FINANCIAL STATEMENT INTERPRETATION - ANSWERS

Analyse Plc (note market value of share for previous year $2.85)

1. Completed ratio table:

	Workings	2015	Workings	2014
Return on capital employed (ROCE)	(1195 + 328)/(10147 – 3242)	22.1%		15.9%
Net profit margin	1523/21750	7.0%		6.8%
Net asset turnover	21750/(10147-3242)	3.15		2.33
Gross profit margin	4133/21750	19.0%		21.0%
Debtor days	2385/21750 x365	40 days		35 days
Creditor days	595/17617 x365	13 days		13 days
Stock days	1207/17617 x365	25 days		20 days
Cash conversion cycle	40 + 25 - 13	52 days		43 days
Fixed asset turnover	21750/6425	3.39		3.14
Current ratio	3722/3242	1.15		2.67
Quick ratio	(3722-1207)/3242	0.77		2.01
Capital gearing ratio	1300/(1650+5255)	18.8%		19.9%
Debt/equity ratio	1300/5255	24.7%		26.1%
Interest cover	1523/328	4.64		8.00
Return on equity	875/5255	16.7%	650/4980	13.1%
Dividend per share (DPS)	600/3000	0.20		0.20
Earnings per share (EPS)	875/3000	0.29		0.22
Dividend cover	875/600	1.45	650/600	1.08
Price/earnings ratio (PE ratio)	4.80/0.29	16.6	2.85/0.22	13.00
Payout ratio	600/875 or (0.20/.29)	68.6%	600/650	92.3%
Dividend yield	0.20/4.80	4.2%	0.20/2.85	7%
Earnings yield	0.29/4.80	6.0%	0.22/2.85	7.7%

2. An **equity investor** would be most interested in the following ratios:

	workings	2015	workings	2014
Debt/equity ratio		24.7%		26.1%
Interest cover		4.64		8.00
Return on equity		16.7%		13.1%
Dividend per share (DPS)		0.20		0.20
Earnings per share (EPS)		0.29		0.22
Dividend cover		1.45		1.08
Price/earnings ratio		16.6		13.0
Payout ratio		68.6%		92.3%
Dividend yield		4.2%		7.1%
Earnings yield		6.0%		7.8%

The gearing ratios have all been affected by the increased use of short-term borrowing to fund the new project started in 2015. The company pays a constant dividend per share in 2014 and 2015, but the increased profits from the new project have caused Return on Equity, EPS and dividend cover to improve. The market is optimistic about the company and this has caused the PE ratio to rise. The increased market value has caused a decrease in the dividend yield and the earnings yield of the company.

A **long-term lender** would be most interested in the following ratios:

		2015		**2014**
Debt/equity ratio		24.7%		26.1%
Interest cover		4.64		8.00
Current ratio		1.15		2.67

As stated above the increased use of short-term borrowings has improved the gearing ratio, but has had a detrimental effect on interest cover. Lenders may also be concerned with the decrease in liquidity caused by the increase in short-term borrowings.

An **operations director** would be most interested in the following ratios:

		2015		**2014**
Return on capital employed (ROCE)		22.1%		15.9%
Net profit margin		7.0%		6.8%
Net asset turnover		3.15		2.33
Gross profit margin		19.0%		21.0%
Debtor days		40.0 days		35.0 days
Creditor days		12.3 days		12.3 days
Stock days		25.0 days		20.0 days
Cash conversion cycle		52.7 days		42.7 days
Fixed asset turnover		3.39		3.14
Current ratio		1.15		2.67
Quick ratio		0.77		2.01
Capital gearing ratio		18.8%		19.9%

The profitability ratios have all improved except for the gross profit margin. This could indicate that the new sales are being made at lower margins (e.g. loss-leaders) in order to stimulate demand. As costs have not risen to the same extent as sales, net profit margins have improved.

The activity ratios for assets have all worsened indicating that more cash is tied up in the business. Creditors are still being paid at the same time as previously which also affects cash-flow. These increases could be a timing effect with high credit sales and purchases in the last quarter of the year.

The effect of the above and also the increase in short-term borrowings have had a detrimental effect on liquidity. If this is a long-term phenomenon, then the company should consider more long-term debt which is usually cheaper.

Other information:

More historic information would be useful, as would ratios from competitors or from similar companies in the same industry sector. Sight of budgeted results would also be useful as this would enable investors to see whether management had control over the company's operations.