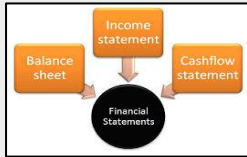


RATIO ANALYSIS



FINANCIAL STATEMENT OF A BUSINESS

1. Profit and loss account
2. Balance sheet
3. Cashflow statement

1

RATIO ANALYSIS



INCOME STATEMENT LAYOUT

Sales	200
Less cost of sales	<u>50</u>
Gross Profit	150
Less expenses	<u>40</u>
Net Profit	110
Less corporation tax	50
Less dividends	<u>20</u>
Retained earnings	40

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RATIO ANALYSIS

Define

COST OF SALES

Definition

This is the cost of purchasing or making the product (Raw materials, purchases stock)

3

RATIO ANALYSIS

Define

GROSS PROFIT

Definition

This is the profit before any expenses, interest are deducted. Low gross profit indicated that the cost of raw materials are too high or the selling price is not high enough

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RATIO ANALYSIS

Define

EXPENSES

Definition

These included items such as Rent, wages, Electricity, Light and heat

5

RATIO ANALYSIS

Define

NET PROFIT

Definition

This is the profit after expenses are deducted. A low net profit indicated that the business expenses are too high

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RATIO ANALYSIS

Define

CORPORATION TAX

Definition

This is tax that is paid by companies on their profits.
It is 12.5%

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RATIO ANALYSIS

Define

DIVIDENDS

Definition

This is a share of the profits that are paid to the shareholders

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RATIO ANALYSIS

Define

RETAINED EARNINGS

Definition

This is the profits that is left after all the expenses, cost and dividends have been taken out (It is an important source of long-term finance)

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RATIO ANALYSIS



BALANCE SHEET LAYOUT

1. Fixed Assets
2. Current Assets
3. Current Liabilities
4. Working Capital
5. Finance By

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RATIO ANALYSIS



FIXED ASSETS

Definition

These are permanent items owned by the business. They can be tangible - they can be seen or touched (Building) or intangible - They can't be seen (Good Will). Fixed assets show a bank how much security a business has when they are applying for a loan

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RATIO ANALYSIS



CURRENT ASSETS

Definition

These are assets that are always changing during the year.
Included debtors who are people who owe the business money, Closing stock, Bank and Cash

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RATIO ANALYSIS



CURRENT LIABILITIES

Definition

These are debts that should be paid within one year. The included Creditors who are the people the business owe money too and bank overdraft

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RATIO ANALYSIS



WORKING CAPITAL

Definition

This is the finance that is used for the day to day running of a business. It is usually gotten by subtracting the current Liabilities figure from the current assets figure. It shows if the business has enough money to pay their short term debts

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RATIO ANALYSIS



FINANCE BY

Definition

This section shows the source of long term finance that is raised by a business. It included ordinary shared, preference shares, Debentures and loans. It shows the borrowing in a business and if they can borrow more

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RATIO ANALYSIS



ORDINARY SHARES

Definition

This is the value of share that have been issued to shareholders

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RATIO ANALYSIS



CAPITAL EMPLOYED

Definition

This is the total finance that the company used in a year.
It shows the value of the business or how much it is worth

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RATIO ANALYSIS



PROFIT AND LOSS ACCOUNT

Definition

A profit and loss (P&L) account shows the amount of income earned, expense incurred, and profit made by the business. It also shows

1. How much profit was paid out in tax
2. How much was paid in dividends
3. How much was retained in the business for the future

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RATIO ANALYSIS

Define

BALANCE SHEET

Definition

This is a statement of the wealth of a business. It shows all the assets (something the business owns) and liabilities (Owes) by the business at a specific date

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RATIO ANALYSIS

Profitability

PROFITABILITY RATIOS

The profitability ratios include

1. Gross Profit Margin
2. Net Profit Margin
3. Return on Capital Employed

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RATIO ANALYSIS

Define

GROSS PROFIT MARGIN

Definition

1. It shows the amount of Gross Profit the company will get from Sales.
2. For example, a Gross Margin of 45% means that the business is earning 45c Gross Profit.
3. The higher the Gross Profit the easier the business can pay its expenses

