

LIQUIDITY RATIO RESULT



| Liquidity Ratio Result | What it means <i>Measures the ability of business to pay their short term debts</i> |
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| 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



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| 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

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



INVESTMENT RATIOS



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|----------------------------|---|
| Investment Ratios | Measures the profitability of the business against the capital invested |
| What it is used for | The higher the results the better the business is at generating profit from the resources invested. |



| Return or Capital Employed | |
|---|--|
| $\text{ROCE (\%)} = \frac{\text{Operating profit}}{\text{Capital employed}} \times 100$ | |

