SNS College of Technology

Coimbatore - 35

23BAT605 – FINANCIAL STATEMENT ANALYSIS

Unit II – ANALYSIS OF FINANCIAL STATEMENTS

Topic: Guess?????

Presented by

Ms.S.Swarnam

Design Thinker

1st Indian Institution to Implement Design Thinking Curriculum

Redesigning Common Mind and Business Towards Excellence


RECAP
shutterstock.com • 1316152781

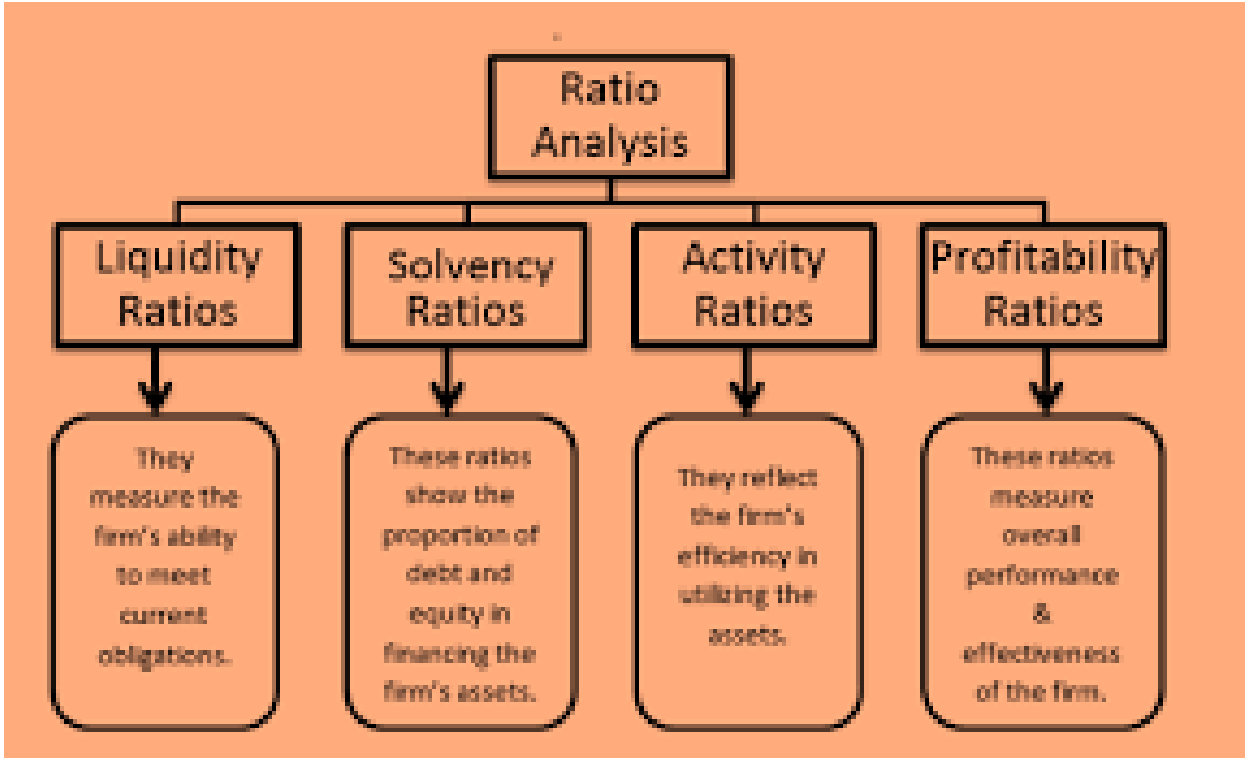
Topic....


