E1.25 **Key Relations: Revenues, Expenses, Dividends, and Retained Earnings.** Compute the missing amounts (in millions) in the following table. (The balance in retained earnings at year-end 2012 was $2.2.) Comment on the firm's performance over the three-year period after calculating the level of expenses as a percentage of total revenues and net income as a percentage of total revenues. What advice would you give to this company in regards to its dividend policy?

CHECK FIGURE

	2010	2011	2012
Retained earnings (beginning)	$1.2	$ 2.0	?
Revenues	8.8	11.8	11.8
Expenses	7.4	?	11.0
Dividends	?	.6	.6

E1.26 **Key Relations: Revenues, Expenses, Dividends, and Retained Earnings.** Compute the missing amounts in the following table. (At the end of 2012, retained earnings had a balance of negative $2,086.) Comment on the company's performance over the three-year period after calculating the relationship of expenses as a percentage of revenues and net income as a percentage of revenues. Do you agree with the company's dividend policy? Why?

	2010	2011	2012
Retained earnings (beginning)	$(1,746.5)	$(1,830.5)	$(2,653.0)
Revenues	4,840.5	5,327.0	?
Expenses	?	5,628.0	5,425.0
Dividends	-0-	?	17.5

E1.27 **Financial Statement Results.** In its 2012 annual report to shareholders, **General Electric** reported the following financial results:

- Revenues increased from $147.3 billion to $147.4 billion.
- Net income decreased from $14.2 billion to $13.6 billion.
- Total assets decreased from $718.2 billion to $685.3 billion.
- Shareholders' equity increased from $116.4 billion to $123.0 billion.
- For the year, the cash flow from operating activities was $31.3 billion, the cash flow from investing activities was $11.3 billion, and the cash flow from financing activities was negative $51.1 billion.

Discuss the possible explanations for the financial results of General Electric.

E1.28 **Financial Statement Results.** In its 2012 annual report to shareholders, **Johnson & Johnson**, a consumer-products company, reported the following financial results:

- Revenues increased from $65.0 billion to $67.2 billion.
- Net income increased from $9.7 billion to $10.9 billion.
- Total assets increased from $113.6 billion to $121.3 billion.
- Shareholders' equity increased from $57.1 billion to $64.8 billion.
- For the year, the cash flow from operating activities amounted to $15.4 billion, the cash flow from investing activities amounted to negative $4.5 billion, and the cash flow from financing activities amounted to negative $20.6 billion.

Discuss the possible explanations for the financial results of Johnson & Johnson.

E1.29 **Calculating Security Returns.** Presented below are the beginning-of-year common share price (P_{t-1}), the end-of-year common share price (P_t), and the annual dividend (D_t) for three competitors—**General Electric**, **Philips Electronics NV**, and **Siemens AG**.

CHECK FIGURE

	P_{t-1}	P_t	D_t
General Electric Co.	$32.01	$34.50	$0.86
Philips Electronics NV	72.52	72.90	1.28
Siemens AG	27.20	25.36	0.52

Calculate the annual return for each of the three individual securities. Which security provided the greatest return over the one-year period? What other information would you need to assess the return/risk trade-off on each of these individual securities?

Probability	Solvency
• Return on sales	• Financial leverage
• Return on assets	• Long-term debt-to-equity
• Return on equity	• Interest coverage ratio
	Asset management
	• Total asset turnover

Would you extend a loan to the Shipleys in the amount of $200,000 in order to open two new restaurants?

CORPORATE ANALYSIS

CA2.32 The Procter & Gamble Company. The 2012 annual report of **The Procter & Gamble Company (P&G)** is available at http://annualreport.pg.com/annualreport2012/index.shtml. After reviewing P&G's annual report, respond to the following questions:

a. P&G's net income decreased each year from 2010 through 2012. Looking at the company's income statement, explain why P&G's net income decreased if its net sales increased over the same period. (To answer this question, divide each of P&G's expenses by net sales and consider the trend over the three-year period.)

b. P&G's total assets decreased by approximately $6.11 billion from 2011 to 2012. Which assets principally accounted for this decline? (To answer this question, calculate each asset as a percentage of total assets and then compare between years.) Is this decline a problem? If so, why? If not, why not?

c. Consider the change in P&G's total debt and total shareholders' equity from 2011 to 2012. Did the $6.11 billion decrease in its assets have an impact on debt? What was the impact on shareholders' equity? Calculate P&G's long-term debt-to-equity ratio and total debt to total assets ratio for both years as part of your analysis. What can you say about P&G's apparent financing strategy?

d. Consider P&G's statement of cash flow. What were the five major cash outflows for the company in 2012? How did P&G finance these cash outflows?

e. Compare P&G's dividend payments to its net income in 2011 and 2012. (Note: The ratio of dividends paid divided by net income is called the *dividend payout ratio*.) What percentage of net income does P&G pay to its shareholders? How does this payout percentage compare to P&G's competitors (such as Johnson & Johnson, Kimberly-Clark Corporation)? Do you agree with this dividend payment policy? What message does this policy convey to investors about the company's future growth potential?

