

## **Razzle-Dazzle Electronics**

Razzle-Dazzle Electronics is a small manufacturer of specialized electronic parts. Sales for last year were \$6.613 million. The firm has been your customer for several years. During your recent visit to the customer, their management was enthusiastic about their substantial recent growth and profitability, with sales growing at a 15 percent yearly rate for the last two years and returns on equity in the 20 percent range. This growth, they said, had necessitated the expansion of assets, including the purchase of a substantial amount of new equipment, which was partially financed with new term loans. They pointed out that their quick and current ratios have not declined over the period. However, payments from the firm have become increasingly slow. (Their financial statements for the last three years and a partial analysis follows.)

1. Assume that the financial statements were prepared by a local accountant and that the statements include a letter from the accountant saying that these financial statements were prepared according to Generally Accepted Accounting Principles as the accountant understands them. Give example of several of the questions you would initially ask the management of Razzle-Dazzle about these statements and the firm's financing.
2. Complete the ratio and cash flow analysis for Razzle-Dazzle.
3. Interpret these results starting with the ratio analysis and proceeding to the cash flow analysis; indicate what has happened to the firm's credit worthiness and why this has occurred. (Notes: (1) While the turnover ratios and days-based ratios for accounts receivable and inventory contain the same information, we are going to compute them both for practice. (2) Similarly, we are going to compute both the Total Debt/Total Assets (the "Debt Ratio") and Total Debt/Equity ratios. (3) This is a manufacturing firm so its cost of goods sold contains both purchases and other costs like factory labor, so days payable outstanding cannot be accurately computed from the information in these financial statements. To allow for this, compute the sum of the ACP and days inventory held rather than the cash conversion cycle.) Graph the following for the three years: (1) quick ratio, current ratio, and the 2013 industry average for each of these; (2) average collection period, days inventory held, and the 2013 industry averages for each of these; (2) total debt to total assets and the 2013 industry ratio for this.
4. Give examples of additional questions you might want to ask the management of Razzle-Dazzle given the results of the financial analysis.

**Razzle-Dazzle Electronics****Financial Statements**, last three fiscal years, rounded thousands  
Reordered for Analysis Purposes: Newest Statement on Right

Year	2011	2012	2013
Income Statements			
Sales	\$5,000	\$5,750	\$6,613
Cost of Goods Sold	\$3,500	\$4,025	\$4,629
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Gross Margin on Sales	\$1,500	\$1,725	\$1,984
Selling and Administrative Expenses	\$1,210	\$1,312	\$1,497
Depreciation	\$40	\$125	\$156
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Earnings Before Interest and Taxes	\$250	\$288	\$331
Interest Expense	\$47	\$74	\$106
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Earnings Before Taxes	\$203	\$214	\$225
Taxes	\$67	\$70	\$75
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Earnings After Taxes	\$136	\$144	\$150
Dividends Paid	\$109	\$115	\$120
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Changes in Retained Earnings	\$27	\$29	\$30
Balance Sheets			
Cash	\$136	\$100	\$35
Accounts Receivable	\$234	\$376	\$545
Inventory	\$650	\$775	\$949
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Total Current Assets	\$1,020	\$1,251	\$1,529
Gross Equipment	\$1,000	\$1,250	\$1,562
Accumulated Depreciation	\$320	\$445	\$601
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Net Equipment	\$680	\$805	\$961
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Total Assets	\$1,700	\$2,056	\$2,490
Short-Term Bank Debt	\$119	\$130	\$178
Trade Payables	\$510	\$617	\$747
Current on Term Loans	\$40	\$53	\$78
Accruals	\$136	\$165	\$199
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Total Current Liabilities	\$805	\$965	\$1,202
Term Loans	\$194	\$361	\$528
Equity	\$701	\$730	\$760
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Total Liabilities and Equity	\$1,700	\$2,056	\$2,490

**Razzle-Dazzle Electronics: Ratios**

Year	2010	2011	Industry 2013 Average 2013
Liquidity			
Current Ratio	1.267		1.700
Quick Ratio	0.460		0.900
Cash Flow Liquidity Ratio		0.247	Not Avail.
Accounts Receivable:			
Accounts Receivable Turnover	21.37		7.80
Average Collection Period (days)	17.08		46.79
Inventory			
Inventory Turnover based on CGS	5.38		6.00
Days Inventory Held	67.79		60.83
Sum of ACP and Days Inv. Held	84.87		107.62
Debt Ratios			
Total Debt/Total Assets	58.76%		57.30%
Total Debt/Equity	1.43		1.34

**Razzle-Dazzle Electronics: FASB 95 Cash Flow Analysis**

Year	2011-12	2012-13
Cash Flow from Operations Calculations:		
Cash flow from income statement		
Earnings after Taxes	\$144	
Depreciation Addback	\$125	
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Total	\$269	
Changes in accounts receivable	(\$142)	
Changes in inventory	(\$125)	
Changes in Trade Payables	\$107	
Changes in Accruals	\$29	
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Total Adjustments	(\$131)	
CFFO	\$138	
Cash Flows from Investing		
Changes in Gross Equipment	(\$250)	
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Cash Flows from Investing	(\$250)	
Cash Flows from Financing		
Change in Short Term Bank Debt	\$11	
Change in Current Long Term Debt	\$13	
Change in Term Loans	\$167	
Dividends Paid	(\$115)	
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Cash Flows from Financing	\$76	
Change in Cash Balance	(\$36)	

**Razzle-Dazzle Electronics: Summary Cash Flow Analysis**

Year	2011-12	2012-13
Inflows		
CFFO	\$138	42%
Change in Short Term Bank Debt	\$11	3%
Change in Current Long Term Debt	\$13	4%
Change in Term Loans	\$167	51%
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Total Cash Inflows	\$329	100%
Outflows		
Changes in Gross Equipment	\$250	68%
Dividends Paid	\$115	32%
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Total Cash Outflows	\$365	100%
Change in Cash	\$ (36)	