

FINANCIAL STATEMENT ANALYSIS

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What is Financial Statements Analysis (FSA)?

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Understanding

Relationships
in Financial
Statements Figures

Trends
in these
Relationships

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Syllabus Overview

FSA Techniques

Ratios

Analyzing

Advise Stakeholders

Limitations

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FSA Techniques

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FSA Techniques

Vertical
Trend
Analysis

Horizontal
Trend
Analysis

Common
Size Financial
Statements

Ratio
Analysis

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Vertical and Horizontal Trend Analysis

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Horizontal Trend Analysis

- YEAR on YEAR variance analysis
- To identify TRENDS

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Factors that Affect Horizontal Trends

Major Transactions	<ul style="list-style-type: none"> • Mergers – Glaxco merging with Smith Kline • Acquisitions – Browns (LOLC) acquired Serendib Hotels PLC (Hemas)
An Incident	<ul style="list-style-type: none"> • Natural Disasters – Floods Affecting Farming • Easter Sunday attack impacts Tourism Sector • Corona impact on all the business
Macro Economic Changes	<ul style="list-style-type: none"> • Changes in Sri Lankan Political Power • Changes in Tax Law (VAT reduction, NBT Waiving)
Changes in Accounting Estimates	<ul style="list-style-type: none"> • Changing depreciation method • Changing warranty provisions

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Vertical Trend Analysis

- Analyze SAME YEAR financials
- with an EQUIVALENT COMPETITOR

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Factors that affect Vertical Trend Analysis

Difficulties in finding an equivalent competitor in terms of

- Business Strategy
- Business Scope
- Life Cycle Stage
- Geographic coverage
- Financial Year End
- Accounting Policies and Estimates

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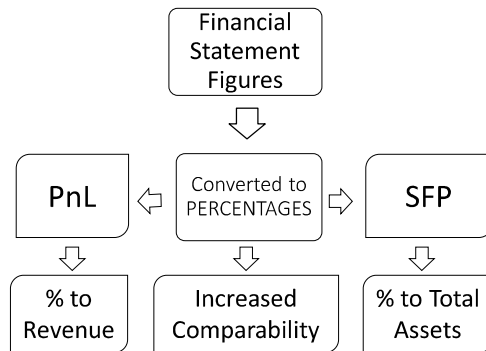
Common Size Financial Statements

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Common Size Financial Statements



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Common Size Financial Statements

Q01

Prepare the Common Size Financials and analysis report for a potential investor on Nawaloka Hospitals Corporation PLC and Durdans Hospitals PLC for the Year ended 31/3/20X9

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SFP @ 31/3/X9

Rs.Mn	Nawaloka	Durdans
Non-Current Assets		
Property Plant and Equipment	14,063	6,959
Other Non-Current Assets	20	82
Total Non-Current Assets	14,083	7041
Current Assets		
Inventory	489	309
Trade and Other Receivables	1,327	385
Other Financial Assets	284	659
Cash and Cash Equivalents	158	405
Total Current Assets	2,258	1,756
Total Assets	16,341	8,797

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Rs.Mn	Nawaloka	Durdans
Equity		
Stated Capital	1,208	916
Other Components of Equity	1,084	1,989
Retained Earnings	1,317	2,238
Total Equity	3,609	5,143
Non-Current Liabilities		
Interest Bearing Borrowings	6,383	593
Employee Benefits	246	228
Deferred Tax Liabilities	1,051	736
Total Non-Current Liabilities	7,680	1,556
Current Liabilities		
Trade and Other Payables	1,689	555
Bank Overdraft	1,625	755
Interest Bearing Borrowings	1,738	222
Total Current Liabilities	5,052	1,532
Total Liabilities	16,341	8,797

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Profit or Loss F/T/Y/E 31/3/20X9

Rs.Mn	Nawaloka	Durdans
Revenue	8,756	5,806
Cost of Service	(4,365)	(2,181)
Gross Profit	4,390	3,625
Other Income	343	118
Admin Expenses	(3,761)	(2,514)
Other Expenses	(73)	(545)
Finance Cost	(1,289)	(136)
Profit Before Tax	(389)	549
Tax	(176)	(173)
Profit After Tax	(565)	376

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Drawbacks in Common Size Financials

Difficulties in finding an equivalent competitor in terms of

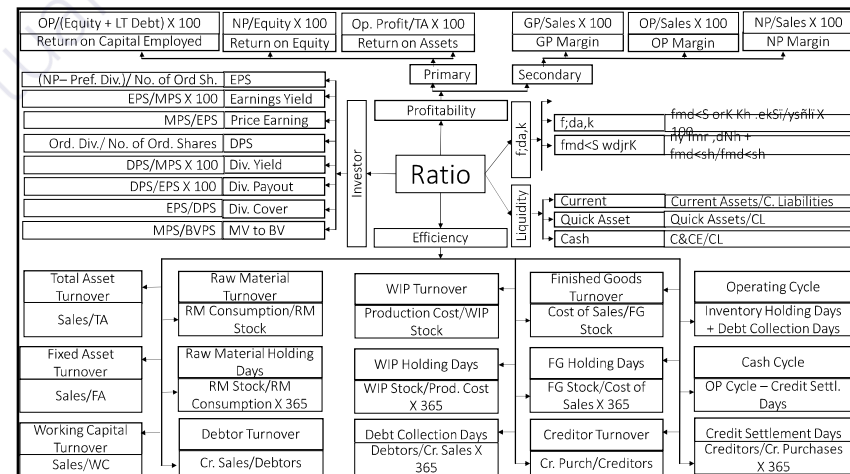
- Business Strategy
- Business Scope
- Life Cycle Stage
- Geographic coverage
- Financial Year End
- Accounting Policies and Estimates

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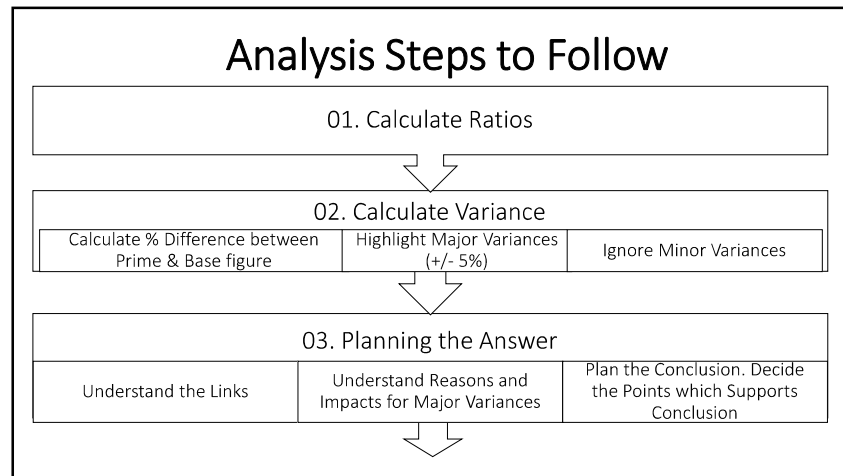
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Ratio Analysis

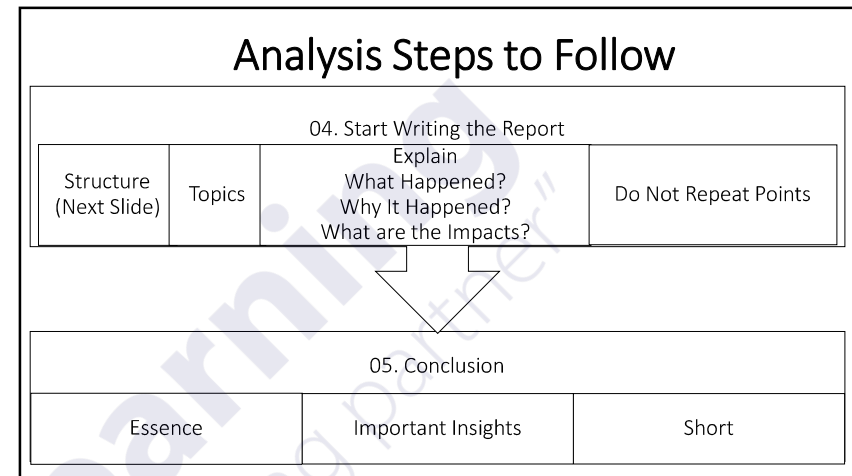


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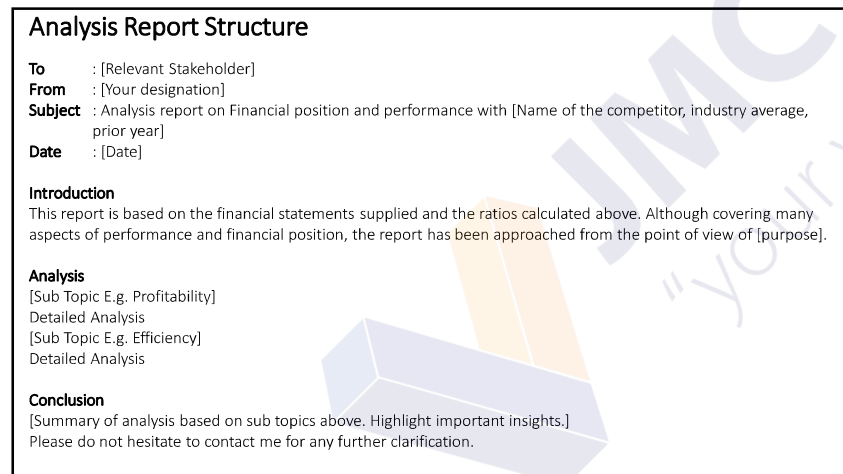
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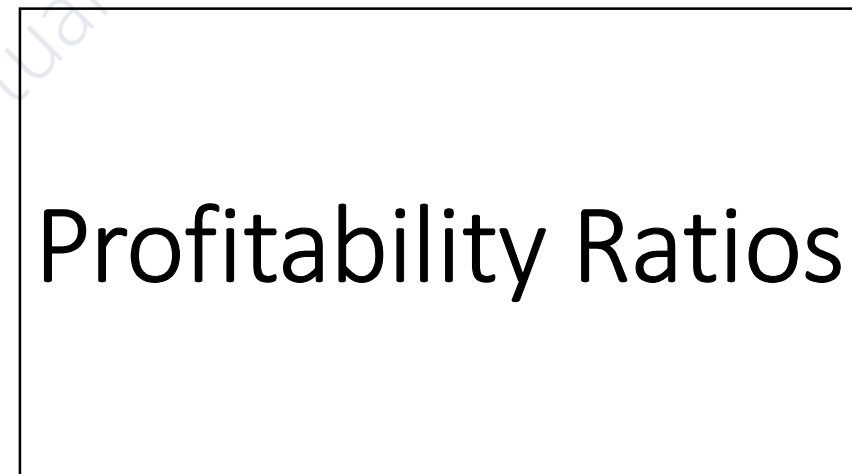
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Secondary Profitability Ratios

