Activity 3

Financial Statements & Credit Ratings

The purpose of this assignment is twofold: to give you practice working with income statement numbers to understand the drivers of net income; and (separately) to use company financial statement information to ascertain your firm's bond credit rating(s).

Group:

Section:

1. Sales =$10,000; tax rate is 35%; Costs = $6,000 (not including depreciation); Depreciation = $1,000; Net income = $1,771.25. What is Interest Expense?

2. Sales = $10,000; tax rate is 40%; Net income = $2,520; Depreciation = $900; Interest expense = $400. What is the amount of costs (not including depreciation)?

3. Sales = $10,000; tax rate is 20%; Net income = $3,000; Interest expense = $350; Costs = $5,100 (not including depreciation). What is the amount of depreciation?

4. Calculate your firm's D/TA ratio and its EBIT/Int ratio. Be careful to only include short term debt and long term debt in your calculation of "D".

Ticker		
D/TA		(debt = short/long-term debt + long-term debt)
EBIT/Int		

Using the two above ratios for your firm, and the table below, determine what your firm's (S&P) credit rating should be.

Rating	D/TA	EBIT/Int	EBITDA/Int
AAA	0.17	64.10	71.88
AA	0.32	26.15	58.60
A	0.36	12.60	16.68
BBB	0.38	8.79	12.29
BB	0.39	6.14	8.67
B	0.78	1.22	2.39

What credit rating that you think the firm should have? Go to www.finra.org and look up your firm's *actual* credit rating on its bonds. Is your projected credit rating the same as the credit rating you found on FINRA? If not, discuss why you think there is a difference.