Liquidity
Profitability
DEBT
Turnover

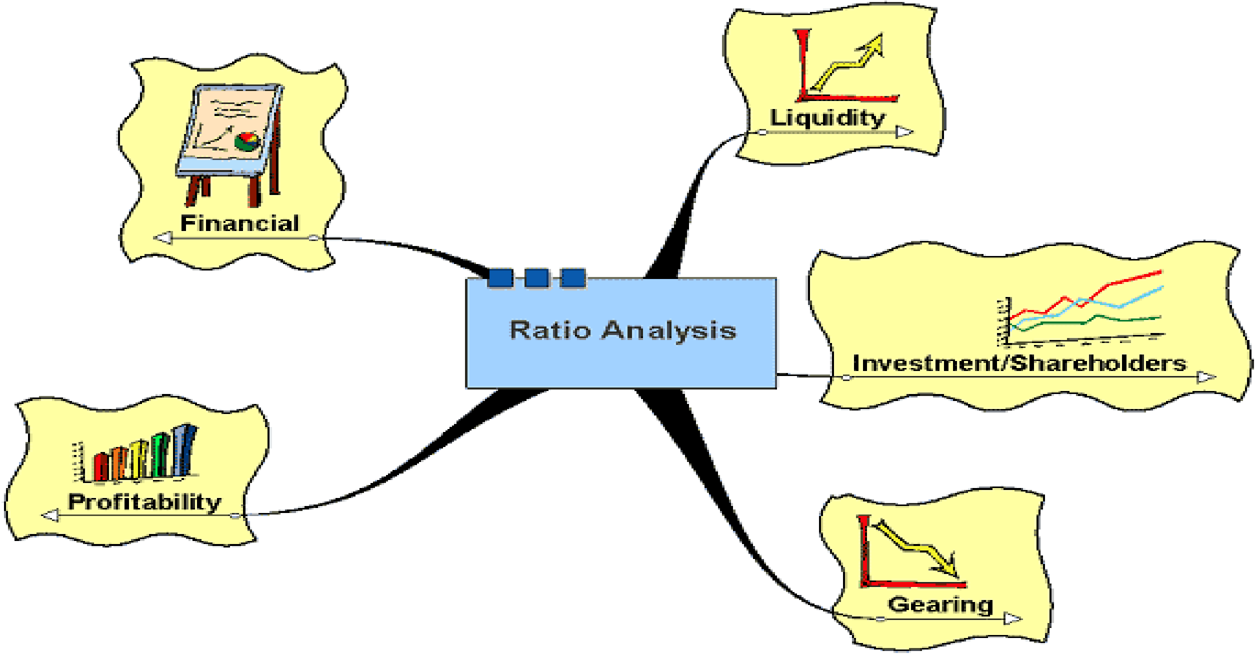

Meaning of Ratio Analysis
Ratio Analysis is a tool for analyzing and interpreting the financial position of a business. It is a method used for evaluating the financial statements of organizations.
CommerceMates.com

Purpose:

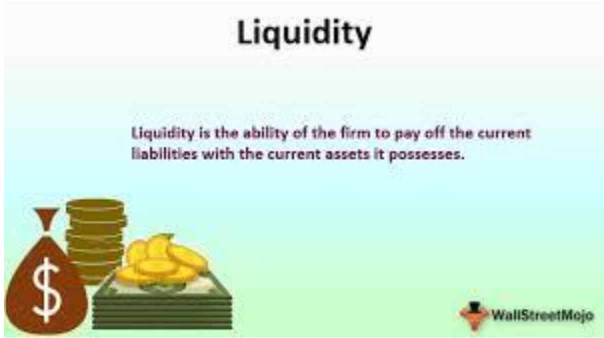
- To identify aspects of a business's performance to aid decision making
- Quantitative process – may need to be supplemented by qualitative factors to get a complete picture


Ratio Analysis
Liquidity Ratios
Solvency Ratios
Activity Ratios
Profitability Ratios
They measure the firm's ability to meet current obligations.
These ratios show the proportion of debt and equity in financing the firm's assets.
They reflect the firm's efficiency in utilizing the assets.
These ratios measure overall performance & effectiveness of the firm.

Ratio Analysis



1. **Liquidity** – the ability of the firm to pay its way
2. **Investment/shareholders** – information to enable decisions to be made on the extent of the risk and the earning potential of a business investment

