marks)

QUESTION 3

(a)		2006		2007
(i)	$\frac{750{,}650 - 30{,}000}{2{,}000{,}000}$	$0.36	$\frac{910{,}300 - 30{,}000}{2{,}000{,}000}$	$0.44
(ii)	$\frac{200}{36}$	5.56 times	$\frac{300}{44}$	6.82 times
(iii)	$\frac{15 \times 100}{200}$	7.50%	$\frac{20 \times 100}{300}$	6.67%
(iv)	$\frac{750{,}650 - 30{,}000}{300{,}000}$	2.40 times	$\frac{910{,}300 - 30{,}000}{400{,}000}$	2.20 times
(v)	$\frac{800{,}650 \times 100}{4{,}600{,}400}$	17.40%	$\frac{960{,}300 \times 100}{5{,}080{,}700}$	18.90%

(20 marks)

(b)

[1] In a highly geared company ordinary shareholders could be left with little or no dividend payments because of the prior interest charges and preferred dividends accounting for the majority of the profit. This would be especially true during an economic downturn.

[2] Ordinary shareholders would also be more at risk in the event of a company insolvency as secured loans and preferred shares are always a prior charge when it comes to the liquidation of a company

(5 marks)

(Total 25 marks)