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RATIO ANALYSIS

Profitability

GROSS PROFIT MARGIN

Formula

$$\frac{\text{Gross Profit}}{\text{Sales}} \times \frac{100}{1}$$

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RATIO ANALYSIS

Profitability

A DECLINE IN THE GROSS PROFIT MARGIN IS DUE TO

1. Increased cost of Sales - This can be due to higher material or production costs
2. Lower profit - This is because the selling price is low

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RATIO ANALYSIS

Define

NET PROFIT MARGIN

Definition

1. It shows the amount of Net Profit the company will get from sales.
2. For example, a Net Margin of 20% means that the business is earning 20c Net Profit.
3. The higher the Net Profit Margin the higher the profits.

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RATIO ANALYSIS

Profitability

NET PROFIT MARGIN

Formula

$$\frac{\text{Net Profit}}{\text{Sales}} \times \frac{100}{1}$$

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RATIO ANALYSIS

Profitability

A DECLINE IN THE NET PROFIT MARGIN IS DUE TO

1. an increase in the expenses

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RATIO ANALYSIS

Define

RETURN ON CAPITAL EMPLOYED

Definition

1. This figure measures the firm's ability to generate profits from the money invested in the business.
2. It shows the return the investor will get for the money they give to the business.
3. The higher the ROI the better

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RATIO ANALYSIS

Profitability

RETURN ON CAPITAL EMPLOYED

Formula

$$\frac{\text{Net Profit}}{\text{Capital Employed}} \times \frac{100}{1}$$

$$\text{Net Profit} = \text{Gross Profit} - \text{Expenses}$$

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RATIO ANALYSIS



CURRENT RATIO

Definition

1. Also known as the Working Capital Ratio.
2. The ideal Ratio here is to have 2:1.
3. This means that for every 1 Liability we owe we have 2 Assets to pay for it or for every €1 we own we have €2 to pay.
4. This means that we can repay our debts and still have money in the business

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RATIO ANALYSIS



CURRENT RATIO

Formula

$$\frac{\text{Current Assets}}{\text{Current Liabilities}}$$

OR

$$\text{Current Assets} : \text{Current Liabilities}$$

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RATIO ANALYSIS



ACID TEST RATIO

Definition

1. This is also known as the Quick Ratio.
2. The Ideal Ratio here is to have 1:1.
3. This means that for every 1 Liability we owe we have 1 Assets to pay for it or for every €1 we own we have €1 to pay.
4. This means that we can repay our debts and still have closing stock left

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RATIO ANALYSIS



ACID TEST RATIO

Formula

$$\frac{\text{Current Assets} - \text{Closing stock}}{\text{Current Liabilities}}$$

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RATIO ANALYSIS



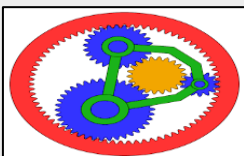
GEARING

Definition

This ratio shows the capital structure of the business and its ability to repay long term debts.

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RATIO ANALYSIS



GEARNING

Definition

$$\frac{\text{Debt Capital}}{\text{Equity Capital}}$$

OR

$$\text{Debt Capital} : \text{Equity Capital}$$

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RATIO ANALYSIS



GEARING TYPES

1. **Lowly Geared** - Equity > debt usually less than 1 or 100%
2. **Neutral Geared** - 1 or 100%
3. **Highly Geared** - Debt higher than equity usually higher than 1 or 100%

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RATIO ANALYSIS



WHAT LIQUIDITY RATIOS SAY A BUSINESS

1. **Liquidity** - This is the firm's ability to repay back its debts.
2. **Insolvency** - This occurs when the liabilities (Debt) is higher than the Assets. This means that the business can't pay its debts back. This is very serious and can result liquidation
3. **Liquidation** - is when a business is closed, and their assets are sold off. The money raise is used to pay the creditors