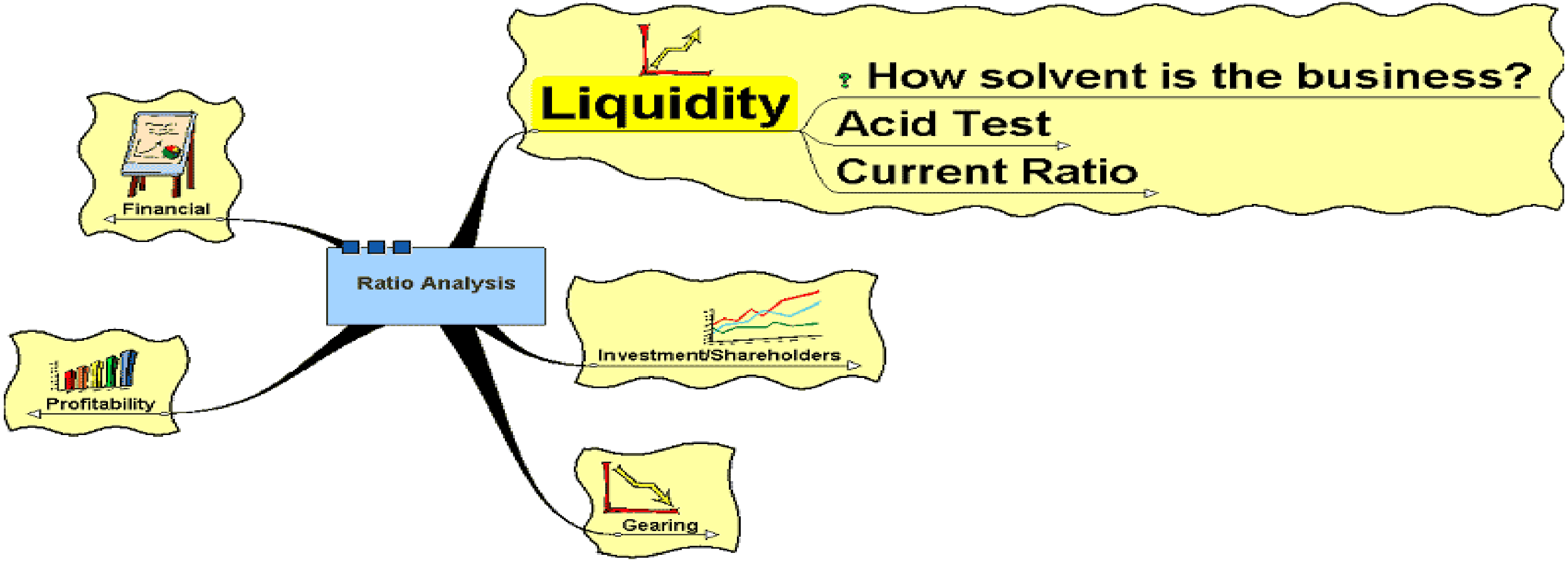


3. **Gearing** – information on the relationship between the exposure of the business to loans as opposed to share capital

4. **Profitability** – how effective the firm is at generating profits given sales and or its capital assets

5. **Financial** – the rate at which the company sells its stock and the efficiency with which it uses its assets

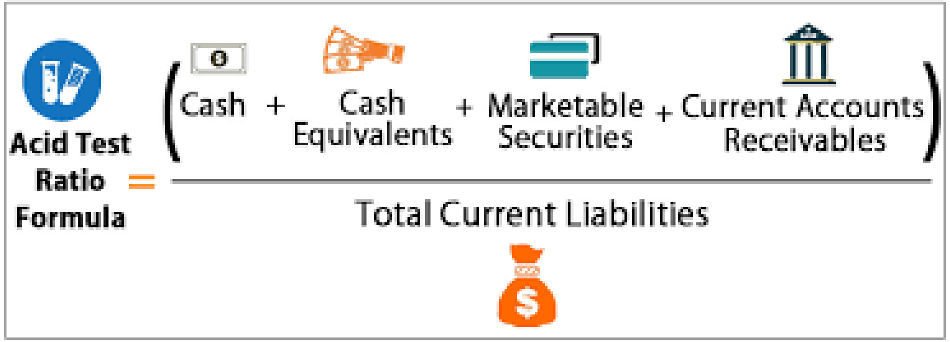
Liquidity



Liquidity
How solvent is the business?
Acid Test
Current Ratio
Financial
Ratio Analysis
Investment/Shareholders
Profitability
Gearing

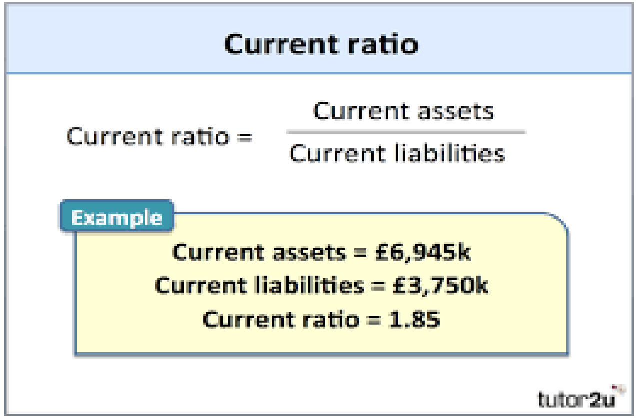
Acid Test

- Also referred to as the ‘Quick ratio’
- **(Current assets – stock) : liabilities**
- 1:1 seen as ideal

