

Specification Topic - Ratio analysis (2)

Q1	Fill in the gaps
<p>There are several types of _____ ratios which can help analyse different aspects of financial performance.</p> <p>Gearing looks at the proportion of _____ which is borrowed and is a key indicator of both risk and how new sources of finance could be raised. If interest rates rise, it can be very difficult for a highly geared firm to cope with _____.</p> <p>However, ratios need to be taken in context – for example a highly geared firm may still cope with high _____ rates, as long as it has healthy liquidity. Therefore, by looking at more ratios like the current and _____ test ratio, the analyst can draw clearer conclusions.</p> <p>Performance or profitability ratios show the relative success of the business. There are a host of these ratios such as ROCE, _____ profit margin, gross profit and profit for the year margin.</p>	
<p>Choose from: acid; operating; repayments; interest; capital; financial</p>	

Q2	Match the ratio with the correct statement below	
	Acid test ratio	A. Over 50% is deemed high and may leave the business at risk if interest rates rise
	Gearing ratio	B. Should be between 1.5:1 and 2:1; over 2:1 would show inefficient use of cash that might be better invested
	Gross profit margin	C. This should be well above bank interest rates; many text books suggest over 20% is an acceptable level
	Return on capital employed (ROCE)	D. 0.7:1 is fairly typical for a retailer
	Current ratio	E. The higher the better; can be increased by lowering cost of sales

Q3	Briefly explain why...
	<p>3.1 Accountants often try to “window dress” financial accounts</p> <p>3.2 A retailer like Morrisons may be able to survive with an acid test ratio of 0.4:1</p>

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Q4	<p>Calculation time! Based on the selected financial information for Windermere Boats Ltd, calculate the following for both years and comment on the results...</p>										
	<p>This year £'000</p>	<p>Last year £'000</p>									
	Operating profit	66	76								
	Revenue	680	620								
	Current assets	680	660								
	Inventory	340	440								
	Current liabilities	440	380								
	<p>4.1 Current ratio</p> <table border="1" style="width: 100%;"> <thead> <tr> <th style="width: 30%;"></th> <th style="width: 35%; text-align: center;">This Year</th> <th style="width: 35%; text-align: center;">Last Year</th> </tr> </thead> <tbody> <tr> <td> <p>Calculation: (show your workings)</p> </td> <td></td> <td></td> </tr> <tr> <td> <p>Comment:</p> </td> <td colspan="2"></td> </tr> </tbody> </table>			This Year	Last Year	<p>Calculation: (show your workings)</p>			<p>Comment:</p>		
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	<p>4.2 Acid test ratio</p> <table border="1" style="width: 100%;"> <thead> <tr> <th style="width: 30%;"></th> <th style="width: 35%; text-align: center;">This Year</th> <th style="width: 35%; text-align: center;">Last Year</th> </tr> </thead> <tbody> <tr> <td> <p>Calculation: (show your workings)</p> </td> <td></td> <td></td> </tr> <tr> <td> <p>Comment:</p> </td> <td colspan="2"></td> </tr> </tbody> </table>			This Year	Last Year	<p>Calculation: (show your workings)</p>			<p>Comment:</p>		
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	<p>4.3 Operating profit margin</p> <table border="1" style="width: 100%;"> <thead> <tr> <th style="width: 30%;"></th> <th style="width: 35%; text-align: center;">This Year</th> <th style="width: 35%; text-align: center;">Last Year</th> </tr> </thead> <tbody> <tr> <td> <p>Calculation: (show your workings)</p> </td> <td></td> <td></td> </tr> <tr> <td> <p>Comment:</p> </td> <td colspan="2"></td> </tr> </tbody> </table>			This Year	Last Year	<p>Calculation: (show your workings)</p>			<p>Comment:</p>		
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Q5	Give me 3...
5.1 ways ratios should be compared to make them meaningful	
1.	
2.	
3.	
5.2 limitations of using financial ratios	
1.	
2.	
3.	
5.3 ratios that could help a firm to decide how best to raise new finance for expansion	
1.	
2.	
3.	