Gross Profit Margin

- $\text{Gross Profit/Sales} \times 100$

Operating Profit Margin

- $\text{Operating Profit/Sales} \times 100$

Net Profit Margin

- $\text{Profit Before Tax/Sales} \times 100$

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GP Margin

Point	Explanation
Definition	Per rupee sales how much of Gross profits were generated
Reflects	Manufacturing efficiency and effectiveness of pricing strategy
Higher the ratio	Higher the manufacturing efficiency Differences in pricing strategies
How to increase ratio	<ul style="list-style-type: none"> • Increase Sales <ul style="list-style-type: none"> ◦ Changes to pricing strategy ◦ Effective marketing ◦ Target driven sales • Reduce cost of sales <ul style="list-style-type: none"> ◦ Eliminate or exchange idle and unnecessary PPE ◦ Economies of scale ◦ Budgetary controls to reduce the cost ◦ Use of technology to reduce overheads ◦ Waste management
Remarks	<ul style="list-style-type: none"> • Higher gross profit margin enables higher ability to cover the admin, sales and other overheads. • GP margin does not have a standard limit. It depends on industry. <ul style="list-style-type: none"> ◦ E.g. GP margin for trading < manufacturing industry

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OP Margin

Point	Explanation
Definition	Per rupee sales how much of Operating profits were generated
Reflects	Operational efficiency and effectiveness in operations management
Higher the ratio	Higher the operational efficiency and effectiveness in management
How to increase ratio	<ul style="list-style-type: none"> • Increase Sales <ul style="list-style-type: none"> ◦ Effective marketing ◦ Target driven sales ◦ Changes to pricing strategy • Reduce Expenses <ul style="list-style-type: none"> ◦ Eliminate or exchange idle and unnecessary assets ◦ Economies of scale ◦ Budgetary controls to reduce the cost ◦ Use of technology to reduce overheads ◦ Waste management
Remarks	<ul style="list-style-type: none"> • OP margin does not have a standard limit. It depends on industry

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NP Margin

Point	Explanation
Definition	Per rupee sales how much of Net profits were generated
Reflects	Overall efficiency and effectiveness in management
Higher the ratio	Higher the efficiency and management Higher savings for company growth Higher ability to declare dividends
How to increase ratio	<ul style="list-style-type: none"> • Increase Sales <ul style="list-style-type: none"> ◦ Effective marketing ◦ Target driven sales ◦ Changes to pricing strategy • Reduce Expenses <ul style="list-style-type: none"> ◦ Eliminate or exchange idle and unnecessary assets ◦ Economies of scale ◦ Budgetary controls to reduce the cost ◦ Use of technology to reduce overheads ◦ Waste management ◦ Reschedule the existing borrowings at higher rates ◦ Tax planning
Remarks	<ul style="list-style-type: none"> • NP margin does not have a standard limit. It depends on industry

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Return Ratios

Return on Capital Employed (ROCE)	$\frac{\text{Operating Profit}}{\text{Capital Employed}} \times 100$
Return on Assets (ROA)	$\frac{\text{Operating Profit}}{\text{Total Assets}} \times 100$
Return on Equity (ROE)	$\frac{\text{Profit After Tax}}{\text{Equity}} \times 100$

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ROCE

Point	Explanation
Definition	Per rupee capital employed how much of operating profit were generated
Higher the ratio	<ul style="list-style-type: none"> Higher return for capital employed investment Higher value created to financial providers
How to increase ratio	<ul style="list-style-type: none"> Increase earnings <ul style="list-style-type: none"> Effective marketing, branding etc. Target driven sales, incentives Cost reduction through economies of scale and controls Reduce capital employed <ul style="list-style-type: none"> Reducing the debt capital Eliminate or exchange idle and unnecessary assets Rent out assets than purchasing
Remarks	<ul style="list-style-type: none"> ROCE should be > company's Finance cost. Otherwise it indicates that, the company is not employing its capital efficiently and is not generating shareholder value The EBIT is taken as the numerator as it reflects the returns (Profit before tax and Interest) to parties reflected under denominator (Shareholders & LT debt providers)

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ROE

Point	Explanation
Definition	Per rupee equity how much of net profits were generated
Reflects	How well equity capital invested was able to generate profits
Higher the ratio	More efficient use of equity capital in generating profits
How to increase ratio	<ul style="list-style-type: none"> Increase earnings <ul style="list-style-type: none"> Effective marketing Target driven sales Cost reduction through controls Tax planning strategies Reduced finance cost
Remarks	<ul style="list-style-type: none"> The Net profit after preference dividend is taken as the numerator as it reflects the return due to shareholders This ratio is not widely used

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ROA

Point	Explanation
Definition	Per rupee total assets how much of operating profits were generated
Reflects	How well total assets were able to generate an operating profit
Higher the ratio	More efficient use of total assets in generating profits
How to increase ratio	<ul style="list-style-type: none"> Increase earnings <ul style="list-style-type: none"> Effective marketing Target driven sales Cost reduction through controls Reduce Total assets <ul style="list-style-type: none"> Eliminate or exchange idle and unnecessary assets Rent out assets than purchasing
Remarks	<ul style="list-style-type: none"> The EBIT is taken as the numerator as EBIT reflects the returns (Profit before tax and Interest) due to parties reflected under denominator (Shareholders and Debt providers) Return on Investment (ROI) and ROA both have similar meaning.

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Profitability Ratios

Q02

Prepare a Profitability Ratio analysis report for a potential investor on Kingsbury PLC and Cinnamon Lakeside PLC for the Year ended 31/3/20X9

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SFP @ 31/3/X9

Rs.Mn	Kingsbury	Lakeside
Non-Current Assets		
Property Plant and Equipment	3,707	7,061
Other Non-Current Assets	-	7
Total Non-Current Assets	3,707	7,068
Current Assets		
Inventory	70	36
Trade and Other Receivables	157	594
Other Financial Assets	124	65
Cash and Cash Equivalents	253	51
Total Current Assets	605	746
Total Assets	4,312	7,814

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Rs.Mn	Kingsbury	Lakeside
Equity		
Stated Capital	836	1,113
Other Components of Equity	826	1,528
Retained Earnings	912	3,803
Total Equity	2,574	6,444
Non-Current Liabilities		
Interest Bearing Borrowings	551	33
Employee Benefits	65	142
Deferred Tax Liabilities	271	381
Total Non-Current Liabilities	887	555
Current Liabilities		
Trade and Other Payables	389	576
Bank Overdraft	71	104
Interest Bearing Borrowings	392	133
Total Current Liabilities	852	814
Total Liabilities	4,312	7,814

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Profit or Loss F/T/Y/E 31/3/20X9

Rs.Mn	Kingsbury	Lakeside
Revenue	2,956	2,825
Cost of Service	(1,526)	(1,169)
Gross Profit	1,430	1,657
Other Income	9	179
Admin Expenses	(1,020)	(692)
Marketing Expenses	(151)	(293)
Other Expenses	(29)	(269)
Finance Cost	(66)	(58)
Profit Before Tax	173	524
Tax	(72)	(53)
Profit After Tax	101	471

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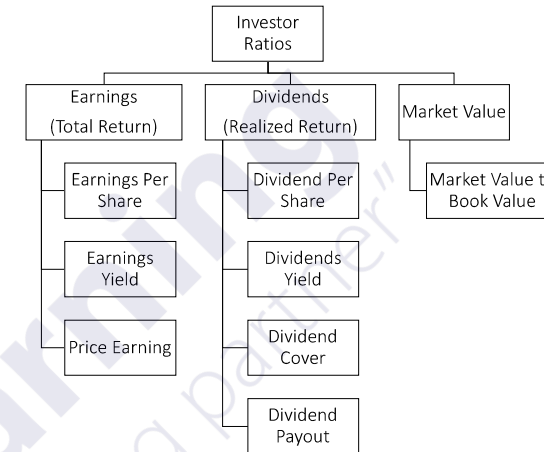
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Investor Ratios

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Earnings based Ratios

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Earning Based Ratios

Earnings Per Share (EPS)	Profits Attributable for Ord Shareholders
	Weighted Average Number of Ord Shares

Earnings Yield	$\frac{\text{EPS}}{\text{Market Price Share}} \times 100$
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Price Earning (PE)	$\frac{\text{MPS}}{\text{EPS}}$
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EPS

