Business Management for IT (IT8090)

Financial Statement Analysis

Lesson-8

Ms.Chalani Kuruppu MLRHRM-UOC, BBA(Hons) in Business Management (UK)

Learning outcomes

Get an overall idea about the financial analysis

- Classifications of financial ratios
 - -Profitability Ratios
 - -Liquidity Ratios
 - -Activity Ratios (Efficiency Ratios)
 - -Debt Ratios

• Interpretation of ratio analysis.

Financial Statements

Financial statements are the **end product** of the 'Financial Accounting' process.

The objective of financial statements is,

Provide information about the *financial position, performance* and changes in *financial position of an entity* that is useful to a wide range of users in making economic decisions.

Financial Statement analysis

Financial analysis is the process of identifying the financial strengths and weaknesses of a firm by properly establishing relationship between the items in financial statements.

'Financial Statement Analysis' is a part of large information processing system on which informed decisions can be based.

The type of analysis varies according to the specific interests of the party involved.

Ratio Analysis

'Ratio analysis' is a study of various relationships between different items reported in a set of financial statements.

Objective:

Ratios enable an analyst to make a **comparison** of a firm's **financial condition over a time or in relation to other firms.**

Classification of Financial Ratios

- Profitability Ratios
- Liquidity Ratios
- Activity Ratios (Efficiency Ratios)
- Debt Ratios

PROFITABILITY RATIOS

Profitability ratios measure the results of business operations or *overall performance and effectiveness* of the firm.

It evaluates a firm's effectiveness in using its resources to generate profits.

- **✓** Gross profit Rate
- **✓** Net profit Rate

Gross profit Rate

Gross profit margin measures the percentage of each sales rupee remaining after the firm has paid for its goods.

The higher gross profit margin is better for the company.

Gross Profit Rate = <u>Gross Profit</u> x 100 Net revenue

Kuruwita Textile Ltd Income Statement For the year ended 31st March 2007

Г		_			
١.		1	4	Ŀ	
	۰	1			

	31 st March 2007 (000')	31st March 2006 (000')
Sales	6891	5279
Cost of sales	(6138)	(4793)
Gross Profit / Loss	753	486
Other operating income	9	1
Sales & administrative expenditure	(222)	(391)
Operation Profit/ loss	540	96
Financial Income	118	2
financial expenditure	(111)	(49)
Profit / loss before tax	547	49
Tax	(17)	(10)
Net profit	530	39



2007

Gross Profit Rate=753/6891*100 = 10.93%

2006

Gross Profit Rate=486/5279*100 =9.21%

Net Profit Rate

 % of each sales rupee remaining after all costs and expenses deducted

Net Profit Rate

= <u>Net Profit</u> x 100

Net Revenue

Kuruwita Textile Ltd Income Statement For the year ended 31st March 2007

	-		
l a	J	_	

	31st March 2007 (000')	31st March 2006 (000')
Sales	6891	5279
Cost of sales	(6138)	(4793)
Gross Profit / Loss	753	486
Other operating income	9	1
Sales & administrative expenditure	(222)	(391)
Operation Profit/ loss	540	96
Financial Income	118	2
financial expenditure	(111)	(49
Profit / loss before tax	547	49
Tax	(17)	(10
Net profit	530	35



2007

Net Profit Rate=530/6891*100

= 7.69%

2006

Net Profit Rate=39/5279*100 =0.74%

LIQUIDITY RATIOS

Liquidity of a firm is measured by its ability to satisfy its short – term obligations as they come due.

These ratios can provide early signs of cash flow problems and impending business failure.

✓ Current Ratio

✓ Quick (Acid – Test) Ratio

Current Ratio

Current ratio compares the company's current assets with its current liabilities.

The higher the current ratio, the more liquid the firm is considered to be.