CA2.33 Internet-based Analysis. Consider a publicly-held company whose products you are familiar with. Some examples might include:

Company	Product	Corporate Website
• **Johnson & Johnson Company**	• Band-Aids	• www.jnj.com
• **Microsoft Corporation**	• Windows XP software	• www.microsoft.com
• **Nokia Corporation**	• Cellular phones	• www.nokia.com
• **Intel Corporation**	• Pentium processors	• www.intel.com
• **Kimberly-Clark Corporation**	• Kleenex	• www.kimberly-clark.com

Access the company's public website and search for its most recent annual report. (Note: Some companies will provide access to their financial data through an "investor relations" link, while others will provide a direct link to their "annual reports.") After locating your company's most recent annual report, open the file and review its contents. After reviewing the annual report for your selected company, prepare answers to the following questions:

a. Calculate the cost of goods sold, operating expenses, and net income as a percentage of net sales for the last two years. What is the trend in each of these percentages? Explain what might be driving the trend.

b. Calculate the company's total liabilities as a percentage of total assets for the last two years. Did this percentage increase or decrease? Is the company principally debt-financed or equity-financed?

c. Determine if the company paid dividends to its shareholders. (Hint: Look at the statement of shareholders' equity or the statement of cash flow.) If the company paid dividends, calculate the ratio of dividends paid divided by net income. (Note: This ratio is known as the dividend payout ratio.) What percentage of its net income did the company pay to its shareholders in each of the last two years?

d. Review the company's statement of cash flow. Identify the major sources of financing used by the company in each of the last two years.

CA6.34 IFRS Financial Statements. The 2012 financial statements of **LVMH Moet Hennessey-Louis Vuitton S.A.** are presented in Appendix C of this book. LVMH is a Paris-based holding company and one of the world's largest and best-known luxury goods companies. As a member-nation of the European Union, French companies are required to prepare their consolidated (group) financial statements using International Financial Reporting Standards (IFRS). In LVMH's Notes to the Consolidated Financial Statements (not presented in Appendix C), the company discloses its inventory policy:

> Inventories are valued using the weighted average cost or FIFO methods. Inventories other than wine produced by the Group are recorded at the lower of cost (excluding interest expense) and net realizable value; cost comprises manufacturing cost (finished goods) or purchase price, plus incidental costs (raw materials, merchandise). Provisions for impairment of inventories are chiefly recognized . . . because of product obsolescence (date of expiry, end of season or collection, etc.) or lack of sales prospects.

Consider the following questions:

a. If LVMH followed U.S. GAAP, what inventory valuation method would you expect the company to use? Why?

b. Where would you expect to find the provision for inventory impairment in the company's financial statements?

SOLUTION TO REVIEW PROBLEM

Solution Part A.

1.

LIFO earnings before income tax provision (see Panel A of Review Problem Exhibit)	$3,376
Add: Change in inventory reserve (as reported in Walgreen's footnote disclosures)	310
Earnings before income tax provision assuming use of FIFO	$3,686

2.

Inventory (see Panel B of Review Problem Exhibit)	$7,036
Add: Inventory reserve	1,897
Inventory assuming use of FIFO	$8,933

3. Walgreen's effective tax rate for 2012: $1,249 ÷ $3,376 = 37.0%

Inventory reserve data

Inventory reserve (2012)	$1,897
Less: Inventory reserve (2011)	(1,587)
Change in the reserve	$ 310

Income tax savings in 2012: $310 × 37.0% = $114.7 million

4. $$\text{LIFO Inventory-on-hand period} = \frac{365}{\text{Cost of sales/Inventory}}$$

$$2012: \frac{365}{(\$51{,}291/\$7{,}036)} = 50.1 \text{ days}$$

$$2011: \frac{365}{(\$51{,}692/\$8{,}044)} = 56.8 \text{ days}$$