Point	Explanation
Definition of Ratio	Per ordinary share, how much of earnings has been generated
Reflects	Distribution of Earnings among the Ordinary Shareholders
Higher the ratio	<ul style="list-style-type: none"> • Higher earnings generated for ordinary shareholders • Higher ability to pay dividends
How to increase the ratio	<ul style="list-style-type: none"> • Increase earnings <ul style="list-style-type: none"> ○ Increase sales ○ Reduce expenses ○ Reduce interest and tax expenses
Remarks	<ul style="list-style-type: none"> • The EPS helps in conducting valuations of companies. (PE based pricing method)

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Earnings Yield

Point	Explanation
Definition of Ratio	Per rupee investment, how much of earnings will be generated
Reflects	<ul style="list-style-type: none"> • Earnings potential • Relationship between EPS (Return) to Market Price per Share (Cost)
Higher the ratio	<ul style="list-style-type: none"> • Higher earnings for Investment
How to increase the ratio	<ul style="list-style-type: none"> • Increase earnings <ul style="list-style-type: none"> ○ Increase sales ○ Reduce expenses ○ Reduce interest and tax expenses

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Price Earning

Point	Explanation
Definition of Ratio	Number of times of Earnings required to recover the investment (Investment Recovery Period)
Reflects	<ul style="list-style-type: none"> • Investors faith over growth potential • Investor's Risk Appetite
Higher the ratio	<ul style="list-style-type: none"> • Investors are having growth prospects about the company • Mature Company
Lower the ratio	<ul style="list-style-type: none"> • Either <ul style="list-style-type: none"> ○ Company is doing exceptionally well in return ○ Company may be undervalued
Remarks	<ul style="list-style-type: none"> • PE is used in investment selections

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Dividends based Ratios

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Dividends Based Ratios

Dividend Per Share (DPS)	$\frac{\text{Ordinary Share Dividends}}{\text{Weighted Average Number of Ord Shares}}$
Dividend Yield	$\frac{\text{DPS}}{\text{Market Price Share}} \times 100$
Dividend Cover	$\frac{\text{EPS}}{\text{DPS}}$
Dividend Payout	$\frac{\text{DPS}}{\text{EPS}} \times 100$

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Dividends Per Share

Point	Explanation
Definition of Ratio	Per Share How much of Dividend Paid (Realized Return)
Reflects	<ul style="list-style-type: none"> Dividend received to Single share
Higher the ratio	<ul style="list-style-type: none"> Dividend seeking investors get encouraged Affect the growth, as dividend is a cash outflow
How to increase the ratio	<ul style="list-style-type: none"> Increase amount of dividend paid

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Dividends Yield

Point	Explanation
Definition of Ratio	Per rupee investment (Cost) how much of dividends (Realized Return) being paid
Reflects	<ul style="list-style-type: none"> Dividend payout per market price
Higher the ratio	<ul style="list-style-type: none"> Investors gets encouraged Affect the growth, as dividend is a cash outflow
How to increase the ratio	<ul style="list-style-type: none"> Increase dividends

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Dividend Cover

Point	Explanation
Definition of Ratio	How many times dividends can be paid out of the earnings
Reflects	<ul style="list-style-type: none"> Dividend coverage over earnings Dividend policy
Higher the ratio	<ul style="list-style-type: none"> Investors are discouraged as low dividend paid Beneficial for the growth
How to increase the ratio	<ul style="list-style-type: none"> Reduce dividends

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Dividend Payout

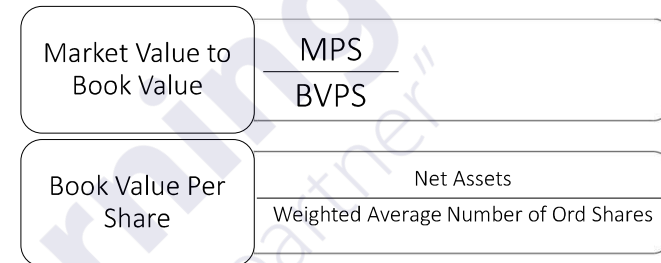
Point	Explanation
Definition of Ratio	How much of earnings are being distributed among ordinary shareholders.
Reflects	<ul style="list-style-type: none"> Dividend policy Retention of earnings (1 – Dividend payout)
Higher the ratio	<ul style="list-style-type: none"> Investors are encouraged Affect the growth
How to increase the ratio	<ul style="list-style-type: none"> Increase dividends

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Market Value to Book Value



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Market Value to Book Value

Point	Explanation
Definition of Ratio	How many times market value is higher than book value
Reflects	<ul style="list-style-type: none"> Market value compared to book value Asset impairments if any Availability of off-balance sheet assets and liabilities
Higher the ratio	<ul style="list-style-type: none"> Existence of off-balance sheet assets Undervaluation of assets
How to increase the ratio	<ul style="list-style-type: none"> Fair value assets Recognize off balance sheet assets
Remarks	<ul style="list-style-type: none"> Book value per share will be calculated as follows <ul style="list-style-type: none"> Book value of Net assets/ Weighted average number of shares

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Q03

Prepare an analysis on investor ratios for Three Acre Farms PLC and Bairaha Farms PLC on Latest Financials available.

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Profit or Loss

Rs.Mn	Bairaha	Three Acre
Revenue	4,723	2,626
Cost of Sales	(3,648)	(1,911)
Gross Profit	1,076	715
Other Income	74	218
Admin Expenses	(263)	(12)
Distribution Expenses	(302)	(25)
Finance Cost	(76)	-
Profit Before Tax	510	896
Tax	(97)	(147)
Profit After Tax	413	749

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Rs.Mn	Bairaha	Three Acre
Non-Current Assets		
Property Plant and Equipment	2,196	1,397
Biological Assets	52	556
Investments	920	0
Total Non-Current Assets	3,168	1,953
Current Assets		
Biological Assets	478	18
Inventory	216	111
Trade and Other Receivables	631	324
Short Term Investments	39	0
Cash and Cash Equivalents	429	1,956
Total Current Assets	1,792	2,410
Total Assets	4,960	4,363

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Rs.Mn	Bairaha	Three Acre
Equity		
Stated Capital	256	626
Other Reserves	413	0
Retained Profits	3,197	3,014
Total Equity	3,866	3,637
Non-Current Liabilities		
Interest Bearing Borrowings	298	0
Employee Benefits	79	22
Deferred Tax Liabilities	164	209
Total Non-Current Liabilities	541	221
Current Liabilities		
Trade and Other Payables	366	495
Interest Bearing Borrowings	187	0
Total Current Liabilities	553	495
Total Liabilities	4,960	4,363

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Other Information required

Rs.Mn	Bairaha	Three Acre
Gross Dividend	112	71
Market Price Per Share	115	101
No. of Shares (Mn)	16	24

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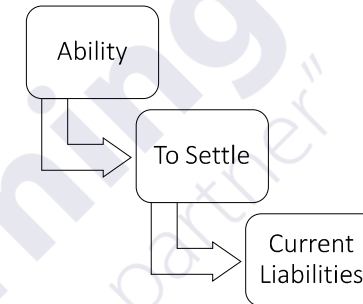
Liquidity Ratios

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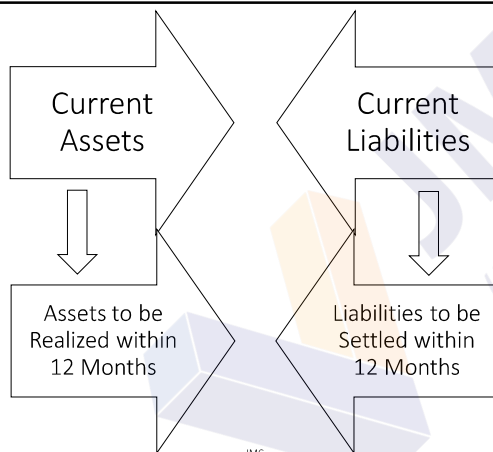
Liquidity Ratios



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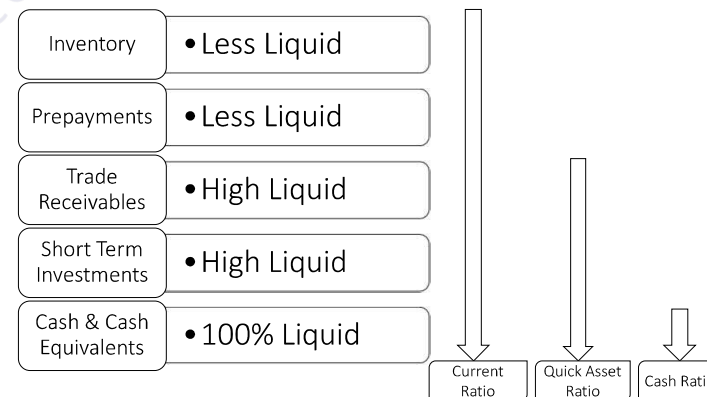


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Different Types of Current Assets



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Liquidity Ratios (Times)

Current Ratio

Current Assets
Current Liabilities

Quick Asset Ratio

Quick Assets
Current Liabilities

Cash Ratio

Cash and Cash Equivalents
Current Liabilities

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Current Ratio

Point	Explanation
Definition	Per rupee Current Liability how much of Current Assets are available
Reflects	Adequacy of current assets to settle current liabilities
Higher the ratio	Strong ability to settle current liabilities Strong liquid position
How to increase ratio	<ul style="list-style-type: none"> • Reduce current liabilities <ul style="list-style-type: none"> ◦ Reschedule existing borrowings ◦ Overcome investments in non-current assets using short term loans ◦ Dispose idle and unnecessary assets and settle loans taken at higher rates ◦ Rent out properties than purchasing • Increase current assets <ul style="list-style-type: none"> ◦ Increase sales ◦ Strengthen recoveries from debtors
Remarks	<ul style="list-style-type: none"> • There's no specific standard or norm for current ratio. Depending on industry and company's power it may vary ◦ E.g. Higher current ratio in manufacturing entity compared to lower current ratio in service entity