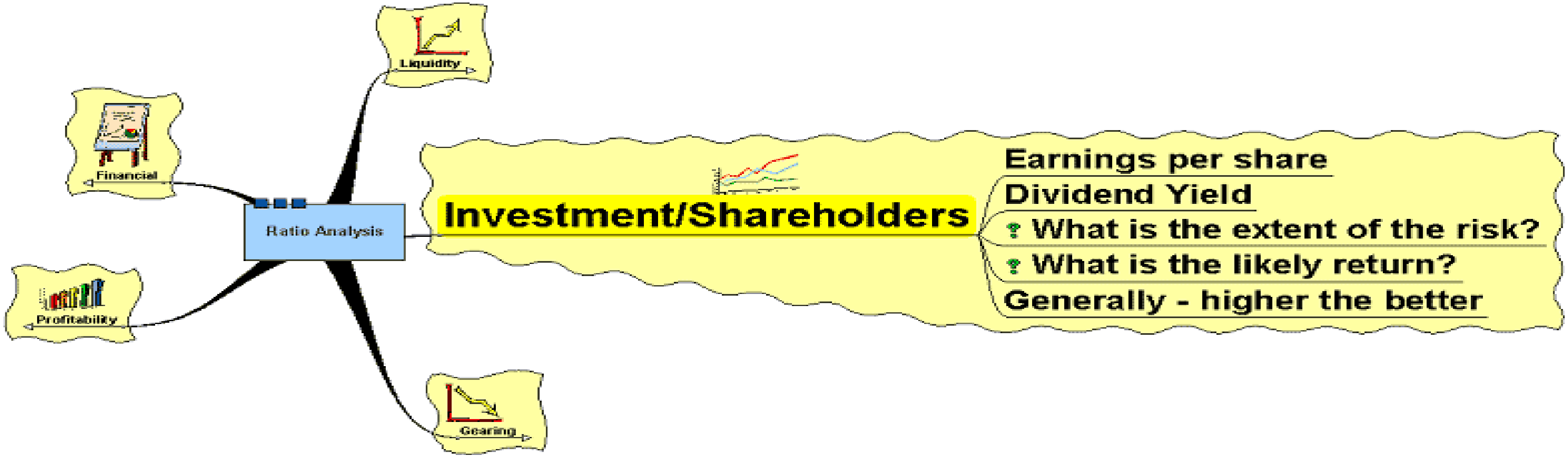


Current Ratio

- Looks at the ratio between Current Assets and Current Liabilities
- Current Ratio = Current Assets : Current Liabilities
- Ideal level? – 1.5 : 1



