Suggestions for case Study on Income Statement Analysis

1. **For the last three years Ramchandra analyzed, sales have shown a moderate increase from approximately Rs.895,000 to Rs.918,000. Sales have declined, however, during the most recent year. Ramchandra sees this decrease as more of a concern than the three-year increase: What are some questions Ramchandra should ask Dry Supply to help explain this sales decrease?**
   - **Was the increase in 2016 attributable to sales increases to existing accounts or to new accounts?**
   - **If primarily from new accounts, was it because of an aggressive sales effort or because Dry Supply decreased its prices?**
   - **Are the new accounts as profitable as the old accounts?**
   - **Will the new accounts pay as promptly as the existing accounts?**
   - **Has the company increased product prices?**
   - **What caused the decline in 2017?**
   - **Is this the beginning of a declining trend?**
   - **Were prices reduced or were fewer items sold?**
   - **Did the company lose a customer or drop a product line?**

2. **Dry Supply's cost of goods sold has decreased over the three-year period. What questions should Ramchandra develop to ask Dry Supply regarding the cost of goods sold?**
   - **How is cost of goods sold determined?**
   - **Does Dry Supply consider all material costs in its calculation?**
   - **How much has Dry Supply increased prices in the last two years?**
   - **Is the sales mix changing?**

3. **Operating expenses increased from Rs.157,000 to Rs.180,000 in two years. What are some questions Ramchandra should ask about the operating expenses?**
   - **What caused operating expenses to increase faster than sales?**
   - **How long will the company continue to increase these costs faster than sales?**
   - **When will the maximum capacity of sales per person be reached and thereby necessitate an increase in sales expenses?**
   - **If officer salaries are a large part of the operating expenses, should the bank consider a loan agreement that would limit this expense?**
   - **Is the debt structured on a fixed- or variable-interest rate basis?**
   - **If a variable interest rate, what are the expectations for interest rate levels in upcoming years, and what effect will this have on the cost of debt?**

4. **Overall, Dry Supply has been consistently profitable, with after-tax profits rising each year. What are some questions Ramchandra should ask Dry Supply about the growing profitability?**
   - **Is this growth attributable to good management, industry conditions, or a combination of the two?**
   - **Will the company be keeping most of the net profits as retained**

earnings, or will they be taken out in dividends?

- **What does management foresee for profits in upcoming years?**

As the income statements are analyzed, Ramchandra addresses these and other questions. The right questions will help him "get behind" the numbers and better predict the company's future ability to repay debt.

By asking the above questions Ram Chandra got the information that 2016 increase in sales were because of hard sales effort and offering some discounts to add new clients and 2017 decrease in sales was because of frequent breakdowns of delivery vans resulting in undelivered orders. Mr. Ramchandra, though Mr. jugal Kishor did not categorically mention it, sensed that he was not very happy with the new clients marketed. Owners did not have any plans to distribute dividends.

Based on his analysis of Dry Supply's income statements, Ramchandra has drawn some preliminary conclusions about the company's strengths, weaknesses and uncertainties. Bearing in mind the formula for an acceptable credit risk, he has listed his observations in the following table:

Strengths –	Weaknesses >	Uncertainties [?]
• Length of time in business • Established customer base • Cost of goods sold • Increasing profits • Retained earnings • Management	• Reaching maximum shipping capacity • Continued future customer growth • Lack of sales growth	• New customers' ability to pay • Fixed asset needs