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Quick Asset (Acid Test) Ratio

Point	Explanation
Quick Assets	Current Assets – Inventory - Prepayments
Definition	How much of Quick Assets available, per rupee Current Liability
Reflects	Adequacy of quick assets to settle current liabilities
Higher the ratio	Strong ability to settle current liabilities Stronger Liquidity position
How to increase ratio	<ul style="list-style-type: none"> • Reduce current liabilities <ul style="list-style-type: none"> ◦ Reschedule existing borrowings ◦ Overcome investments in non-current assets using short term loans ◦ Dispose idle and unnecessary assets and repay the loans taken at higher interest rates ◦ Rent out properties than purchasing • Increase current assets <ul style="list-style-type: none"> ◦ Increase sales ◦ Strengthen recoveries from debtors
Remarks	<ul style="list-style-type: none"> • There's no standard or norm. Depending on industry and company's power it may vary

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Cash Ratio - Explanation

Point	Explanation
Definition of Ratio	How much of Cash and Cash Equivalents available, per rupee Current Liability
Reflects	Adequacy of cash to settle current liabilities
Higher the ratio	Strong ability to service current liabilities Stronger Liquidity position
How to increase ratio	<ul style="list-style-type: none"> • Reduce current liabilities <ul style="list-style-type: none"> ◦ Reschedule existing borrowings ◦ Overcome non-current asset investments using short term loans ◦ Dispose idle and unnecessary assets and repay the loans taken at higher interest rates ◦ Rent out properties than purchasing

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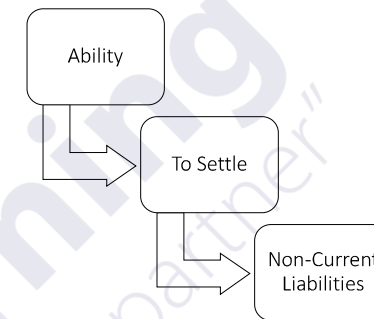
Leverage Ratios

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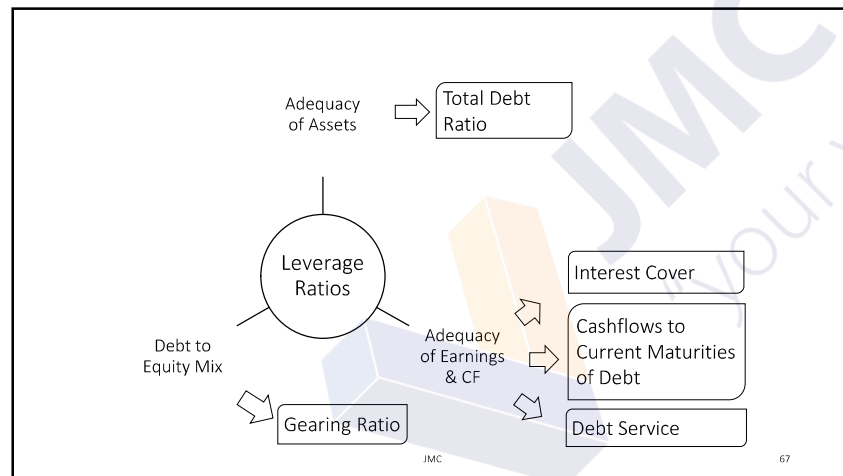
Leverage Ratios



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Leverage Ratios

Total Debt
Ratio

$$\frac{\text{Total Assets} - \text{Equity}}{\text{Total Assets}} \times 100$$

Gearing
Ratio

$$\frac{\text{Interest Bearing Borrowings}}{\text{Equity}} \times 100$$

Gearing
Ratio

$$\frac{\text{Interest Bearing Borrowings}}{\text{Equity} + \text{Interest Bearing Borrowings}} \times 100$$

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Leverage Ratios

Interest
Cover

Operating Profit

Interest Expense

Cashflows to
Current Maturities
of Debt

Earnings Before Interest, Tax, Depreciation &
Amortization (EBITDA)

Current Portion of Long Term Debt

Debt
Service

EBITDA

Interest + Current Portion of Long Term Debt

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Total Debt Ratio

Point	Explanation
Definition	<ul style="list-style-type: none"> Per rupee Total Asset, how much of Debt Financing has been used Availability of Assets to cover Total Debt
Reflects	<ul style="list-style-type: none"> Proportion of Total Assets financed through Debt Long term solvency
Lower the ratio	<ul style="list-style-type: none"> Lower solvency risk (inability to meet financial obligations) Lower risk of obtaining further loans Higher retained earnings due to lower interest charge Not beneficial for a growth oriented entity. As interest is a fixed expense. Despite losses amount need to be paid
How to reduce the ratio	<ul style="list-style-type: none"> Reduce Debt financing <ul style="list-style-type: none"> Rent out assets than purchasing Eliminate or exchange idle and unnecessary assets and utilize those funds to settle debts Increase Equity <ul style="list-style-type: none"> Increased earnings (Increase sales and reduce expenses) Raise capital from shares or rights issues and utilize those funds to settle debt at higher cost

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Gearing Ratio

Point	Explanation
Definition	Per rupee Equity Capital, how much of Debt Capital is available or Per rupee Capital Employed how much of Debt capital is available
Reflects	Debt to equity composition of an entity Long term solvency
Lower the ratio	<ul style="list-style-type: none"> Lower solvency risk Lower risk of obtaining further loans Higher retained earnings due to lower interest charge Not beneficial for a growth oriented entity. As interest is a fixed expense. Despite losses amount need to be paid
How to reduce the ratio	<ul style="list-style-type: none"> Reduce Debt financing <ul style="list-style-type: none"> Reschedule the existing debt at a lower rate Rent out assets than purchasing Eliminate or exchange idle assets and utilize those funds to settle debts Increase Equity <ul style="list-style-type: none"> Increased earnings (Increase sales and reduce expenses) Raise capital from shares or rights issues and utilize those funds to settle debt at higher cost

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Gearing Ratio

Point	Explanation
Remarks	<ul style="list-style-type: none"> If the gearing ratio is calculated using following formula $\text{Interest Bearing Debt} / (\text{Equity} + \text{Interest Bearing Debt}) * 100$ <ul style="list-style-type: none"> >50% - High Geared 50%-25% - Normally Geared <25% - Low Geared The gearing ratio can be calculated using following formula $\text{Interest Bearing Debt} / \text{Equity} * 100$ <ul style="list-style-type: none"> >100% - High Geared 100%-50% - Normally Geared <50% - Low Geared

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Interest Cover

Point	Explanation
Definition	How many times Interest can be paid out of Operating Profit
Reflects	Adequacy of earnings to settle interest payments
Higher the ratio	<ul style="list-style-type: none"> • Higher ability to pay interest • Higher ability to obtain further loans • Lower risk of defaulting interest payments • Lower solvency risks
How to reduce the ratio	<ul style="list-style-type: none"> • Increase earnings <ul style="list-style-type: none"> ◦ Increase sales (Marketing, incentive driven sales etc.) ◦ Reduce manufacturing and other operating expenses • Reduce interest expense <ul style="list-style-type: none"> ◦ Reschedule the existing debt at a lower rate ◦ Rent out assets than purchasing ◦ Eliminate or exchange idle and unnecessary assets and utilize those funds to settle debts

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CF to Current Maturities of LT Debt

Point	Explanation
Definition	How many times Current Portion of Long-Term debt can be paid out of the operating cashflow
Reflects	Availability of operating cashflows to settle Current Portion of Long-Term debt
Higher the ratio	<ul style="list-style-type: none"> • Higher ability to pay current portion of long term debt • Higher ability to obtain further loans • Lower risk of defaulting loan repayments • Lower solvency risks
How to reduce the ratio	<ul style="list-style-type: none"> • Increase earnings <ul style="list-style-type: none"> ◦ Increase sales (Marketing, incentive driven sales etc.) ◦ Reduce manufacturing and other operating expenses • Reduce interest expense <ul style="list-style-type: none"> ◦ Reschedule the existing loan for an extended period ◦ Rent out assets than purchasing ◦ Eliminate or exchange idle and unnecessary assets and utilize those funds to settle debts

JMC

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Debt Service

Point	Explanation
Definition of Ratio	How many times current portion of long-term debt and loan interest can be paid out of the operating cashflow
Reflects	Availability of operating cashflows to service current portion of long-term debt and interest
Higher the ratio	<ul style="list-style-type: none"> • Higher ability to pay current portion of long term debt • Higher ability to obtain further loans • Lower risk of defaulting loan repayment and Interest
How to reduce the ratio	<ul style="list-style-type: none"> • Increase earnings <ul style="list-style-type: none"> ◦ Increase sales (Marketing, incentive driven sales etc.) ◦ Reduce manufacturing and other operating expenses • Reduce interest expense <ul style="list-style-type: none"> ◦ Reschedule the existing loan for an extended period ◦ Reschedule the existing loans to lower interest rates ◦ Rent assets than purchasing ◦ Eliminate or exchange idle and unnecessary assets and utilize those funds to settle debts
Remarks	<ul style="list-style-type: none"> • Less than 01 ratio indicates, operating cash flows are inadequate to service the debt, this would mean that the borrower would have to obtain equity capital or debt capital or sell the non-current assets to service the debt.