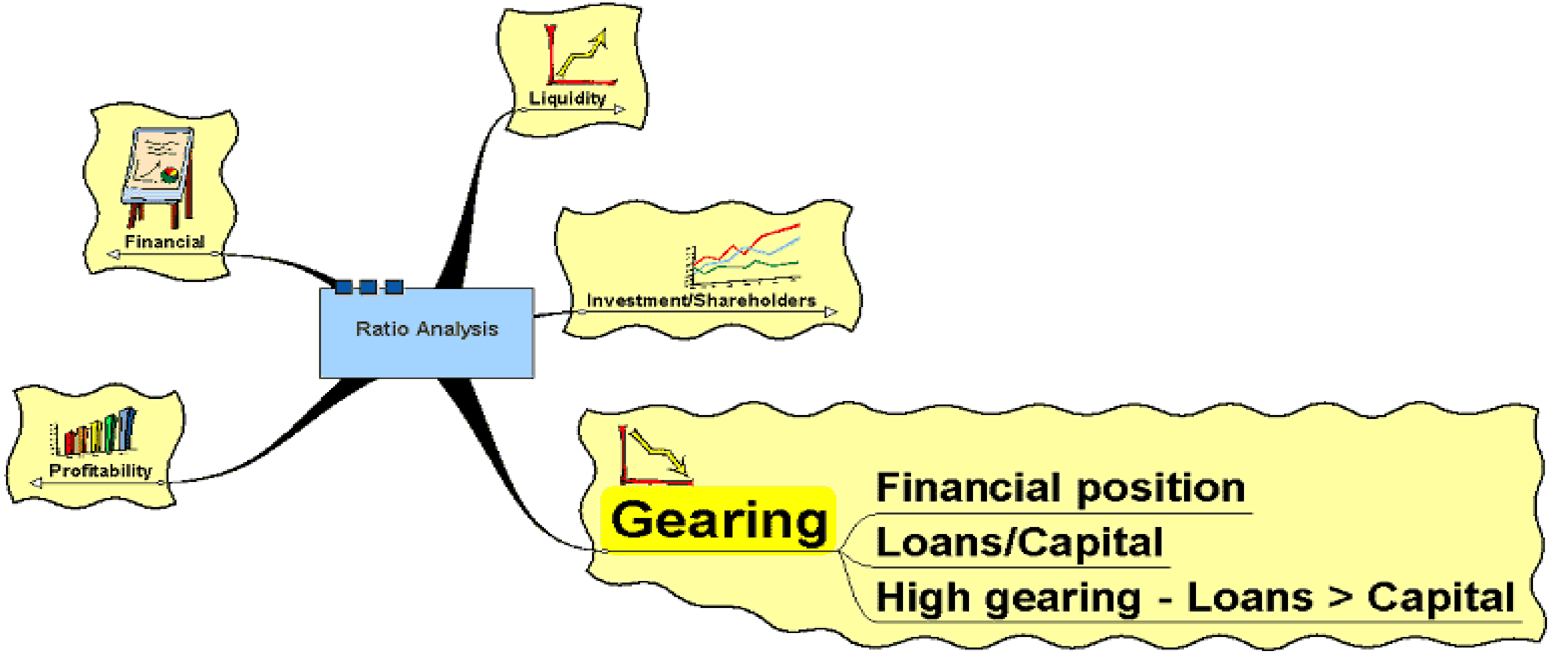
Investment/Shareholders



Investment/Shareholders

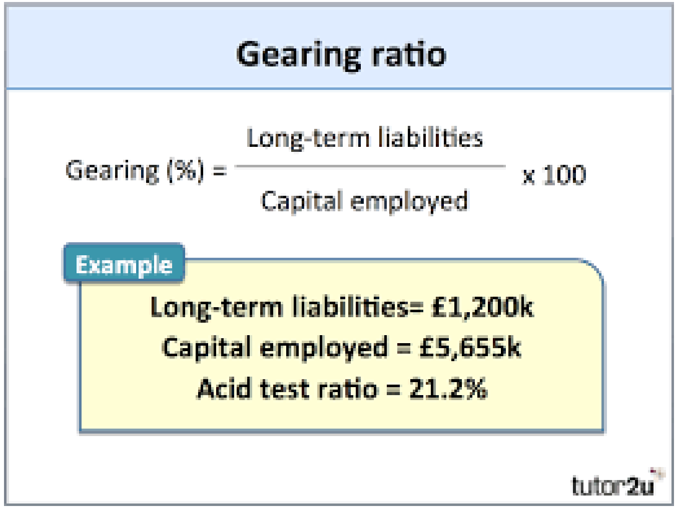
- **Earnings per share** – profit after tax / number of shares
- **Price earnings ratio** – market price / earnings per share – the higher the better generally. Comparison with other firms helps to identify value placed on the market of the business.
- **Dividend yield** – ordinary share dividend / market price x 100 – higher the better. Relates the return on the investment to the share price.

