

Ratio category essay examples

[Business](#), [Company](#)



Gross profit margin

First of all, we analyze the performance of the two companies in relation to one another, and to the industry in regard to financial ratios. In most of the ratios, Stevens performed better than Piper and even the industry in both gross and net profit margins and equity ratio. The earnings per share for Stevens is still much higher compared to Piper.

Piper on the other hand has recorded much lower performance as compared to Stevens and industry at large. This indicates poor utilization of resources to generate revenue for the company.

Recommendation

Purchasing shares in each of the presents the following scenario.

Stevens

Piper Cash involved $(1500 \times 18) = \$27,000$ $(5000 \times 15) = \$75,000$

Dividend $(36,000/15000) \times 1500 = \$3,600$ $(150,000/50,000) \times 5000 = \$15,000$

Investor is better off buying 20% of the shares of Piper as compared to the same amount in Stevens. This is because, assuming a constant dividend payout ratio, the investor is guaranteed a 20% share in the dividends as opposed to 13% in Stevens.

Moreover, Piper has a greater P/E ratio of 5.5 as compared to 2.8 in Stevens.

This shows that investors have more confidence in Piper than in Stevens, despite her good performance.

Other commonly used ratios that have not been considered in this report are the liquidity and efficiency ratios.

Liquidity ratios

The liquidity ratios include the current ratio, the acid test ratio, the working capital ratios, current assets turnover ratios etc. Inclusion of these ratios would help an investor analyze the ability of the company to meet its short term obligations as they fall due. Failures to which the company may be required to go under as creditors demand their moneys.

The efficiency ratios will range from inventory turnover, the debtors and creditors turnover ratios.

These ratios indicate the efficiency of the company in generating revenues from the available assets. It indicates areas where the company is losing as a result of inefficiencies in its operations and thus suggests areas of improvement.

Importance of the cash flow statement

This is a statement that shows the company's sources and use of funds. It shows where the company has obtained the funds used in the company and the particular uses that the funds have been put.

Cash flow statement is also used as a management tool for cash planning and the maintenance of a proper match between inflows and outflows.

It also provides information on cash that has been utilized to make very long-term investments such as the purchase of fixed assets that will be in use to generate revenues for many years.

Cash flow statement is also used to determine the cash received or expended in various financing activities, which include the issue of shares, debentures and raising of long term finance.

It's a tool used to show how the company has been efficient or otherwise in generating cash from its assets

Cash flow statement shows efficiency of a firm in generating cash inflows from its regular operations and areas that would be improved.

Last but most importantly, cash flow statement is the most important statement that is used to appraise various capital investment programmes so as to determine their viability and profitability

Reliability of advice based solely on financial ratios

Ratio analysis is retrospective and not prospective in the sense that it utilizes historical data. Such data is not reliable since it doesn't reflect future prospects of the company.

Ratio analysis is not adequate as it relies on accounting and not economic data. Accounting data is known to be adjusted for many non cash items such as depreciations, provisions etc, which makes it unreliable.

Ratios are affected by many accounting policies that can be used to manipulate accounting information making it appear different all together. This means that similar policies have to be adopted to make ratio analysis relevant to decision making.

Ratios do not capture significant off balance sheet items that can be of significance to investor.

The above drawbacks clearly indicate that while my advice is most reasonable, it may not be very reliable given the many drawbacks of the cash flow statement as enumerated above.