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Q04

Prepare an analysis on liquidity and leverage ratios for John Keells Holdings PLC and Hayleys PLC for the year ended 31st March 20X9.

JMC Jayasekera Management Centre

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Profit or Loss F/T/Y/E 31/03/20X9

Rs.Mn	JKH	Hayleys
Revenue	135,456	219,182
Cost of Sales	(107,669)	(170,207)
Gross Profit	27,787	48,975
Other Income	6,978	2,786
Admin Expenses	(12,411)	(25,188)
Distribution Expenses	(5,939)	(9,889)
Other Expenses	(7,128)	(405)
Finance Cost	(2,722)	(13,369)
Finance Income	12,051	2,566
Profit Before Tax	18,616	5,476
Tax	(2,378)	(2,726)
Profit After Tax	16,237	2,750

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SFP @ 31/03/20X9

Rs.Mn	JKH	Hayleys
Non-Current Assets		
Property Plant and Equipment	126,086	89,343
Intangible Assets	3,406	14,174
Investments	60,355	2,226
Other Non-Current Assets	78,528	15,024
Total Non-Current Assets	268,375	120,767
Current Assets		
Inventory	9,547	39,743
Trade and Other Receivables	14,421	55,241
Other Non-Financial Assets	5,742	3,160
Short Term Investments	52,757	3,685
Cash and Cash Equivalents	12,955	8,971
Total Current Assets	95,421	110,980
Total Assets	363,796	231,747

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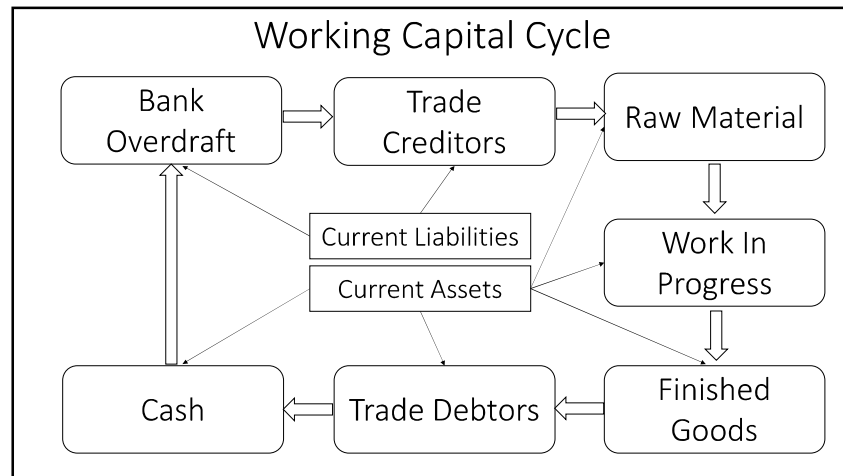
SFP 31/03/20X9

Rs.Mn	JKH	Hayleys
Equity		
Stated Capital	62,806	1,575
Other Reserves	84,718	45,345
Retained Profits	82,834	14,958
Total Equity	230,358	61,878
Non-Current Liabilities		
Interest Bearing Borrowings	21,277	39,662
Insurance Contract Liabilities	32,833	-
Employee Benefits	2,086	8,500
Other Non-Current Liabilities	11,929	4,419
Deferred Tax Liabilities	7,757	5,191
Total Non-Current Liabilities	75,881	57,772
Current Liabilities		
Trade and Other Payables	19,745	28,540
Other Current Liabilities	3,072	9,165
Income Tax Payable	1,505	769
Interest Bearing Borrowings	33,237	73,622
Total Current Liabilities	57,557	112,096
Total Liabilities	363,796	231,747

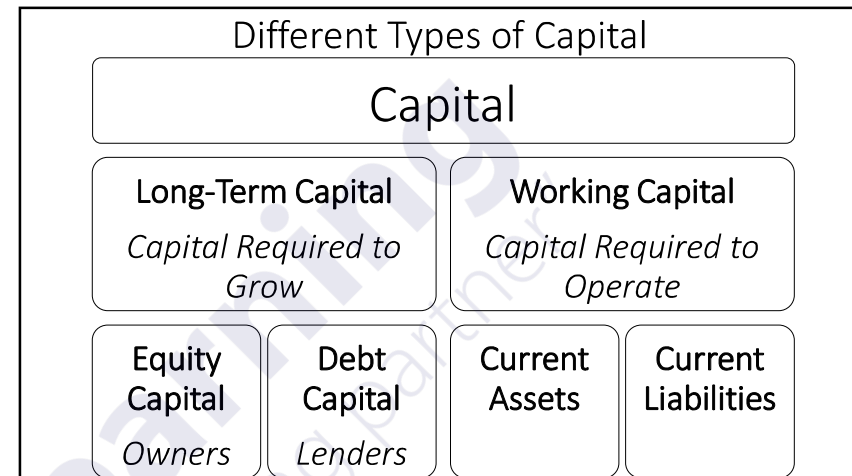
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Efficiency Ratios

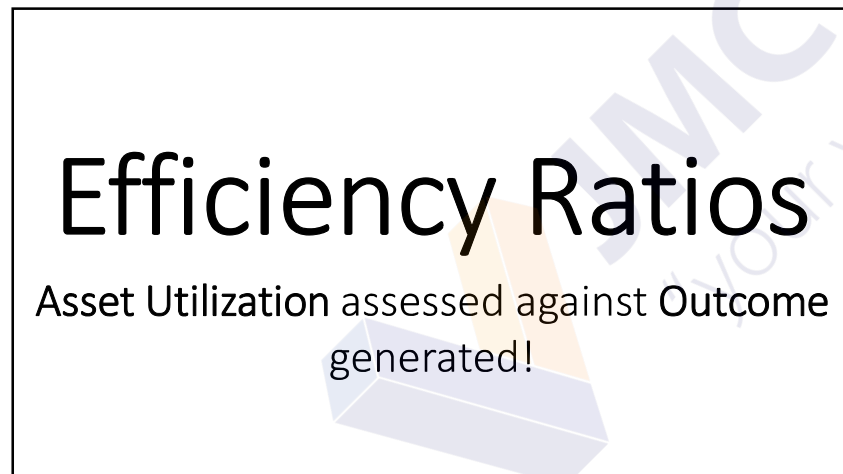
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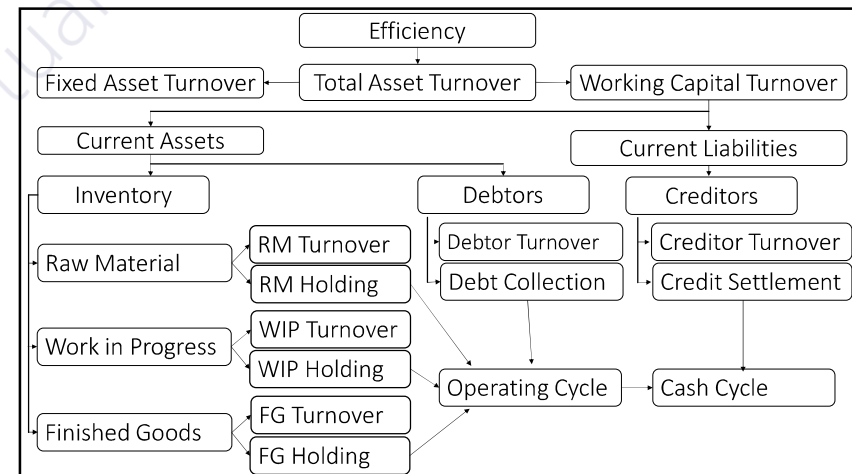
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83



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Asset Turnover Ratios (Times)

Total Asset
Turnover

• Sales/Total Assets

Fixed Assets
Turnover

• Sales/Fixed Assets

Working Capital
Turnover

• Sales/Working Capital

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Total Asset Turnover - Explanation

Point	Explanation
Definition	Per rupee asset how many times sales were generated in a given period of time
Reflects	Asset utilization in terms of generating sales
Higher the ratio	Higher the asset utilization Lower overstatements in assets Lower idle and unnecessary assets
How to increase ratio	<ul style="list-style-type: none"> • Increase Sales <ul style="list-style-type: none"> ○ Effective marketing ○ Target driven sales ○ Changes to pricing strategy • Reduce total assets <ul style="list-style-type: none"> ○ Rent out assets than purchasing ○ Conduct an analysis of total assets and identify idle assets, unnecessary assets, impairments and reduce overstatement in assets.

