

5. CALCULATE PROFITABILITY RATIOS AND CONSIDER A LOAN

Sally's Surf Store is a manufacturer and retailer of beach products. Consider the following information pertaining to the business for the 2023 financial year.

Sales	\$450 000
Cost of sales	200 000
Selling expenses	30 000
General and administrative expenses	50 000
Financial expenses	20 000
Assets	200 000
Liabilities	170 000
Equity	30 000

- Calculate profitability ratios for Sally.
- Consider how these ratios might change if the business had decided to take out a \$100 000 loan in 2023 to purchase its premises, resulting in an increase in sales of 10% and an increase in cost of sales of 5%. Show your calculation and comments.
- Advise Sally about the decision to borrow \$100 000.
- What limitations on the financial information provided will affect the advice that you give?

6. CALCULATE RATIOS FOR A MANUFACTURING BUSINESS AND MAKE SUGGESTED COMPARISONS

Income Statement
For Clyde Dale's Carpets and Horsehair Rugs
For the year ended 30 June 2020

Sales	440 000	
Less: Sales Returns	(40 000)	400 000
Less: Cost of Sales		200 000
Gross profit		200 000
Add: Other Income		
Interest Income	8 000	
Donations Received	12 000	
Total income		220 000
Less: Expenses		
Selling costs		
Sales Staff Wages	90 000	
Advertising	2 000	
Office costs		
Administrative Assistant Salary	33 000	
Accountant's Fees	5 000	
Rent	10 000	
Electricity and Telephone	4 000	

Transport costs	
Delivery Costs	10 000
Packaging and Handling Costs	15 000
Finance costs	
Interest	30 000
PROFIT	\$ 21 000

- Use ratio analysis to comment on the profitability of the business for the 2020 period.
- Compare the results for this business with the previous year's results, and advise Clyde on appropriate action to be taken:

Clyde Dale's Carpets and Horsehair Rugs – 2019 results

Net sales	=	\$400 000
Gross profit ratio	=	55%
Profit margin	=	25%
Expense ratio	=	30%
Transport expenses ratio	=	5%
Stock turnover ratio	=	19 times per period.

- Compare the results with the industry average ratios for the homeware textiles manufacturing industry in Australia for the 2020 financial year as shown below.

Homeware textiles manufacturing industry – 2020 industry average results

Gross profit ratio	=	40%
Profit margin	=	30%
Expense ratio	=	35%
Stock turnover ratio	=	10 times per period.

7. STABILITY, PROFITABILITY AND LIQUIDITY

Burke's Bikes, a tricycle manufacturer, is considering taking out a loan to expand the business, as it is currently manufacturing at full capacity and has unfilled orders. The business owns the factory where the bikes are manufactured, and rents the shop front where they are sold. However, it is having difficulty with debtor repayments, and wages have been escalating in recent years. Calculate the stability, profitability, efficiency and liquidity ratios for 2021 and 2022, and advise the business on the loan decision.

8. CALCULATE AND INTERPRET LIQUIDITY AND GEARING RATIOS

Kieron's Kitchenware Kapers Balance Sheet as at			
	2019	2020	2021
Current assets			
Cash at Bank	20 000	19 000	19 500
Debtors	19 000	18 000	48 000
Inventory	140 000	130 000	80 000
Non-current assets			
Shop Fittings	40 000	40 000	40 000
Office Furniture	10 000	10 000	10 000
Building	303 000	303 000	303 000
Liabilities			
Overdraft	26 000	26 000	26 000
Creditors	37 000	36 000	44 000
Loan	200 000	200 000	200 000
Equity			
Capital	250 000	250 000	250 000
Profit/(Loss)	19 000	8 000	(19 500)
Additional information:			
Sales (90% on credit)		500 000	480 000
Purchases		440 000	460 000
Cost of sales		480 000	485 000

A. Calculate the liquidity and gearing ratios. Comment on these.

B. Kieron wishes to borrow \$40 000 from a finance company to purchase some new inventory, to make up for the current shortfall in inventory, and so that he can run kids' cooking classes. Advise him as to why he should or should not do this.

9. ANALYSIS OF RATIO INFORMATION

The following table contains ratio information for the retail business Jive Jewellery. Write a brief report interpreting these ratios and providing an analysis of the liquidity and leverage of the business.

RATIO	2017 RESULT	2018 RESULT	2018 INDUSTRY AVERAGE
Debt to equity	110%	90%	80%
Working capital	210%	300%	140%
Quick asset	1.7:1.0	0.8:1.0	0.5:1.0

10. FINANCIAL INFORMATION AND ANALYSIS

Your friend Bryson owns a pizza restaurant, Pepperoni Pete's Pizza Treats, where he manufactures gourmet pizzas from scratch, importing several of the raw ingredients and creating new, innovative menus each month. He enjoys working as the chef, however, he finds the front-of-house managing more fun, so he is considering employing more staff in the kitchen. He also needs to renovate the coolroom attached to the kitchen at a cost of \$6 700, in preparation for a Health Department inspection. The sale of 'pick up' pizzas, where people order and pick up their food from the restaurant on their way home from work, is very seasonal. As the business is just coming into a low period for these sales, Bryson would like to spend some money on signage and advertising, but he is not sure how much he can afford. The business's loan repayments are quite low and could be increased. Bryson would also like to know if the business can afford to purchase a \$300 000 oven in the coming financial year – and, if so, how it should be financed.

Pepperoni Pete's Pizza Treats Balance Sheet for the year:			
	2021	2022	2023
Assets			
Cash at Bank	10 000	11 500	14 000
Prepaid Rent	10 000	8 500	5 500
Accounts Receivable	9 000	8 000	10 000
Stock	140 000	130 000	80 000
Restaurant Fittings	540 000	540 000	540 000
Kitchen Equipment	120 000	120 000	230 000
Building	211 000	211 000	211 000
Accumulated Depreciation	(90 000)	(125 000)	(170 000)
Liabilities			
Accounts Payable	37 000	36 000	44 000
Loan	220 000	200 000	180 000
Equity			
Capital	650 000	650 000	650 000
Add: Profit	43 000	18 000	46 500
Sales (50% on Credit)		600 000	570 000
Cost of Sales		550 000	545 000

A. Prioritise Bryson's requirements and list your expectations for Pepperoni Pete's Pizza Treats.

B. Calculate relevant liquidity and gearing ratios.

C. Using the steps for appraising business performance outlined in this chapter, complete a simple feasibility study.

D. Work in pairs to research current financial information – such as loans and interest rates for small businesses – and non-financial information – such as the regulations governing this area of manufacturing. Summarise the four most useful points in a table.

E. Compare your analysis of the data with expectations, and outline an action plan for Pepperoni Pete's Pizza Treats.