S6 Business, Accounting and Financial Management Practice Paper (Set 4): Financial Ratios, Working Capital, Cost of Capital and Dividend Policy

S6 Business, Accounting and Financial Management | Time: 75 minutes | Total: 100 marks | 29 questions

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1. Financial ratios and company valuation (18 marks)

Company A, year ended 31 March 2026: sales $5,000,000; cost of sales $3,500,000; net profit $400,000; total assets $2,500,000; equity $1,000,000; current assets $600,000 (inventory $250,000); current liabilities $400,000; 800,000 ordinary shares in issue; market price $5.00 per share.

1. (a) Calculate the gross profit margin.

2. (b) Calculate the net profit margin.

3. (c) Calculate the current ratio and the quick ratio.

4. (d) Calculate the earnings per share and the price-earnings ratio.

5. (e) Calculate the return on equity.

6. (f) Calculate the return on assets and explain why it differs from the return on equity.

2. Inventory and receivables management (16 marks)

Company B: opening inventory $200,000, closing inventory $250,000; cost of sales $3,500,000 for the year; closing receivables $300,000; credit sales $4,800,000; assume 365 days a year.

7. (a) Calculate the inventory turnover rate.

8. (b) Calculate the inventory turnover period in days.

9. (c) Calculate the receivables turnover rate.

10. (d) Calculate the average collection period.

11. (e) If the average collection period were shortened to 20 days, estimate the cash released.

3. Capital structure and weighted average cost of capital (18 marks)

Company C: debt with market value $3,000,000 at a pre-tax cost of 6%; equity with market value $7,000,000 and a required return of 12%; profits tax rate 16.5%.

12. (a) Calculate the after-tax cost of debt.

13. (b) Calculate the weights of debt and equity.

14. (c) Calculate the weighted average cost of capital.

15. (d) If the company borrows another $2,000,000 to buy back shares and the cost of equity rises to 14%, calculate the new WACC.

16. (e) Comment on the effect of higher gearing on the cost of capital and financial risk.

4. Dividend policy and retained earnings (16 marks)

Company D: net profit $2,400,000; 1,200,000 ordinary shares in issue; current payout ratio 40%; market price $6.00 per share; next year investment plan requires $1,200,000.

17. (a) Calculate the earnings per share.

18. (b) Calculate the dividend per share.

19. (c) Calculate the dividend yield.

20. (d) Calculate the retained earnings under the current policy and state whether they cover the investment plan.

21. (e) Under a residual dividend policy, calculate total dividends, the payout ratio and the dividend per share.

5. Loan amortisation and leasing (16 marks)

Company E needs equipment costing $800,000. Option 1: a loan of $800,000 at 6% per annum repaid by equal year-end instalments over 5 years (annuity factor at 6% for 5 years = 4.2124). Option 2: lease at $185,000 payable at each year end for 5 years.

22. (a) Calculate the annual loan instalment.

23. (b) Calculate the interest and principal portions in year 1.

24. (c) Calculate the outstanding principal at the end of year 1.

25. (d) Compare the total cash outflow of the two options and state the difference in asset ownership.

6. Working capital and the cash conversion cycle (16 marks)

Company F: inventory period 40 days, receivables period 35 days, payables period 30 days; annual cost of sales $3,650,000; assume 365 days a year.

26. (a) Calculate the cash conversion cycle.

27. (b) Calculate the daily operating cash outflow.

28. (c) Calculate the working capital needed to finance the cycle.

29. (d) If the payables period is extended to 40 days, recalculate the cycle and the funding needed, and state the saving.

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