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Fixed Asset Turnover - Explanation

Point	Explanation
Definition of Ratio	Per rupee fixed asset how many times sales were generated in a given period of time
Reflects	Fixed asset utilization in terms of generating sales
Higher the ratio	Higher fixed asset utilization Lower overstatements in fixed assets Lower idle and unnecessary fixed assets
How to increase ratio	<ul style="list-style-type: none"> • Increase Sales <ul style="list-style-type: none"> ○ Effective marketing ○ Target driven sales ○ Changes to pricing strategy • Reduce fixed assets <ul style="list-style-type: none"> ○ Rent out assets than purchasing ○ Conduct an analysis of total assets and identify idle assets, unnecessary assets, impairments and reduce overstatement in assets. ○ Strengthen the asset maintenance to ensure effective utilization

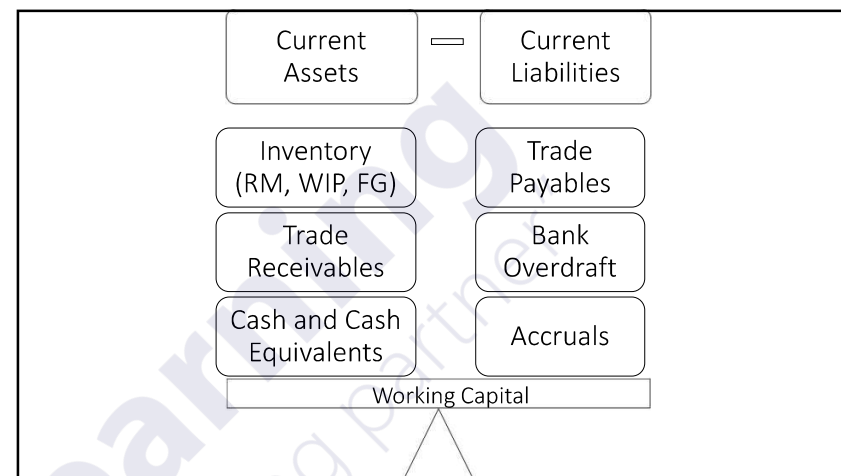
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Working Capital

88

Capital required to run routine operations

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Working Capital Turnover - Explanation	
Point	Explanation
Definition of Ratio	Per rupee working capital how many times sales were generated in a period of time
Reflects	Working capital utilization in terms of generating sales
Higher the ratio	Higher the working capital utilization
How to increase ratio	<ul style="list-style-type: none"> • Increase Sales <ul style="list-style-type: none"> ○ Effective marketing ○ Target driven sales ○ Changes to pricing strategy • Reduce working capital <ul style="list-style-type: none"> ○ Strengthen debt recoveries ○ Write off slow moving inventories ○ Negotiate settlement periods with creditors ○ Negotiate with banks and refinance the existing loan commitments ○ Rent out assets than purchasing
Remarks	<ul style="list-style-type: none"> • Working Capital includes management of Inventories, Accounts receivable, Accounts payable, Cash etc.

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Inventory Turnover Ratios (Times)	
Raw Material Turnover	$\frac{\text{Raw Material Consumption}}{\text{Closing Raw Materials}}$
Work in Progress Turnover	$\frac{\text{Cost of Production}}{\text{Closing Work in Progress}}$
Finished Goods Turnover	$\frac{\text{Cost of Sales}}{\text{Closing Finished Goods}}$

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Inventory Turnover Requisites

Raw Material
Consumption

Opening Raw Material Stock
+ Raw Material Purchases
(-) Closing Raw Material Stock

Cost of
Production

Cost of Sales
+ Closing Finished Goods Stock
(-) Opening Finished Goods Stock

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Inventory Holding Ratios (Days)

Raw Material
Holding Period

$\frac{365}{\text{Raw Material Turnover}}$

Raw Material
Holding Period

$\frac{365}{\text{RM Consumption}} \times \text{Closing Raw Material Stock}$

Work in Progress
Holding Period

$\frac{365}{\text{Work in Progress Turnover}}$

Work in Progress
Holding Period

$\frac{365}{\text{Cost of Production}} \times \text{Closing Work in Progress Stock}$

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Inventory Holding Ratios (Days)

Finished
Goods Holding
Period

$\frac{365}{\text{Finished Goods Turnover}}$

Finished
Goods Holding
Period

$\frac{365}{\text{Cost of Sales}} \times \text{Closing Finished Goods Stock}$

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Raw Material Turnover - Explanation

Point	Explanation
Definition of Ratio	How many times raw materials have been issued to the production during a given period of time
Reflects	Movability of raw materials from Raw materials warehouse to production
Higher the ratio	Highly moving raw materials Lower slow-moving inventories Lower risk of impairment, obsolescence Lower risk of cash tied up in raw materials
How to increase ratio	<ul style="list-style-type: none"> • Increase Sales <ul style="list-style-type: none"> ○ Effective marketing ○ Target driven sales ○ Changes to pricing strategy • Reduce raw materials stock <ul style="list-style-type: none"> ○ Write off slow moving inventories ○ Increase efficiency in operations ○ Increase effectiveness warehouse management

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Raw Material Holding Period - Explanation	
Point	Explanation
Definition of Ratio	How many days raw materials were within the Raw Material warehouse prior to be issued to production
Reflects	Movability of raw materials
Lower the ratio	Highly moving raw materials Lower slow-moving inventories Lower risk of impairment, obsolescence Lower risk of cash tied up in raw materials
How to decrease ratio	<ul style="list-style-type: none"> • Increase Sales <ul style="list-style-type: none"> ○ Effective marketing ○ Target driven sales ○ Changes to pricing strategy • Reduce raw materials stock <ul style="list-style-type: none"> ○ Write off slow moving inventories ○ Increase efficiency in operations ○ Increase effectiveness

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Work in Progress Turnover - Explanation	
Point	Explanation
Definition of Ratio	How many times work in progress have become finished goods during a given period of time (No. of Production Batches)
Reflects	Manufacturing efficiency
Higher the ratio	Highly moving work in progress Lower slow-moving work in progress Lower risk of impairment, obsolescence Lower risk of cash tied up in work in progress
How to increase ratio	<ul style="list-style-type: none"> • Increase Sales <ul style="list-style-type: none"> ○ Effective marketing ○ Target driven sales ○ Changes to pricing strategy • Reduce work in progress stock <ul style="list-style-type: none"> ○ Write off slow moving inventories ○ Increase efficiency in operations

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Work in Progress Holding Period - Explanation	
Point	Explanation
Definition of Ratio	How many days work in progress were within the Production prior becoming a finished good (Manufacturing Time)
Reflects	Manufacturing efficiency
Lower the ratio	Highly moving work in progress Lower slow-moving work in progress Lower risk of impairment, obsolescence Lower risk of cash tied up in work in progress
How to decrease ratio	<ul style="list-style-type: none"> • Increase Sales <ul style="list-style-type: none"> ○ Effective marketing ○ Target driven sales ○ Changes to pricing strategy • Reduce work in progress stock <ul style="list-style-type: none"> ○ Write off slow moving inventories ○ Increase efficiency in operations

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Finished Goods Turnover - Explanation	
Point	Explanation
Definition of Ratio	How many times finished goods have become sales during a given period of time
Reflects	Movability and income generation frequency of finished goods
Higher the ratio	Highly moving finished goods Lower slow-moving finished goods Lower risk of impairment, obsolescence Lower risk of cash tied up in finished goods
How to increase ratio	<ul style="list-style-type: none"> • Increase Sales <ul style="list-style-type: none"> ○ Effective marketing ○ Target driven sales ○ Changes to pricing strategy • Reduce finished goods stock <ul style="list-style-type: none"> ○ Write off slow moving inventories ○ Increase efficiency in operations ○ Increase effectiveness warehouse management

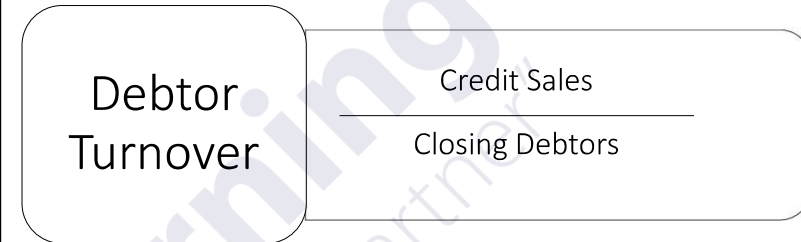
100

Finished Goods Holding Period - Explanation

Point	Explanation
Definition of Ratio	How many days Finished Goods were within the Finished Goods warehouse prior becoming a sale
Reflects	Movability and income generation frequency of finished goods
Lower the ratio	<ul style="list-style-type: none"> Highly moving finished goods Lower slow-moving finished goods Lower risk of impairment, obsolescence Lower risk of cash tied up in finished goods
How to decrease ratio	<ul style="list-style-type: none"> • Increase Sales <ul style="list-style-type: none"> ◦ Effective marketing ◦ Target driven sales ◦ Changes to pricing strategy • Reduce finished goods stock <ul style="list-style-type: none"> ◦ Write off slow moving inventories ◦ Increase efficiency in operations ◦ Increase effectiveness warehouse management

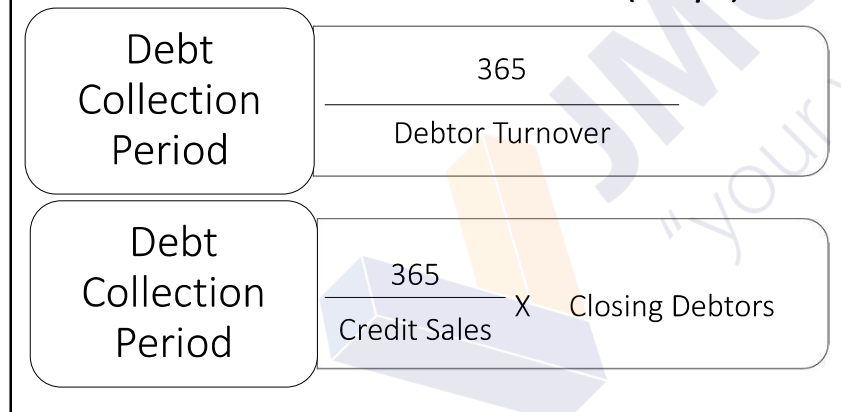
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Debtor Turnover (Times)



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Debt Collection Period (Days)



