

ECON 313- HW 4  
**Due: Monday, NOV 1**

7.1 Anna Wise is a young career woman. She lives in Phoenix, Arizona, where she owns and operates a highly successful modeling agency. Anna manages her modest but rapidly growing investment portfolio, made up mostly of high-grade common stocks. Because she's young and single and has no pressing family requirements, Anna has invested primarily in stocks that offer the potential for attractive capital gains. Her broker recently recommended an auto company stock and sent her some literature and analytical reports to study. One report, prepared by the brokerage house she deals with, provided an up-to-date look at the economy, an extensive study of the auto industry, and an equally extensive review of several auto companies (including the one her broker recommended). She feels strongly about the merits of security analysis and believes it is important to spend time studying a stock before making an investment decision.

- a. Anna tries to stay informed about the economy on a regular basis. At the present time, most economists agree that the economy is getting stronger. What information about the economy do you think Anna would find helpful in evaluating an auto stock? Prepare a list—and be specific. Which three items of economic information (from your list) do you feel are most important? Explain.
- b. In relation to a study of the auto industry, briefly note the importance of each of the following.
  - 1) Auto imports
  - 2) The United Auto Workers union
  - 3) Interest rates
  - 4) The price of a gallon of gas
- c. A variety of financial ratios and measures are provided about one of the auto companies and its stock. These are incomplete, however, so some additional information will have to be computed. Specifically, we know the following:

Net profit margin: 15%

Total assets: \$25 billion

Earnings per share: \$3.00

Total asset turnover: 1.5

Net working capital: \$3.4 billion

Payout ratio: 40%

Current liabilities: \$5 billion

Price-to-earnings ratio: 12.5

d. Given this information, calculate the following:

- 1) Sales
- 2) Net profits after taxes
- 3) Current ratio
- 4) Market price of the stock
- 5) Dividend yield

\*P7.18 The following table lists the 2018 and 2019 financial statements for Otago Bay Marine Motors, a major manufacturer of top-of-the-line outboard motors.

**Otago Bay Marine Motors Balance Sheets (\$ in thousands)**

|   | As of December 31 |                   |
|---|-------------------|-------------------|
|   | 2019              | 2018              |
| <b>Assets</b>                                   |                   |                   |
| Current assets                                  |                   |                   |
| Cash and cash equivalents                       | \$ 56,203         | \$ 88,942         |
| Accounts receivable, net of allowances          | \$ 20,656         | \$ 12,889         |
| Inventories                                     | \$ 29,294         | \$ 24,845         |
| Prepaid expenses                                | <u>\$ 5,761</u>   | <u>\$ 6,536</u>   |
| Total current assets                            | \$ 111,914        | \$133,212         |
| Property, plant, and equipment, at cost         | \$ 137,273        | \$ 85,024         |
| Less: Accumulated depreciation and amortization | <u>-\$ 50,574</u> | <u>-\$ 44,767</u> |
| Net fixed assets                                | \$ 86,699         | \$ 40,257         |
| Other assets                                    | <u>\$105,327</u>  | <u>\$ 51,001</u>  |
| Total assets                                    | <u>\$303,940</u>  | <u>\$224,470</u>  |
| <b>Liabilities and shareholders' equity</b>     |                   |                   |
| Current liabilities                             |                   |                   |
| Notes and accounts payable                      | \$ 28,860         | \$ 4,927          |
| Dividends payable                               | \$ 1,026          | \$ 791            |
| Accrued liabilities                             | <u>\$ 20,976</u>  | <u>\$ 16,780</u>  |
| Total current liabilities                       | \$ 50,862         | \$ 22,498         |
| Noncurrent liabilities                          |                   |                   |
| Long-term debt                                  | \$ 40,735         | \$ 20,268         |
| Shareholders' equity                            |                   |                   |
| Common stock                                    | \$ 7,315          | \$ 7,103          |
| Capital in excess of par value                  | \$ 111,108        | \$ 86,162         |
| Retained earnings                               | <u>\$ 93,920</u>  | <u>\$ 88,439</u>  |
| Total shareholders' equity                      | \$212,343         | \$181,704         |
| Total liabilities and equity                    | <u>\$303,940</u>  | <u>\$224,470</u>  |
| Average number of common shares outstanding     | 10,848,000        | 10,848,000        |

Otago Bay Marine Motors income statements (\$ in thousands)

|   | For the Year Ended December 31 |                   |
|---|--------------------------------|-------------------|
|   | 2019                           | 2018              |
| Sales revenue   | \$ 259,593                     | \$245,424         |
| Cost of goods sold  | <u>\$ 133,978</u>              | <u>\$ 127,123</u> |
| Gross profit margin   | \$ 125,615                     | \$ 118,301        |
| Operating expenses  | <u>\$ 72,098</u>               | <u>\$ 70,368</u>  |
| Earnings from operations  | \$ 53,517                      | \$ 47,933         |
| Other income (expense), net   | <u>\$ 4,193</u>                | <u>\$ 3,989</u>   |
| Earnings before income taxes  | \$ 57,710                      | \$ 51,922         |
| Provision for income taxes  | <u>\$ 22,268</u>               | <u>\$ 19,890</u>  |
| Net earnings  | <u>\$ 35,442</u>               | <u>\$ 32,032</u>  |
| Cash dividends (\$0.35 and \$0.27 per share)                                | \$ 3,769                       | \$ 2,947          |
| Average price per share of common stock (in the fourth quarter of the year) | \$ 74.25                       | \$ 80.75          |

- a. On the basis of the information provided, calculate the following financial ratios for 2018 and 2019.

|                           | Otago Bay Marine Motors |      | Industry Average<br>(for 2019) |
|---------------------------|-------------------------|------|--------------------------------|
|                           | 2019                    | 2018 |                                |
| Current ratio             |                         |      | 2.36                           |
| Total asset turnover      |                         |      | 1.27                           |
| Debt-equity ratio         |                         |      | 10.00                          |
| Net profit margin         |                         |      | 9.30                           |
| ROA                       |                         |      | 15.87                          |
| ROE                       |                         |      | 19.21                          |
| EPS                       |                         |      | 1.59                           |
| P/E ratio                 |                         |      | 19.87                          |
| Dividend yield            |                         |      | .44                            |
| Payout ratio              |                         |      | .26                            |
| Price-to-book-value ratio |                         |      | 6.65                           |

- b. Considering the financial ratios you computed, along with the industry averages, how would you characterize the financial condition of Otago Bay Marine Motors? Explain.