Financial Ratio Analysis

Cranswick Plc is a food supplier company listed on the London Stock Exchange. The following represent ratios for the company for the year ended 31st March 2012.

Investors ratios

Earning per share: it measures earning attributable to equity shareholders over outstanding number of equity ordinary shareholders.

$$\frac{\text{Profit after tax}}{\text{number of outstanding shareholders}}$$

$$=\frac{37,480,000}{48,042,086}= 78$$

EPS= 78pence

Dividend per share: it measures dividend paid out over the number of outstanding equity shareholders.

$$\frac{\text{amount distributed to shareholders as dividend}}{\text{number of outstanding shareholders}}$$

$$= \frac{13,700,000}{48,042,086}= 28.5$$

DPS= 28.5pence

Price to earning ratio: it is a ratio that measures how much investors have to pay for every pound of an entity's earning.

$$\frac{\text{share's market price}}{\text{earning per share}}$$

$$= \frac{805}{75}$$

=10.3

Dividend cover: it is a ratio of entity's earning over dividend paid out.

$$\frac{\text{earning per share}}{\text{dividend per share}}$$

$= \frac{78}{28.5} = 2.74$

=2.74 times

Dividend yield: it measures the actual return an investor earns from investing in an entity

$\frac{\text{dividend per share}}{\text{share price}} * 100\%$

$= \frac{28.5}{805} * 100\%$

=3.5%

Management ratios

Management uses the following ratios to establish how an entity is efficiently utilizing its resources to generate income.

Return on equity: it is a measure of how a company is using equity shareholders fund to generate profits

$$\frac{\text{profit after tax}}{\text{equity shareholders fund}} * 100\%$$

$= \frac{34,653,000}{245,932,000} * 100\%$

=14.1%

Return on capital employed: it measures how an entity is utilizing shareholders fund and long term financing to generate profit.

$$\frac{\text{profit before interest and tax}}{\text{shareholders fund} + \text{long} - \text{term finance}} * 100\%$$

$= \frac{48,351,000}{245,932,000+42,301,000} * 100\%$

=16.8%

Operating profit margin: it is a measure of operating profit to turnover

$$\frac{\text{profit before interest and tax}}{\text{turnover}}$$

$$= \frac{49{,}354{,}000}{820{,}775{,}000} * 100\%$$

=6%

Asset turnover: This is a ratio that shows how much sales an entity generates from 1 pound of capital employed or total assets.

$$\frac{\text{turnover}}{\text{total assets}}$$

$$= \frac{820{,}775{,}000}{400{,}157{,}000}$$

=2.1

Inventory turnover: this ratio shows the length of time an entity takes to sell its inventory.

$$\frac{\text{cost of sales}}{\text{average inventory}}$$

$$= \frac{718{,}605{,}000}{38{,}516{,}000}$$

=18.7

Inventory days: the ratio shows the length of time inventory stays in the entity's warehouse before it is sold.

$$\frac{1}{\text{inventory turnover}} * 365$$

$$=\frac{1}{18.7}*365$$

=19 days

Trade receivable days: it measures the length of time customers or debtors take to settle their outstanding bills.

$$\frac{\text{credit sales}}{\text{net sales}} * 365$$

$= \frac{85,534,000}{820,775,000} * 365$

=38 days

Working capital cycle: this is a measure of how long it takes between an entity receiving good from suppliers to the time an it receives cash from sales

=working capital cycle= inventory days+trade receivable days-trade payable days

=19+38-46=11

=11 days

Suppliers and trade creditors ratios

Suppliers and trade creditors use the following ratios to determine credit worthiness of an entity.

Current ratio: this ratio measures the ability of an entity to cover its short term liability over a short period of time usually one year period.

$$\frac{\text{current assets}}{\text{current liabilities}}$$

$= \frac{144,846,000}{99,027,000}$

=1.5

Quick ratio/ acid test: this is an improvement of current ratio and establishes the ability of an entity to meet its short term liabilities using its most liquid assets

$$\frac{\text{current assets less inventories}}{\text{current liabilities}}$$

$= \frac{144,846,000-38,516,000}{99,027,000}$

=1.1

Cash ratio: it further refines measures of liquidity, which include current ratio and quick ratio by ascertaining the amount of liquid cash or cash equivalent that an entity can use to cover its current liabilities.

$$\frac{\text{cash} + \text{cash equivalents} + \text{invested funds}}{\text{current liabilities}}$$

$$=\frac{20,100,000+696,000+1,398,000}{99,027,000}$$

=0.22

Trade payables: this ratio measures the length of time an entity takes to pay its trade suppliers

$$\frac{\text{credit purchases}}{\text{net purchases}} * 365$$

$$= \frac{91,078,000}{718,605,000} * 365$$

= 46 days

Net profit margin: this measures the net profit that an entity generates from its sales

$$\frac{\text{Net profit before tax}}{\text{sales}} * 100\%$$

$$= \frac{48,351,000}{820,775,000} *100\%$$

=5.9%

Loan creditors or lenders ratio

Lenders and loan creditors use the following ratios to determine solvency, financial risk and liquidity ability to pay borrowed funds.

Gearing ratio: it is a ratio used by banks to measure financial risk of borrowers.

$$\frac{\text{total debt}}{\text{total debt} + \text{equity}} * 100\%$$

$$= \frac{42,301,000}{245,932,000+42,301,000} * 100\%$$

=14.7%

Debt to equity ratio: it is a ratio that measures the amount of capital shareholders have invested in an entity for every pound borrowed.

$$\frac{\text{total debt}}{\text{shareholders equity}}$$

$$= \frac{42{,}301{,}000}{245{,}932{,}000}$$

=0.2

Interest cover: it is a ratio that measures the number of times interest payable can be able to be covered by profit generated.

$$\frac{\text{profit before interest and tax}}{\text{interest payable}}$$

$$= \frac{49{,}354{,}000}{1{,}624{,}000}$$

=30.4

Debt service or coverage ratio: it is a ratio that measures an entity's ability to pay its debts from profit generated.

$$\frac{\text{net operating profit}}{\text{total debt service}}$$

$$= \frac{37{,}480{,}000}{42{,}301{,}000+1{,}624{,}000}$$

=0.9