

## Solutions to Chapter 17

### Financial Statement Analysis

8.
  - a. The consulting firm will have relatively few assets. The major “asset” is the know-how of its employees. It will have the higher asset turnover ratio.
  - b. Catalog shopping will generate far more sales relative to assets since it does not have to sell goods from stores with high expenses and probably can maintain relatively lower inventories. Its asset turnover ratio will be higher.
  - c. The supermarket has a far higher ratio of sales to assets. The supermarket itself is a simple building and the store sells a high volume of goods with relatively low mark-ups (profit margins). Its asset turnover will be the highest.
11.
  - a. Current ratio will be unaffected. Inventories are replaced with either cash or accounts receivable, but total current assets are unchanged.
  - b. Current ratio will be unaffected. Accounts due are replaced with the bank loan, but total current liabilities are unchanged.
  - c. Current ratio will be unaffected. Receivables are replaced with cash, but total current assets are unchanged.
  - d. Current ratio will be unaffected. Inventories replace cash, but total current assets are unchanged.
22. The firm has less debt relative to equity than the industry average but its ratio of EBIT plus depreciation to interest expense is lower. Perhaps the firm has a lower ROA than its competitors, and is therefore generating less EBIT per dollar of assets. Perhaps the firm pays a higher interest rate on its debt. Or perhaps its depreciation charges are lower because it uses less capital or older capital.
23. The decline in market interest rates will increase the value of the fixed-rate debt and thus increase the market-value debt-equity ratio. By this measure, leverage will increase. The decline in interest rates will also reduce the firm's interest payments on the floating rate debt, which will increase the times-interest-earned ratio. By this measure, leverage will decrease. The impact of the lower rates on “leverage” is thus ambiguous. The firm has higher indebtedness relative to assets, but greater ability to cover its cash flow obligations.
24.
  - a. The shipping company, which has more tangible assets, will tend to have the higher debt-equity ratio. (See Chapter 15, Sections 15.3 and 15.4, for a discussion of the reasons that firms holding tangible assets with active secondary markets tend to maintain higher debt-equity ratios.)

- b. United Foods is in a more mature industry and probably has fewer favorable opportunities for reinvesting income. We would expect it to have the higher payout ratio.
- c. The paper mill will have higher sales per dollar of assets. It is less capital intensive (that is, has less capital per dollar of sales) than the integrated firm.
- d. The discount outlet sells many of its goods for cash. The power company bills monthly and usually gives customers a month to pay bills. It will have the longer collection period.
- e. Fledging Electronics will have the higher P/E multiple, reflecting its greater growth prospects. (Recall from Chapter 5, Section 5.5, that the P/E ratio is an indicator of the firm's growth prospects.)