Class Notes

Formulas with explanations

Section 2

Part A & B

RATIO	FORMULA	UNIT	COMMENT
Return on Capital Employed **(Profitability)**	<u>Net Profit (Before Interest) x 100</u> Capital Employed	Percentage (%)	1. Should be compare to risk free investments, debentures and preference shares 2. A company is profitable if their ROCE is higher than the return from risk free investments
Return on Shareholders' Equity **(Profitability)**	<u>Net Profit (After Pref Dividend) x 100</u> Ordinary Share Capital + Reserves	Percentage (%)	1. This shows the return to stakeholder after the following have been paid a. Interest b. Taxes and c. Preference Dividends
Current Ratio **(Liquidity)**	Current Assets : Current Liabilities OR <u>Current Assets</u> Current Liabilities	Ratio 2:1	1. This shows if the working capital (CA – CL) is enough to meet the day-to-day cost of the business 2. Recommended ratio is 2:1 3. This means that for every €1 owed by the business in the short term the business has €2 to pay
Acid Test **(Liquidity)**	Current Assets – Closing stock : Current Liabilities OR <u>Current Assets – Closing stock</u> Current Liabilities	Ratio 1:1	1. The acid test ratio doesn't use closing stock as it is hard to convert it to cash quickly 2. A recommended ration is 1:1 3. Any it is a good indicator how liquid a company is

Stock Turnover **(Usually asked in Part A (i))**	<u>Cost of Sales</u> Average Stock	Times	1. This shows the number of times in a year that average stock is sold 2. If this figure is lower, it could be an indicator that the business is slowing down 3. If this figure is high the business could run the risk of running out of stock due to a tight policy
Average Stock **(Usually asked in Part A (i))**	<u>Opening + Closing Stock</u> 2	Euro	
Debtors Collection Period **(Usually asked in Part A (i))**	<u>Debtors x 12/52/365</u> Credit Sales	Months/Weeks/Days	1. This shows that amount of time it takes the business to collect form their debtors 2. The business should collect debt quickly this can be done by given a discount to invoice are paid before the due date
Creditors Collection Period **(Usually asked in Part A (i))**	<u>Creditors x 12/52/365</u> Credit Purchases	Months/Weeks/Days	1. This shows that amount of time it takes the business to pay their creditors (Debts) 2. Having a long credit period can help the business but they will lose out on discount

Gearing Ratio (Total Capital) **(Gearing)**	Loan + debenture + Preference Shares x 100 Capital Employed	Percentage (%)	1. Lowly geared company = fixed interest is less than 50% 2. Highly geared company = fixed interest if higher than 50% 3. It's important that is business is not too dependent on outside finance (Borrowings) 4. As interest and dividend (Pref) must be paid even if a profit is not made
Gearing Ratio (Equity Capital **(Gearing)**	Loan + debenture + Preference Shares x 100 Ordinary Shares issued + Reserves	Percentage (%)	1. Lowly geared company = fixed interest is less than 50% 2. Highly geared company = fixed interest if higher than 50% 3. It's important that is business is not too dependent on outside finance (Borrowings 4. As interest and dividend (Pref) must be paid even if a profit is not made
Interest Cover **(Gearing)**	Net Profit Before Interest and Tax Interest for the year	Times	1. This means the firms has money available for expansion, paying dividends and paying interest/loans 2. It should be compared to the recommended ratio of 3:1
Dividend Cover **(Dividend Policy)**	Net Profit (After Tax & Preference Dividend) Ordinary Dividends	Times	1. This indicates the amount of earning/profit are being retained by the business 2. Retained earnings help to increase share value – shareholder like to see a high dividend cover because of this. It show the risk to dividend if profits decrease

Dividend Yield **(Dividend Policy)**	$\frac{\text{DPS x 100}}{\text{Market Value per Share}}$	Percentage (%)	1. This shows the return to shareholders form their investment 2. It should be compared to risk free investments, debentures, and preference share
Dividend Per Share (DPS) **(Dividend Policy)**	$\frac{\text{Ordinary Dividends}}{\text{Ordinary Shares issued}}$	Cent	1. This is the amount of dividend ordinary shareholders will receive per share owned
Dividend Pay-out **(Dividend Policy)**	$\frac{\text{DPS x 100}}{\text{EPS}}$	Percentage (%)	1. The is the percentage of profit that is paid out to shareholders 2. Is should be as close to 50% as possible
Earnings Per Share (EPS) **(Share performance)**	$\frac{\text{Net Profit (After Preference Dividend Paid)}}{\text{Number of Ordinary Shares}}$	Cent	1. This shows the profit coming from each ordinary share 2. It is expressed as a percentage 3. It shows investors how well their investment is being used

P/E Ratio **(Share Performance)**	<u>Market Price Per Share</u> Earnings Per Share	Years	1. This shows how long it will take a shareholder to get their investment back 2. It is expressed in years