Gearing

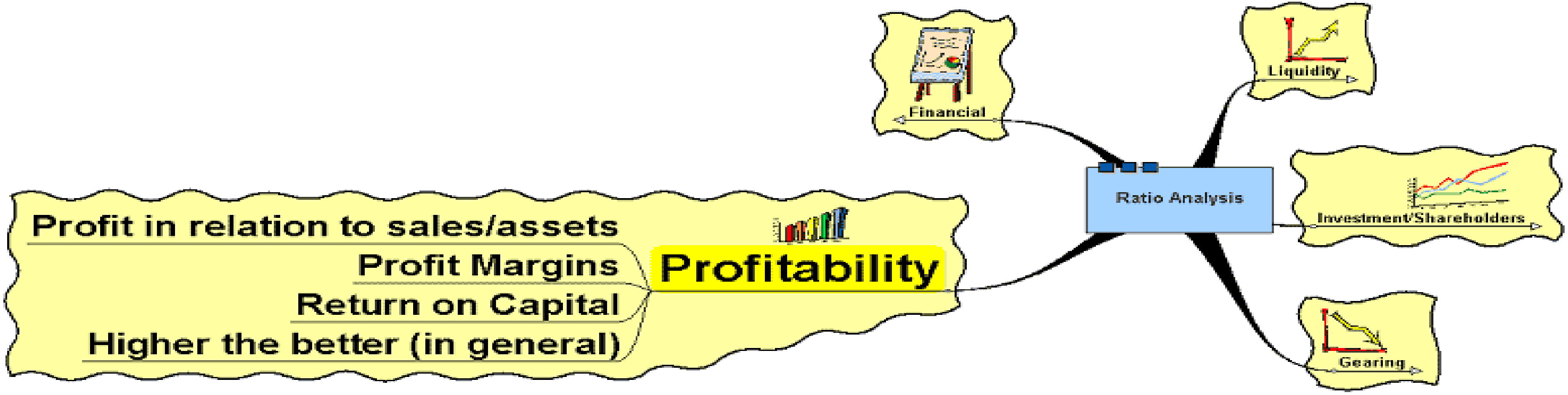


Liquidity
Financial
Ratio Analysis
Investment/Shareholders
Profitability
Gearing
Financial position
Loans/Capital
High gearing - Loans > Capital

- **Gearing Ratio = Long term loans / Capital employed x 100**
- The higher the ratio the more the business is exposed to interest rate fluctuations and to having to pay back interest and loans before being able to re-invest earnings



Profitability



Profitability

- Profitability measures look at how much profit the firm generates from sales or from its capital assets
- Different measures of profit – gross and net
  - **Gross profit** – effectively total revenue (turnover) – variable costs (cost of sales)
  - **Net Profit** – effectively total revenue (turnover) – variable costs and fixed costs (overheads)

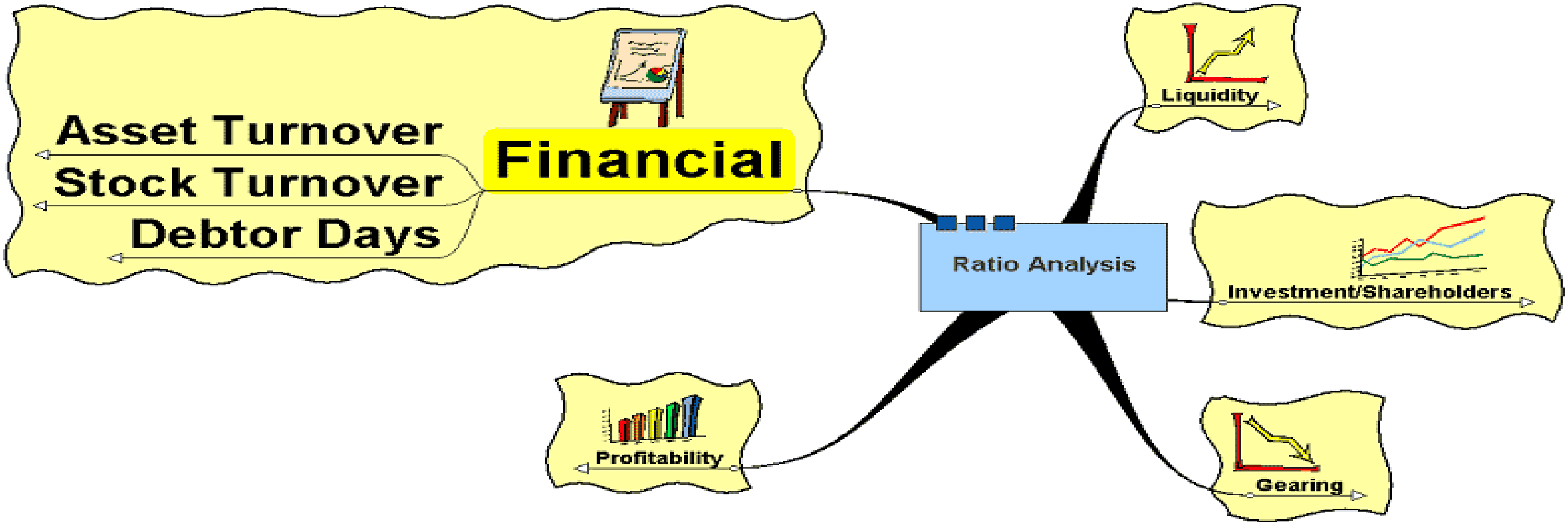
Gross Profit Margin = Gross profit / turnover x 100