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RATIO ANALYSIS

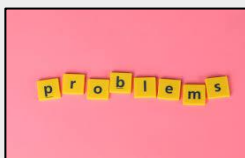


HOW TO MANAGE THE WORKING CAPITAL IN A BUSIENSS

1. **Sell of slow-moving stock** - this will result in the company getting cash
2. **Proper stock control** - This will reduce the amount of money in stock
3. **Credit Control** - Monitor which customers to give credit, for how long - less bad debts
4. **Increase prices** - This will increase the profit margin
5. **Raise more finance** - This can be done by selling shares,

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RATIO ANALYSIS

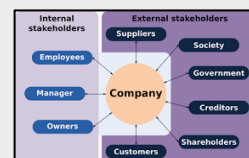


HIGH GEARING CAN CAUSE THE FOLLOWING PROBLEMS

1. **Greater pressure on Management** - To increase profits to repay the interest
2. **Reduced dividends** - Payments of Preference and debenture paid first
3. **Difficulty raising finance** - Less likely to pay dividends and therefore more risky
4. **Difficulty raising loan finance** - Bank will have doubts in firm's ability to repay loans
5. **Risk of Liquidation** - risk interest rate ore not paid on time

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RATIO ANALYSIS

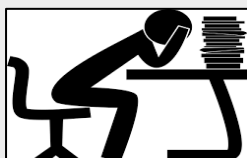


WHY STAKEHOLDERS ARE INTERESTED IN MONOTORING A BUSIENSS

1. **Managers** - Help with decision and how well the business is performing
2. **Investors** - How risky the business is, ability to make a profit & the return they will get
3. **Employees** - If they will have a job, use to seek a wage increase
4. **Banks** - Ability to repay a loan, looking at the liquidity ratios
5. **Suppliers** - Ability to pay for supp

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PAST QUESTIONS

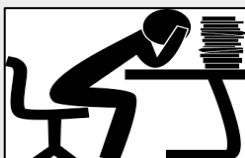


DECREASE IN SALES HAS ON A BUSINESS

1. Reduction in profits
2. Restructuring of costs required
3. Employee numbers may have to be reduced
4. Sales Promotions may need to be increased
5. Identify alternative suppliers
6. Product modifications
7. Market Research - new markets required.

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PAST QUESTIONS



EXPLAIN WHAT IS MEANT BY A LIQUIDITY

A Liquidity problem refers to the inability of a business to raise funds to pay short term debts as they fall due.

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PAST QUESTIONS

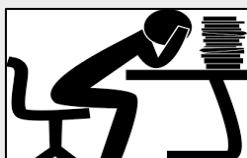


EXPLAIN THE TERM WORKING CAPITAL

1. The level of cash available for the **day by day** running of a business/ the level of cash available to run the business in the **short run**
2. It is used to **pay current liabilities** such as creditors, bank overdraft, accruals/Working Capital is **calculated by subtracting current liabilities from current assets.**

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RATIO ANALYSIS

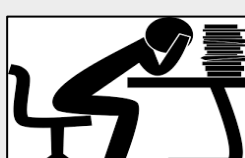


OUTLINE TWO PROBLEMS CAUSED BY INSUFFICIENT WORKING CAPITAL FOR A START-UP BUSINESS

1. Objectives of the business cannot be achieved affects the liquidity position
2. Short term liabilities cannot be met on time
3. Business opportunities like cash discount and trade discount cannot be availed
4. The business may be overtrading

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RATIO ANALYSIS

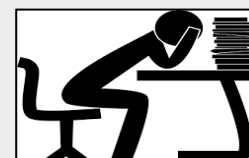


OUTLINE TWO LIMITATIONS OF USING RATIOS

1. Staff relations with Management not taken into account
2. Assets not shown at their true value.
3. Ratios are based on past figures and not on projected
4. Final Accounts only hold for a certain year/Balance Sheets are only true for the day they are written.
5. Does not consider business environment i.e. Competition

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RATIO ANALYSIS



EXPLAIN THE TERM 'DEBT/EQUITY RATIO'.

1. The debt/equity ratio is an analysis of the capital structure of the business.
2. It indicates what proportion of capital is made up of long term loans and what proportion of capital is made up of reserves and issued ordinary share capital.

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