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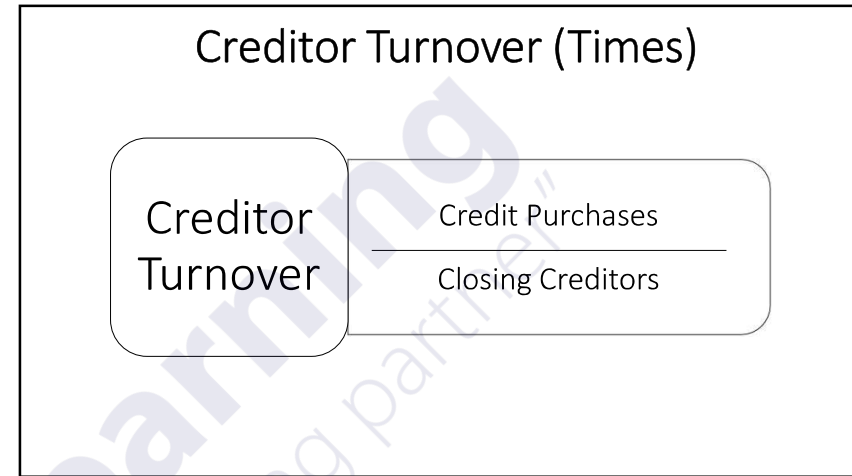
Debtor Turnover - Explanation

Point	Explanation
Definition	How many times a debtor has settled the debt in a given period of time
Reflects	Frequency of debt recoveries
Higher the ratio	<ul style="list-style-type: none"> Higher recoveries Aggressive recovering strategy Lower risk of debtor impairment Negative impacts over relationships with the customers
How to increase ratio	<ul style="list-style-type: none"> • Increase Sales <ul style="list-style-type: none"> ◦ Effective marketing ◦ Target driven sales ◦ Changes to pricing strategy • Reduce debtors <ul style="list-style-type: none"> ◦ Increase aggressiveness of debt collection ◦ Strengthen recovery team ◦ Write off impaired debtors ◦ Factoring
Remarks	◦ In the absence of Credit Sales put an assumption an assume all sales to be Credit Sales

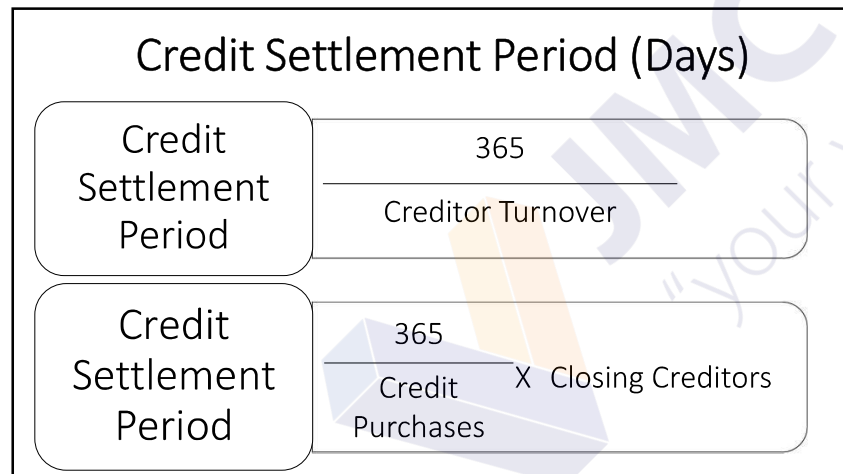
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Debtor Collection Period - Explanation	
Point	Explanation
Definition of Ratio	How many days an average debtor takes to settle the debt.
Reflects	Credit period given to debtors
Lower the ratio	Higher recoveries Aggressive recovering strategy Conservative credit policy Lower risk of debtor impairment Negative impacts over relationships with the customers
How to decrease ratio	<ul style="list-style-type: none"> • Increase Sales <ul style="list-style-type: none"> ◦ Effective marketing ◦ Target driven sales ◦ Changes to pricing strategy • Reduce debtors <ul style="list-style-type: none"> ◦ Increase aggressiveness of debt collection ◦ Strengthen recovery team ◦ Write off impaired debtors

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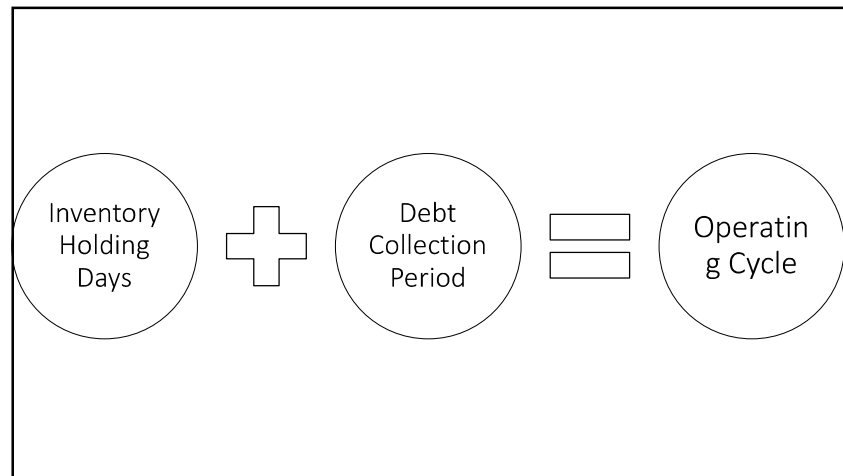


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Operating Cycle

How long it takes an inventory to realize in to cash?

108

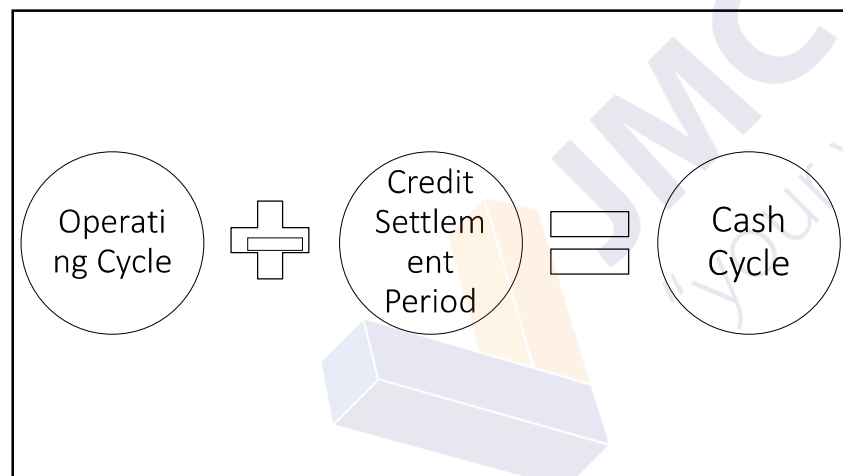


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Cash Cycle

Time Gap between Cash Collection and Disbursement

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Efficiency Ratios

Q05

Prepare a report analyzing efficiency ratios of Kegalle Plantations PLC and Namunukula Plantations PLC for the Year ended

31/3/20X9

Assume – *All Inventory to be finished goods*

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Profit or Loss

Rs.Mn	Kegalle	Namunukula
Revenue	2,422	2,414
Cost of Sales	(2,310)	(2,078)
Gross Profit	112	336
Other Income	589	176
Admin Expenses	(83)	(148)
Finance Cost	(285)	(65)
Profit Before Tax	333	300
Tax	65	(44)
Profit After Tax	398	256

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SFP

Rs.Mn	Kegalle	Namunukula
Non-Current Assets		
Property Plant and Equipment	480	864
Biological Assets	2,567	2,837
Financial Assets	1,490	134
Total Non-Current Assets	4,537	3,836
Current Assets		
Inventory	354	266
Trade Receivables	256	56
Other Receivables	186	130
Short-Term Investments	2,611	250
Cash and Cash Equivalents	17	22
Total Current Assets	3,425	725
Total Assets	7,962	4,561

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Equity		
Stated Capital	250	350
Other Reserves	306	-
Retained Profit	2,809	2,313
Total Equity	3,364	2,664
Non-Current Liabilities		
Interest Bearing Borrowings	772	213
Deferred Income	213	132
Employee Benefits	489	551
Deferred Tax Liabilities	145	255
Total Non-Current Liabilities	1,619	1,150
Current Liabilities		
Trade Payables	252	404
Other Payables	116	252
Bank Overdraft	1,957	26
Interest Bearing Borrowings	656	65
Total Current Liabilities	2,979	747
Total Equity and Liabilities	7,962	4,561

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Limitations of FSA

Historical
Subjectivity
Only Monetary
Negativity Effect
Inflation Ignored
Absence of Standard
Differences in Acc. Policies
Financial Position is a Snap Shot
Manipulations (Window Dressing, Changes in Ac. Estimates etc.)

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PRACTICE QUESTIONS

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Q6. The following financial statements of Mean PLC are given to you.

