Smart Solutions

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2-20. Choose a company that you would like to analyze and then obtain its financial statements. Now, select another firm from the same industry and obtain its financial data. Perform a complete ratio analysis on each firm. How well does your selected company compare with its industry peer? Which components of your firm's ROE are superior, and which are inferior?

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2-21. Compare the profitability of Wal-Mart Stores Inc. (ticker symbol, WMT) and Target Corp. (ticker symbol, TGT) for the latest year. Using the return on total assets (ROA) and return on common equity (ROE) measures, determine which firm is more profitable. Use the DuPont system to determine what drives the difference in the profitability of the two firms.

2-22. Analyze the cash flows of Southwest Airlines (ticker symbol, LUV) over the last five years. Calculate the operating cash flow (using Equation 2.2) and the free cash flow (using Equation 2.4) for each of the last five years. Do the operating cash flows you calculated match the Net Cash Flow from Operating Activities on the 5-Year Annual Cash Flow Statement? If they are different, why are they different?

Mini-Case: Financial Statement and Cash Flow Analysis

Jaedan Industries has the following account balances as of December 31, 2010. The firm's dividend payout ratio is 25% and the tax rate is 34%. The firm's stock price on December 31, 2009, was $42.89 and on December 31, 2010, it was $56.82. Construct an income statement, balance sheet, statement of retained earnings, and statement of cash flows for 2010. Also determine the firm's free cash flow and calculate the liquidity, activity, debt, profitability, and market ratios for Jaedan Industries. Perform a DuPont analysis and compare the firm to the industry ratios (see last table in this sequence). Highlight any financial strengths and weaknesses that Jaedan Industries may have.

Jaedan Industries Account Balances for the Year Ending December 31, 2010

Sales	$42,000,000
Cost of goods sold (COGS)	63%
Portion of COGS that represents purchases	75%
Selling, general, and administrative expenses	$1,621,000
Depreciation	$800,000
Interest rate on short- and long-term debt	10%
Cash balance	$3,689,000
Accounts receivable	$5,423,000
Marketable securities	$1,836,000
Inventory	$4,118,000
Fixed assets	$14,811,000
Accumulated depreciation (does not include depreciation for 2010)	$5,160,000
Accounts payable	$3,136,000
Notes payable	$706,000
Accruals	$500,000
Long-term bonds outstanding	$3,046,000
Preferred stock (at par)	$100,000
Retained earnings (does not include retained earnings for 2010)	$1,628,819
Common stock (at par)	$4,000,000
Paid-in capital in excess of par	$4,500,000
Tax rate	34%
Dividend payout ratio (common stock)	25%
Dividends on preferred stock	8% of par
Number of shares of common stock outstanding	1 million
Terms of trade on accounts receivable	35 days
Terms of trade on accounts payable	45 days

To aid in your calculations, the financial statements from 2009 are given below.

Jaedan Industries Income Statement for the Year Ending December 31, 2009

Sales	$38,578,155
Less: Cost of goods sold	27,004,709
Gross profit	$11,573,447
Less: Operating expenses:	
Selling, general, and administrative expenses	$ 1,000,000
Depreciation	700,000
Earnings before interest and taxes	$ 9,873,447
Less: Interest expense	375,000
Earnings before taxes	$ 9,498,447
Less: Taxes	3,229,472
Net income	$ 6,268,975
Less: Dividends paid	1,575,244
To retained earnings	$ 4,693,731

Jaedan Industries Balance Sheet
as of December 31, 2009

Assets		Liabilities and Equity	
Cash	$ 871,319	Accounts payable	$ 2,946,000
Marketable securities	3,587,000	Notes payable	684,000
Accounts receivable	2,867,500	Accruals	350,000
Inventories	3,210,000	Total current liabilities	$ 3,980,000
Total current assets	$10,535,819	Long-term debt	$ 3,046,000
Fixed assets	$11,879,000	Preferred stock	$ 100,000
Less: Accumulated depreciation	5,160,000	Common stock (at par)	$ 4,000,000
		Paid-in capital in excess of par	$ 4,500,000
Net fixed assets	$ 6,719,000	Retained earnings	$ 1,628,819
Total assets	$17,254,819	Total liabilities and equity	$17,254,819

The industry ratios for 2009 and 2010 are as follows.

Industry Ratios

	2009	2010
Liquidity ratios		
Current ratio	2.89	3.26
Quick ratio	1.42	2.19
Activity ratios		
Inventory turnover	6.71	6.59
Average collection period	35.12	36.17
Average payment period	50.73	49.63
Fixed asset turnover	4.32	4.76
Total asset turnover	2.14	2.33
Debt ratios		
Debt ratio	41.93%	39.36%
Assets-to-equity ratio	165.82%	163.13%
Debt-to-equity ratio	31.26%	30.23%
Times interest earned	15.72	16.81
Profitability ratios		
Gross profit margin	22.19%	23.74%
Operating profit margin	19.32%	20.89%
Net profit margin	15.11%	17.97%
Earnings per share	$4.36	$4.58
Return on total assets	32.34%	41.87%
Return on common equity	53.63%	68.30%
Market ratios		
Price/earnings ratio	5.41	5.97
Market/book ratio	4.19	4.32