LIQUIDITY RATIOS

Liquidity Ratio Result	**What it means** ***Measures the ability of business to pay their short term debts***
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

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

PROFITABILITY RATIOS

Profitability Ratios	**Measures the profitability of business.** ***Can be compared against previous years results or competitors results***
Gross Profit Margin (GPM) **Profit Margin (PM)**	Calculate for every $ worth of revenue what profit has been made (on average) For example: *if the GPM is 20% that means for every $1 of revenue the firm earns $0.20 of gross profit*
How to improve GPM/PM	- Use cheaper materials, - Cut labour cost (increase productivity or relocate, reduce pay) - Raise prices
How to improve PM	- 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

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

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