

Paul Robbins training and consultancy

Credit Management

Performance Indicator Ratios

Exercise 2 **Model Answer**

You have been provided with a summary from the Financial Statements of Harvard Technologies Ltd for the last three years.

	Year 1 (£000)	Year 2 (£000)	Year 3 (£000)
Sales Revenue	876	881	897
Cost of Sales	475	472	478
Current Assets	345	362	370
Current Liabilities	244	243	256
Inventory	47	52	51
Trade Receivables	78	79	81
Trade Payables	59	63	65
Profit from Operations	103	107	112
Interest Paid	16	18	23
Net Profit	87	89	89
Long Term Debt	100	105	115
Equity	300	300	300

Note that Current Liabilities includes short-term debt and trade payables only.

You should express your answers to two decimal places.

You should use this information to calculate the following ratios, including stating the formula you used to perform the calculation.

Performance Indicator Ratio	Year 1	Year 2	Year 3
<u>Current Ratio</u>			
Current Assets / Current Liabilities	345 / 244	362 / 243	370 / 256
	= 1.41	= 1.49	= 1.45

<u>Quick Ratio</u> <i>(Current Assets less Inventories) / Current Liabilities</i>	$(345 - 47) / 244$ $= 1.22$	$(362 - 52) / 243$ $= 1.28$	$(370 - 51) / 256$ $= 1.25$
<u>Inventory Holding Period</u> <i>(Inventory / Cost of Sales) x 365</i>	$(47 / 475) \times 365$ $= 36.12$ days	$(52 / 472) \times 365$ $= 40.21$ days	$(51 / 478) \times 365$ $= 38.94$ days
<u>Accounts Receivable Collection Period</u> <i>(Trade Receivables / Sales) x 365</i>	$(78 / 876) \times 365$ $= 32.50$ days	$(79 / 881) \times 365$ $= 32.73$ days	$(81 / 897) \times 365$ $= 32.96$ days
<u>Accounts Payable Payment Period</u> <i>(Trade Payables / Cost of Sales) x 365</i>	$(59 / 475) \times 365$ $= 45.34$ days	$(63 / 472) \times 365$ $= 48.72$ days	$(65 / 478) \times 365$ $= 49.63$ days
<u>Net Profit Margin %</u> <i>(Net Profit / Sales) x 100</i>	$(87 / 876) \times 100$ $= 9.93\%$	$(89 / 881) \times 100$ $= 10.10\%$	$(89 / 897) \times 365$ $= 9.93\%$
<u>Return on Capital Employed</u> <i>(Operating Profit / Capital Employed) x 100</i>	$103 / (100 + 300) \times 100$ $= 25.75\%$	$107 / (105 + 300) \times 100$ $= 26.42\%$	$112 / (115 + 300) \times 100$ $= 26.99\%$
<u>Interest Cover</u> <i>Operating Profit / Interest Payable</i>	$103 / 16$ $= 6.44$ times	$107 / 18$ $= 5.94$ times	$112 / 23$ $= 4.87$ times
<u>Gearing %</u> <i>(Total Debt / Total Debt plus Equity) x 100</i>	$(185 + 100) / (185 + 100 + 300) \times 100$ $= 48.72\%$	$(180 + 105) / (180 + 105 + 300) \times 100$ $= 48.72\%$	$(191 + 115) / (191 + 115 + 300) \times 100$ $= 50.50\%$