

LIQUIDITY RATIOS



Liquidity Ratio Result	What it means <i>Measures the ability of business to pay their short term debts</i>
CR – over 2.0	Too much cash A ratio higher than 2 suggests that there is too much cash in the business and working capital could be used more effectively elsewhere.
Current Ratio (CR) - 1.5 – 2.0 Acid Test Ratio (ATR) – over 1.0	Positive result Business has healthy level of liquidity/working capital and should be able to pay short term debts
Current Ratio – less than 1.5 ATR less than 1.0	Negative result. Company has unhealthy level of liquidity/working capital and will have difficulty paying short term debts . Need to increase liquidity or could lead to insolvency.

Current ratio

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Acid test ratio

$$\text{Acid test ratio} = \frac{\text{Current assets} - \text{inventory}}{\text{Current liabilities}}$$



PROFITABILITY RATIOS



Profitability Ratios	Measures the profitability of business. <i>Can be compared against previous years results or competitors results</i>
Gross Profit Margin (GPM) Profit Margin (PM)	Calculate for every \$ worth of revenue what profit has been made (on average) <i>For example: if the GPM is 20% that means for every \$1 of revenue the firm earns \$0.20 of gross profit</i>
How to improve GPM/PM	<ul style="list-style-type: none">- Use cheaper materials,- Cut labour cost (increase productivity or relocate, reduce pay)- Raise prices
How to improve PM	<ul style="list-style-type: none">- Cut overhead costs- Reduce promotion cost

Gross profit margin - formula

$$\text{Margin (\%)} = \frac{\text{Gross profit}}{\text{Sales Revenue}} \times 100$$

Profit Margin – the formula

$$\text{Profit margin} = \frac{\text{Profit}}{\text{Sales Revenue}} \times 100$$