A current ratio of 2.0 is occasionally cited as acceptable

Current ratio = <u>Current assets</u> Current liabilities



Kuruwita Textile Ltd. Balance sheet as at 31st March 2007

Assets	31st March 2007 (000°)	31st March 2006 (000')
	313t March 2007 (000')	31st March 2000 (000')
Non - current assets		
Property, Plant and equipments	1558	1348
Good will	-	39
Investment in subsidiary	16	
	1574	1387
Current assets		
Inventories	1288	1225
Current tax receivables	25	12
Trade debtors	356	337
Cash	241	137
	1910	1711)
Total assets	3484	3098
Equity and liabilities		
Capital and reserve		
Ordinary Shares	250	250
Share premium	99	99
Revenue reserves	40	40
Exchange equivalent reserve	260	162
Retained earning	574	215
Minority interest	455	306
	1678	1072
Non-current liability	1073	
Long term borrowings		274
Define benefit obligation	265	
	44	30
Current liabilities	309	304
Trade and other payables	1484	202
Short term borrowings	13	1520
	1497	1722)
Total liabilities		2026
Total equity and liabilities	1806	3098
a sum equity and marketines	3484	3098



2007

Current ratio = 1910/1497 = 1.28 : 1

2006

Current ratio = 1711/1722 = 0.99 : 1

Quick (Acid - Test) Ratio

This ratio is similar to the current ratio except that it excludes inventory, which is generally the least liquid current asset.

The quick ratio provides a better measure of overall liquidity only when a firm's inventory cannot be easily converted into cash.

A quick ratio of 1.0 or greater is occasionally recommended.

Quick ratio = <u>Current assets - Inventory (Closing Stocks)</u>

Current liabilities



Kuruwita Textile Ltd. Balance sheet as at 31st March 2007

Assets	31st March 2007 (000°)	31st March 2006 (000')
Non - current assets		
Property, Plant and equipments	1558	1348
Good will	-	39
Investment in subsidiary	16	-
	1574	1387
Current assets		
Inventories	1288	1225
Current tax receivables	25	12
Trade debtors	356	337
Cash	241	137
	1910	1711
Total assets	3484	3098
Equity and liabilities		
Capital and reserve		
Ordinary Shares	250	250
Share premium	99	99
Revenue reserves	40	40
Exchange equivalent reserve	260	162
Retained earning	574	215
Minority interest	455	306
	1678	1072
Non-current liability		
Long term borrowings	265	274
Define benefit obligation	44	30
	309	304
Current liabilities	309	
Trade and other payables	1484	202
Short term borrowings	13	1520
	1497	1722
Total liabilities	1806	2026
Total equity and liabilities	3484	3098



2007

```
Quick ratio = 1910-(1288) /1497
= 0.42 : 1
```

2006

```
Quick ratio = 1711- (1225) /1722
= 0.28 : 1
```

ACTIVITY RATIOS

Activity ratio measures the how **efficiently** the firm is using its **assets.**

✓ Receivable days

Receivable days

This ratio measures the length of time it takes trade receivables to pay.

This also provides insight into the quality of the firm's receivables and the firm's efficiency in its collection.

The length of time taken to pay the dues represents a cost to a business. (It's like giving free credits).