Profit or Loss F/T/Y/E 31 December

Rs.000	2019	2018
Revenue	386,175	304,754
Cost of Sales	(266,366)	(254,403)
Gross Profit	119,809	50,351
Other Income	445	11,590
Admin Expenses	(60,258)	(81,307)
Distribution Expenses	(34,605)	(38,256)
Finance Cost	(23,007)	(21,381)
Profit Before Tax	2,384	(79,003)
Tax	(3,286)	-
Profit After Tax	(902)	(79,003)
Other Comprehensive Income	287	639
Total Comprehensive Income	(615)	(78,364)

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SFP as at 31 December

Rs.000	2019/12/31	2018/12/31
Non-Current Assets		
Property, plant and equipment	38,429	46,803
Investments	755	584
Total Non-Current Assets	39,184	47,387
Current Assets		
Inventories	146,131	168,722
Trade and other receivables	58,554	63,834
Advances and prepayments	1,763	2,089
Cash and cash equivalents	495	559
Total Current Assets	206,943	235,204
Total Assets	246,127	282,591

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SFP as at 31 December

Rs.000	2019	2018
Equity		
Stated capital	109,187	109,187
Accumulated losses	(293,475)	(292,860)
Total equity	(184,288)	(183,673)
Non-Current Liabilities		
Interest bearing borrowings	132,340	127,160
Retirement benefit obligations	1,225	1,180
	133,565	128,340
Current Liabilities		
Trade and other payables	215,733	251,885
Interest bearing borrowings	81,117	86,039
	296,850	337,924
Total Liabilities	246,127	282,591

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Required:

Analyze the comparative financial performance and financial position of Mean PLC in terms of its capital employed, profit margins, assets utilization, interest cover and gearing for the year ended 31 December 2019. (10 Marks)

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Q.07 Computer Tech PLC (CT) is in the business of selling computers and related accessories. The extracted income statements are provided below:

Profit or Loss F/T/Y/E 31 March

Rs.000	2019	2018
Revenue	645,311	576,171
Cost of Sales	(428,815)	(374,510)
Gross Profit	216,496	201,661
Admin Expenses	(64,531)	(60,497)
Distribution Expenses	(83,890)	(63,378)
Operating Profit	68,075	77,786
Finance Cost	(32,265)	(14,404)
Profit Before Tax	35,810	63,382
Tax	(16,114)	(18,379)
Profit After Tax	19,696	45,003

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Some other Information

	2019	2018
Return on capital employed (ROCE)	7%	13%
Debt ratio	32%	20%
Gearing ratio	54%	38%
Earnings per share (EPS) (Rs.)	0.26	0.60
Market price per share (Rs.)	28	35

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Note:

The market interest rate during 2019 was 8% - 11% compared to 11% - 15% in the previous year.

Damith, an investor, expects to make a few equity investments and CT is one entity he has identified for his investment.

Required:

(a) Assess the profitability and solvency of CT, based on the given financial results. (06 marks)

(b) Advise Damith on the limitations of financial statements analysis of CT. (04 marks)

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Q.08 Ashaa Medical PLC is one of the leading health care service providers in Sri Lanka. The table below presents some key ratios of the company with industry averages for the year ended 31 March 2019.

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	Formula	Company	Industry	Var %
Liquidity ratios				
Current ratio	Current assets/Current liabilities	0.7	0.9	-22%
Quick ratio	Quick Assets/CL	0.6	0.8	-25%
Working Capital Turnover	Sales/Working Capital	(40.0)	(253.1)	-84%
Activity ratios				
Total Asset Turnover	Sales/Total assets	6.6	8.5	-22%
Fixed Asset Turnover	Sales /Fixed Assets	19.6	25.1	-22%

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	Formula	Company	Industry	Var %
Profitability ratios				
Rate of return on assets	Earnings before taxes / Total assets *100	3.7	11.1	-67%
Rate of return on equity	Earnings before taxes / Total equity *100	47.8	48.2	-1%
Coverage ratios				
Debt to equity	Total liabilities / Total equity	11.8	10.4	13%
Interest Cover	Earnings before interest and taxes /interest expense	1.6	4.6	-65%

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Required:

- (a) Interpret the above ratios of Ashaa Medical PLC with industry averages for the year ended 31 March 2019. (6 marks)
- (b) Recommend two (02) measures that Ashaa Medical PLC can use to improve each ratio category. (04 Marks)

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Q09. (a) It has been suggested that ratio analysis is not necessarily the best way of assessing the performance of a company.

Required

List two limitations of using accounting ratios in the appraisal of financial performance (02 Marks)

(b) Below are the financial ratios for the year ended 31 March 2019 for Decimal (Pvt) Ltd, a company engaged in the buying and shipment of agricultural products. The ratios for the industry are also provided.

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	Decimal	Industry Average
Quick ratio	0.52 : 1	0.84 : 1
Current ratio	1.20 : 1	1.80 : 1
Debtor Collection Period	46 Days	41 Days
Inventory Holding Period	58 Days	48 Days
Price-Earnings Ratio	1.4 times	3.4 times
Gross Profit Margin	18%	28%
Net Profit Margin	8%	12.8%
Return on Capital Employed	28%	14%

Required

Prepare a memo to the shareholders of Decimal (Pvt) Ltd assessing its performance in comparison with the industry average under profitability, liquidity and shareholder's investment (08 Marks)

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Q10. Win Lanka PLC and Sun Lanka PLC are two leading biscuit manufacturing companies. Extracts from the financial statements of each company, for the financial year ended 31 March 2019, are listed in the table below.

Rs.Mn	Win	Sun
Earnings before interest and tax	257	274
Earnings available for equity holders	151	113
Total assets	1,856	1,775
Total Debt	464	976
Total Equity	1,392	799
Total Interest	48	117
Total Sales	5,568	5,680
Effective Tax Rate	28%	28%

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Required:

(a) **Calculate** the following ratios for each company for the financial year ended 31 March 2019, based on the available information in the above table.

- (i) Operating profit margin
- (ii) Net profit margin (after tax)
- (iii) Return on equity
- (iv) Debt ratio
- (v) Interest cover (7 marks)

(b) **Discuss** the underlying reasons for a comparatively higher net profit margin in Win Lanka PLC and a lower net profit margin in Sun Lanka PLC, based on the ratios computed in (a) above. (3 marks)

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Q11. The finance manager of Sepala PLC has calculated following ratios for the financial year ended 31/03/2019.

Gross Profit Margin	33.3%
Interest Cover	3 Times
ROE (Profit Att. Ord. Sh./Equity X 100)	4%
Stock Turnover Period (360 days a year)	90
Debt Collection Period (360 days a year)	60
Debt : Equity	12.5% : 87.5%
Acid Test	1.1 Times
ROCE	7.5%
EPS	1.4
P/E	22 Years

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Financials of Sepala PLC is provided with few blanks

Revenue	3,000,000
Cost of Sales	
Gross Profit	
Admin Expenses	(300,000)
Distribution Expenses	
Operating Profit	
Finance Cost	(100,000)
Profit Before Tax	200,000
Tax	
Profit After Tax	
Preference Dividends	
Profits Attributable to Ord Shareholders	140,000
Ordinary Dividends	(40,000)
Retained Profit for the Year	100,000
Retained Profit B/F	2,400,000
Retained Profit C/F	2,500,000

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Non-Current Assets			
Current Assets			
Inventories			
Trade and other receivables			
Other Receivables	100,000		
Prepayments	25,000		
Short-Term Investments	25,000		
Cash at Bank	75,000		
Cash in Hand			
Current Liabilities			
Trade Payables	300,000		
Bank Overdrafts	450,000		
Accrued Expenses	100,000	850,000	
Working Capital			
Shareholder's Funds			
Share Capital			
Reserves			
Non-Current Liabilities			
10% Bank Loan			
10% Preference Shares		100,000	

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Following additional information available

- Nominal value of an ordinary share is Rs.10/-
- Corporate tax rate is 12.5%

Using the ratio knowledge calculate

- Gross Profit
- Operating Profit
- Shareholder's funds
- Trade receivables

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5. Non-Current Liabilities
6. Current Assets
7. Market price of an ordinary share
8. Inventory
9. 10% bank loan
10. Cash in hand

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Q12. Gagana Company is an international airline which flies to destinations all over the world. Gagana Company experienced strong initial growth but in recent periods the company has been criticized for under-investing in its non-current assets.

Extracts from Gagana Co's financial statements are provided below.

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Statement of Financial Position

	31/12/2019		31/12/2018	
	Rs.000	Rs.000	Rs.000	Rs.000
Non-Current Assets				
Property Plant and Equipment	317,000		174,000	
Intangible Assets	20,000	337,000	16,000	190,000
Current Assets				
Inventory	580		490	
Trade and Other Receivables	6,100		6,300	
Cash and Bank	9,300	15,980	22,100	28,890
Total Assets		352,980		218,890

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Statement of Profit or Loss and Other Comprehensive Income and Cashflow Statement Extract

	2019	2018
	Rs.000	Rs.000
Revenue	154,000	159,000
Operating Profit	12,300	18,600
Finance Charges	(9,200)	(10,200)
Cash Generated from Operations	18,480	24,310

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Statement of Financial Position

	31/12/2019		31/12/2018	
	Rs.000	Rs.000	Rs.000	Rs.000
Equity and Liabilities				
Equity Shares	3,000		3,000	
Retained Earnings	44,100		41,800	
Revaluation Surplus	145,000	192,100	Nil	44,800
Non-Current Liabilities				
6% Loan Notes	130,960	130,960	150,400	150,400
Current Liabilities				
Trade and Other Payables	10,480		4,250	
6% Loan Notes	19,440	29,920	19,440	23,690
Total Equity and Liabilities		352,980		218,890

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The following information is also relevant:

- (i) Gagana Company had exactly the same flight schedule in 2019 as in 2018, with the overall number of flights and destinations being the same in both years.
- (ii) In April 2019, Gagana Company had to renegotiate its licences with five major airports, which led to an increase in the prices Gagana Company had to pay for the right to operate flights there. The licences with ten more major airports are due to expire in April 2020, and Gagana Company is currently in negotiation with these airports.

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Required:

(a) Calculate the following ratios for the years ended 31/12/2019 and 2018:

- (i) Operating profit margin;
 - (ii) Return on capital employed;
 - (iii) Net asset turnover;
 - (iv) Current ratio;
 - (v) Interest cover;
 - (vi) Gearing (Debt/Equity).
- Note: For calculation purposes, all loan notes should be treated as debt. (3 marks)

(b) Comment on the performance and position of Gagana Company for the year ended 31/12/2019. Note: Your answer should highlight any issues which Gagana Company should be considering in the near future.

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