

Abington-hill toys

Economics, Financial Markets



Introduction

Abington-Hill Toys' new president, Vernon Albright, hires a new company comptroller, David Hartly. Hartly's first task was to complete an analysis of the firm's condition and generate financial planning for the company.

Methodology

1. Current ratio
2. Acid-test ratio
3. Inventory Turnover Ratio
4. Debt-Equity ratio
5. Gross Margin F. Net Profit Margin G. Z Score

Solution

1. $280,000/290,000 = 0.97$
2. $130,000/290,000 = 0.45$
3. $900,000/150,000 = 6$
4. $490,000/710,000 = 0.69$
5. $300,000/1,200,000 = 0.25$
6. $60,480/1,200,000 = 0.05$
7. $1. (-10,000/1,200,000) + 1.4(60,480/1,200,000) + 3.3(126,000/1,200,000) + 1.05(1,200,000/1,200,000) = 1.46$

Conclusion

The current ratio of 0.97 means for every \$0.97 of current assets, Abington Hill Toys has \$1 of current liabilities. Since the current ratio is less than the standard of 3.5, Abington Hill Toys implies a high risk and probable incapability to generate sufficient working capital to meet its short-term

needs. The acid-test ratio of 0.45 is less than half of its current ratio which means Abington Hill Toys' inventory comprises more than half of its current assets.

The inventory turnover ratio of 6 is higher than 5 which is the standard for companies in this industry. Since this ratio is higher than average, Abington Hill Toys is showing strong sales. The higher than standard inventory ratio could also mean ineffective buying of inventory. The debt-equity ratio of 0.69 means Abington Hill Toys has \$0.69 of debt to every dollar of equity. This would put them in at a lower risk to enhance financial leverage. The gross margin is 25%. This means Abington Hill Toys is only profiting 25% above their direct costs. This is equivalent to the standard of other companies in this industry.

The net profit margin of 5% is less than the standard of 8%. Abington Hill Toys' net profit margin means equity holders will only receive 5% from every dollar after all expenses, interest, and taxes are paid. The low Z score of 1.46 would sway me to not lend them money. By Altman's scale, Abington Hill Toys has a 95% chance of going into bankruptcy in 12 months. Along with the high probability of going into bankruptcy within 12 months, the net profit margin of 5% doesn't seem worthwhile. I would rather invest in something safer for that low of a return.