Less time period is better for the business

Receivable days = <u>Closing trade receivables</u> x 365 Revenue



Kuruwita Textile Ltd. Balance sheet as at 31st March 2007

Non - current assets Property, Plant and equipments 1558 1348 Good will	Assets	31st March 2007 (000°)	31st March 2006 (000')
Good will	Non - current assets		
Trace Trac	Property, Plant and equipments	1558	1348
1574	Good will	-	39
Current assets 1288 1225	Investment in subsidiary	16	-
Inventories		1574	1387
Current tax receivables	Current assets		
Trade debtors Cash 241 137 Cash 1910 1711 Total assets 3484 3098 Equity and liabilities Capital and reserve Ordinary Shares Share premium 99 Revenue reserves 40 Exchange equivalent reserve 260 Retained earning 574 215 Minority interest 455 306 1678 Non-current liability Long term borrowings Define benefit obligation 44 30 Current liabilities Trade and other payables Short term borrowings 13 1520 Total liabilities	Inventories	1288	1225
Total assets	Current tax receivables	2.5	12
1910 1711	Trade debtors	356	(337)
Total assets 3484 3098 Equity and liabilities Capital and reserve 250 250 Chinary Shares 250 250 Share premium 99 99 Revenue reserves 40 40 Exchange equivalent reserve 260 162 Retained earning 574 215 Minority interest 455 306 Non-current liability 1678 1072 Non-current borrowings 265 274 Define benefit obligation 44 30 Current liabilities 309 304 Trade and other payables 1484 202 Short term borrowings 13 1520 Total liabilities 1806 2026	Cash	241	137
Equity and liabilities Capital and reserve		1910	1711
Capital and reserve 250 250 Ordinary Shares 250 250 Share premium 99 99 Revenue reserves 40 40 Exchange equivalent reserve 260 162 Retained earning 574 215 Minority interest 455 306 Non-current liability 1678 1072 Non current liability 265 274 Define benefit obligation 44 30 Current liabilities 309 304 Trade and other payables 1484 202 Short term borrowings 13 1520 Total liabilities 1806 2026	Total assets	3484	3098
Ordinary Shares 250 250 Share premium 99 99 Revenue reserves 40 40 Exchange equivalent reserve 260 162 Retained earning 574 215 Minority interest 455 306 Non-current liability 1678 1072 Long term borrowings 265 274 Define benefit obligation 44 30 Current liabilities 309 304 Trade and other payables 1484 202 Short term borrowings 13 1520 Total liabilities 1806 2026	Equity and liabilities		
Share premium 99 99 99 99 99 8evenue reserves 40 40 40 40 40 40 40 4	Capital and reserve		
Revenue reserves	Ordinary Shares	250	250
Exchange equivalent reserve 260 162 Retained earning 574 215 Minority interest 455 306 1678 1072 Non current liability	Share premium	99	99
Retained earning	Revenue reserves	40	40
Minority interest	Exchange equivalent reserve	260	162
Non current liability 1678 1072	Retained earning	574	215
Non-current liability Long term borrowings 265 274 Define benefit obligation 44 30 Current liabilities 309 304 Trade and other payables 1484 202 Short term borrowings 13 1520 Total liabilities 1806 2026 Total against and liabilities 1806 2026 Total against and liabilities 2026 Total against ag	Minority interest	455	306
Long term borrowings 265 274 Define benefit obligation 44 30 Current liabilities 309 304 Trade and other payables 1484 202 Short term borrowings 13 1520 Total liabilities 1806 2026 Total cavity and liabilities 1806 2026		1678	1072
Define benefit obligation	Non-current liability		
Define benefit obligation	Long term borrowings	265	274
309 304	Define benefit obligation		30
Current liabilities 303 Trade and other payables 1484 202 Short term borrowings 13 1520 Total liabilities 1806 2026 Total equity and liabilities 2026			
Short term borrowings	Current liabilities	309	
1497 1722 Total liabilities 1806 2026 Total capity and liabilities	Trade and other payables	1484	202
Total liabilities 2026 Total capity and liabilities	Short term borrowings	13	1520
Total equity and liabilities		1497	1722
Total equity and liabilities 3484 3098	Total liabilities	1806	2026
	Total equity and liabilities	3484	3098



2007

Receivable days = 356/6891*365 = **19 days**

2006

Receivable days = 337/5279*365 = **23 days**

DEBT RATIOS

This ratio measures the debt position of a firm.

The **more debt** the firm has, the **greater its risks** of being unable to meet its contractual
debt payments and becoming bankrupt.

✓ Gearing Ratio

Gearing Ratio

This quantifies the relationships between debt and equity.

Debt includes loans, debentures, bonds and preference Shares.

Higher proportion of debt indicates high risk.

Gearing Ratio = <u>Debt</u> x 100 Equity



Kuruwita Textile Ltd. Balance sheet as at 31st March 2007

Assets	31st March 2007 (000°)	31st March 2006 (000')
	313(3141 CH 2007 (000)	313(March 2000 (000)
Non - current assets		
Property, Plant and equipments	1558	1348
Good will	-	39
Investment in subsidiary	16	-
	1574	1387
Current assets		
Inventories	1288	1225
Current tax receivables	25	12
Trade debtors	356	337
Cash	241	137
	1910	1711
Total assets	3484	3098
Equity and liabilities		
Capital and reserve		
Ordinary Shares	250	250
Share premium	99	99
Revenue reserves	40	40
Exchange equivalent reserve	260	162
Retained earning	574	215
Minority interest	455	306
	1678	1072
Non-current liability		
Long term borrowings		274
Define benefit obligation	265	
	44	30
Current liabilities	309	304
Trade and other payables	1484	202
Short term borrowings	13	1520
_		1722
Total liabilities	1497	2026
Total equity and liabilities	1806	3098
a come and	3484	3098



2007

2006

```
Gearing ratio = 304/1072*100
= 28.36%
```