- The higher the better
- Enables the firm to assess the impact of its sales and how much it cost to generate (produce) those sales
- A gross profit margin of 45% means that for every £1 of sales, the firm makes 45p in gross profit

- **Net Profit Margin = Net Profit / Turnover x 100**
- Net profit takes into account the fixed costs involved in production – the overheads
- Keeping control over fixed costs is important – could be easy to overlook for example the amount of waste - paper, stationery, lighting, heating, water, etc.

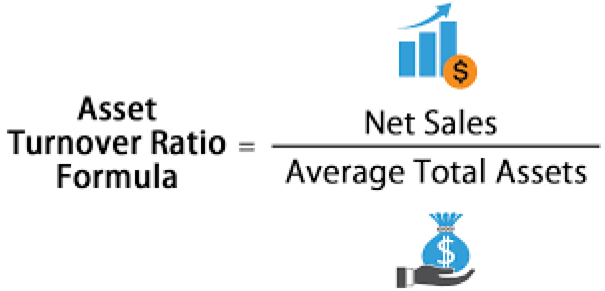
- **Return on Capital Employed (ROCE) = Profit / capital employed x 100**
- The higher the better
- Shows how effective the firm is in using its capital to generate profit
- A ROCE of 25% means that it uses every £1 of capital to generate 25p in profit

Financial


Asset Turnover
Stock Turnover
Debtor Days
Financial
Ratio Analysis
Liquidity
Investment/Shareholders
Profitability
Gearing

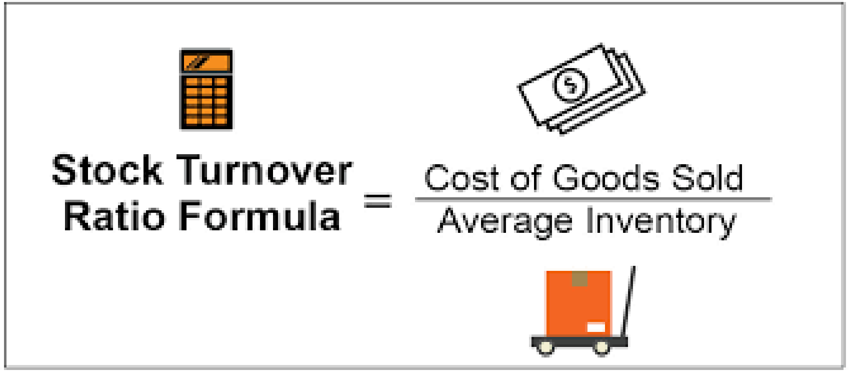
Asset Turnover

- **Asset Turnover = Sales turnover / assets employed**
- Using assets to generate profit
- Asset turnover x net profit margin = ROCE



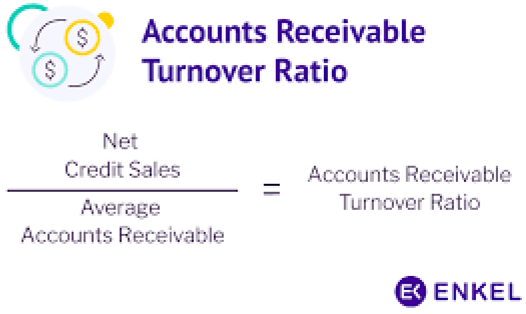
Stock Turnover

- **Stock turnover = Cost of goods sold / stock expressed as times per year**
- The rate at which a company's stock is turned over



Debtor Days

- **Debtor Days = Debtors / sales turnover x 365**
- Shorter the better
- Gives a measure of how long it takes the business to recover debts
- Can be skewed by the degree of credit facility a firm offers



Time for the assessment...

Given Sales is 1,20,000 and Gross Profit is 30,000, the gross profit ratio is

a. 24%
b. 25%
c. 40%
d. 44%

Summary

Ratio Analysis

References...

- https://www.cliffsnotes.com/study-guides/accounting/accounting-principles-ii/financial-statement-analysis/ratio-analysis

Thank you

REACH US

SNSINSTITUTIONS

SNSINSTITUTIONS

SNSINSTITUTIONS

SNSINSTITUTIONS

SNSINSTITUTIONS