Grade 12 Accounting: Financial Ratios & Analysis Study Guide

Grade 12 | Accounting | Study Guide | 2024

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1. Profitability Ratios

Gross Profit %:	(GP / Sales) x 100
Net Profit %:	(NP after tax / Sales) x 100
Operating expenses %:	(Op. expenses / Sales) x 100
Return on Equity (ROE):	(NP after tax / Ave. equity) x 100
Return on Assets (ROA):	(Operating profit / Ave. total assets) x 100

2. Liquidity Ratios

Current ratio:	Current assets : Current liabilities (ideal ~2:1)
Acid test (quick) ratio:	(Current assets - Inventories) : Current liabilities (ideal ~1:1)

Higher current ratio = more liquid (can pay short-term debts). Too high may mean poor inventory management or excess cash that could be invested.

3. Solvency Ratios

Debt : Equity ratio:	Total liabilities : Total equity
Debt ratio:	Total liabilities / Total assets (as %)

Higher debt ratio = more financial risk. Creditors prefer lower debt ratios (safer). Shareholders may prefer some debt (leverage).

4. Activity / Efficiency Ratios

Stock turnover (times):	Cost of Sales / Ave. inventories
Stock turnover (days):	(Ave. inventories / Cost of Sales) x 365
Debtors collection (days):	(Ave. debtors / Credit sales) x 365
Creditors payment (days):	(Ave. creditors / Credit purchases) x 365
Assets turnover:	Sales / Ave. total assets

TIP Debtors days should be LOWER than creditors days (collect from customers BEFORE you have to pay suppliers). If debtors days are increasing over time, it suggests collection problems.

5. Market Value Ratios (Listed Companies)

EPS (Earnings per share):	Net profit after tax / Number of shares
DPS (Dividends per share):	Total dividends / Number of shares
NAV per share:	Total equity / Number of shares
Dividend yield:	(DPS / Market price) x 100
PE ratio:	Market price / EPS

6. Interpreting Ratios

When commenting on ratios:

1. State the ratio value(s)
2. Compare to previous year or industry benchmark
3. Explain what it means for the business
4. Suggest an appropriate action or note the implication