

# LIQUIDITY RATIO RESULT



Liquidity Ratio Result	What it means <i>Measures the ability of business to pay their short term debts</i>
CR – over 2.0	<b>Too much cash</b>  A ratio <b>higher than 2</b> suggests that there is <b>too much cash</b> 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	<b>Positive result</b>  Business has healthy level of liquidity/working capital and should be <b>able to pay short term debts</b>
Current Ratio – less than 1.5 ATR less than 1.0	<b>Negative result.</b>  Company has unhealthy level of liquidity/working capital and will have <b>difficulty paying short term debts</b> . 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



<b>Profitability Ratios</b>	<b>Measures the profitability of business.</b> <i>Can be compared against previous years results or competitors results</i>
<b>Gross Profit Margin (GPM) Profit Margin (PM)</b>	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>
<b>How to improve GPM/PM</b>	<ul style="list-style-type: none"><li>- Use cheaper materials,</li><li>- Cut labour cost (increase productivity or relocate, reduce pay)</li><li>- Raise prices</li></ul>
<b>How to improve PM</b>	<ul style="list-style-type: none"><li>- Cut overhead costs</li><li>- Reduce promotion cost</li></ul>

## 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



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



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

