

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	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

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

INVESTMENT RATIOS



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 on Capital Employed

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

