

Week 8 - CheckPoint 1 - Analyzing Financial Data

Ch.6, Pg. 232

6.6

	Alternative#1 - Debt	Alternative#2 - Equity	
Debt (12% Interest)	\$ 50,000,000	\$ 40,000,000	
Equity	\$ 50,000,000	\$ 60,000,000	
Sales			
Cost of goods sold			
Gross profit			
Operating expenses			
Operating profit	\$ 18,000,000	\$ 18,000,000	
Interest expense	6,300,000	4,800,000	
Earnings before tax	\$ 11,700,000	\$ 13,200,000	
Income tax expense (40%)	4,680,000	5,280,000	
Net income	\$ 7,020,000	\$ 7,920,000	
Number of Shares Issued	800,000	1,000,000	
Return on Equity	14.04%	13.20%	Net Income / Total Eq
Return on Assets	10.80	10.80	
A.			
Debt Ratio	50%	40%	Total Debt / (Total Del
Times Interest Earned	2.86	3.75	Operating Profit / Inter
Earnings per share	\$8.78	\$7.92	Net Income / Number
Financial Leverage Index	1.3	1.2	Return on Equity / Ret

B. Factors to be considered when making the decision:

1. Adding debt would result in additional risk which would in turn cause decline in price to earnin
2. Consider the marketability of stock based on current/future availability of credit sources and in
3. Assess the liquidity of the company. Are they able to pay both short-term and long-term liabilit
4. Review the rationality of projection for operating profit - review past earnings stream.
5. Consider stockholders return they expect to receive in addition to the minimum they expect per

uity

ot + Total Equity)
rest Expense
of Shares Issued
urn on Assets

g ratio. This would then possibly decrease share price.
terest rate expectations.
ties as those come due.

· share owned.