

Assessing a Business

Summary of Ratios

| Category | Name of Ratio | Formula | Ideal Result | Comment |
|---------------|----------------------|--|---|---|
| Profitability | Gross Margin | $\frac{\text{Gross Profit}}{\text{Sales}} \times \frac{100}{1}$ | As high as possible | Also known as the Gross Profit Percentage |
| Profitability | Net Margin | $\frac{\text{Net Profit}}{\text{Sales}} \times \frac{100}{1}$ | As high as possible | Also known as the Net Profit Percentage |
| Profitability | Return on Investment | $\frac{\text{Net Profit}}{\text{Capital Employed}} \times \frac{100}{1}$ | Greater than the return on a Bank Account | Also known as the Return on Capital Employed |
| Liquidity | Current Ratio | Current Assets : Current Liabilities | At least 1.5:1 | Also known as the Working Capital ratio |
| Liquidity | Quick Ratio | Current Assets - Stock : Current Liabilities | At least 1:1 | Also known as the Acid Test ratio |
| Gearing | Gearing | $\frac{\text{Fixed Interest Capital}}{\text{Equity Capital}} \times \frac{100}{1}$ | >50% High <50% Low =50% Neutral | Also known as the Leverage or Debt ratio |

Notes:

1. **Capital Employed** = Ordinary Share Capital (Issued) + Preference Share Capital (Issued) + Reserves + Long Term Liabilities
2. **Fixed Interest Capital** = Preference Share Capital (Issued) + Long Term Liabilities
3. **Equity Capital** = Ordinary Share Capital (Issued) + Reserves
4. A **Debenture Loan** is a long-term loan.
5. As well as knowing how to calculate the above ratios, you must also be able to **comment** on the ratio and be able to explain how all the **stakeholders** would use these ratios.